VIRGIN MONEY UK

Full Year 2020 Financial Results Announcement

Virgin Money UK PLC
Registered number 09595911 (England and Wales)
ARBN 609 948 281 (Australia)

BASIS OF PRESENTATION

Virgin Money UK PLC ('Virgin Money', 'VMUK' or 'the Company'), formerly known as CYBG PLC ('CYBG') (the Company was renamed on 30 October 2019), together with its subsidiary undertakings (which together comprise 'the Group'), operate under the Clydesdale Bank, Yorkshire Bank, B and Virgin Money brands. This results announcement covers the results of the Group for the year ended 30 September 2020. The term 'Virgin Money' is used throughout this results announcement either in reference to the Group, or when referring to the acquired business of Virgin Money Holdings (UK) PLC or subsequent integration of the acquired business, within the newly combined Group.

Statutory basis

Statutory information is set out on page 16 and within the financial statements.

Pro forma results: On 15 October 2018, the Company acquired all the voting rights in Virgin Money Holdings (UK) PLC by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006, with the transaction being accounted for as an acquisition of Virgin Money Holdings (UK) PLC.

We believe that it is helpful to provide additional information which is more readily comparable with the current year results of the combined businesses. Therefore we have prepared pro forma comparative results for the Group as if Virgin Money UK PLC and Virgin Money Holdings (UK) PLC had always been a combined group, in order to assist in explaining trends in financial performance. A reconciliation between the results on a comparative pro forma basis and a statutory basis is included on page 17. The pro forma comparative results are also presented on an underlying basis as there were a number of factors which had a significant effect on the comparability of the Group's financial position and results. Any reference to pro forma results relates to the prior period only as the pro forma basis is not applicable in the current period due to the combined group being in operation for the entire 12 months to 30 September 2020.

Underlying basis

The results are adjusted to remove certain items that do not promote an understanding of historical or future trends of earnings or cash flows, and therefore allows a more meaningful comparison of the Group's underlying performance. A reconciliation from the underlying results to the statutory basis is shown on page 17 and management's rationale for the adjustments is shown on page 129.

Alternative performance measures (APMs)

The financial key performance indicators (KPIs) used by management in monitoring the Group's performance and reflected throughout this results announcement are determined on a combination of bases (including statutory, regulatory and alternative performance measures), as detailed at 'Measuring financial performance – glossary' on pages 127 to 128. APMs are closely scrutinised to ensure that they provide genuine insights into the Group's progress; however statutory measures are the key determinant of dividend paying capability.

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.

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 integration of the business of Virgin Money Holdings (UK) PLC and its subsidiaries into the Group), trends in its operating industry, changes to customer behaviours and covenant, macroeconomic and/or geo-political factors, the repercussions of the outbreak of coronaviruses (including but not limited to the COVID-19 outbreak), changes to its Board and/or employee composition, exposures to terrorist activity, IT system failures, cybercrime, fraud and pension scheme liabilities, changes to law and/or the policies and practices of the Bank of England, the Financial Conduct Authority 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, 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.

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Virgin Money UK PLC 2020 Full Year Results Highlights

David Duffy, Chief Executive Officer:

"It has been an extraordinary year of disruption for all of us. Our priority has been to support our customers and colleagues through this period, and we will continue to do so during the challenging economic environment ahead. I'm proud of the way we've adapted how we work this year to continue serving our customers, while looking after our colleagues and protecting the bank for the future.

"While we are yet to see any material impacts of the pandemic on the credit quality of our loan book, our results reflect a cautious and conservative approach to the coming period as we refine our assessment of the uncertain economic outlook and the impact of the second lockdown. Although the vaccine news is a strong cause of hope for the future, the economic benefits are still some way off when considering the immediate reality of current restrictions and so have not yet been factored into our near-term forecasts.

"Looking into 2021, we are well underway in rolling out our full suite of Virgin Money products and services across personal and business, underpinned by our unique brand proposition and leading digital capabilities. This progress, as well as the steps we have already taken to transform and simplify our business, mean we are well positioned to emerge from the pandemic as an agile, innovative and disruptive force in UK banking."

Supporting our customers, colleagues & communities

- Virgin Money has continued to provide customers with valuable support at this difficult time:
  - c.67k Mortgage payment holidays granted to date (c.20% of balances); c.4% of balances currently on an active payment holiday with 98% of customers who have matured from their holiday period having returned to payment
  - c.58k Personal payment holidays granted to date (c.6% of balances); c.1% of balances currently on an active payment holiday with 93% of customers who have matured from their holiday period having returned to payment
  - Supported c.30k businesses with lending support including c.£1.2bn of Government-backed loans disbursed
- c.6k of our c.9k colleagues enabled to work from home; enhanced safety and wellbeing support for those in offices/branches
- c.£900k distributed to local charities supporting the COVID-19 effort by the Virgin Money Foundation; our not-for-profit Virgin Money Giving platform continues to support fundraising efforts across the UK and helped over 20k charities raise >£100m

FY20 financial highlights

- Balance sheet reflects COVID-19 impacts; lending contraction of 0.7% to £72.5bn and deposit growth of 5.8% to £67.5bn:
  - Business lending growth of 13.6% to £8.9bn due to £1.2bn of Government-backed lending (BBLS/CBILS/CLBILS)
  - Personal lending growth of 3.9% to £5.2bn with the strong H1 growth tempered by lower demand in H2
  - Mortgage lending declined 3.0% to £58.3bn with disciplined pricing in H1 and UK lockdown market impacts in H2
  - Relationship deposits grew 20.3% to £25.7bn as consumer savings increased significantly under lockdown and businesses generally deposited the proceeds from Government-guaranteed lending into short-term cash accounts
- Underlying pre-provision operating profit of £625m is 10% lower YoY primarily due to NIM compression and base rate cuts:
  - FY NIM of 1.56% within guidance; Q4 NIM of 1.52% up vs. Q3 of 1.47% reflecting deposit repricing actions
  - Non-interest income of £191m primarily reflects lower H2 activity based fees partially offset by a £16m H1 gilts gain
  - Operating costs of £917m down 3% YoY with net cost reductions of £30m despite incurring c.£14m of COVID costs
- Credit impairment charge of £501m (68bps cost of risk) reflecting a cautious approach to an uncertain economic environment
  - The Group has deliberately adopted an updated and more conservative set of economic scenarios and weightings reflecting the uncertain economic outlook and heightened risks ahead; a 5% weighting was applied to the Upside scenario, 50% to Base and 45% to Downside; this resulted in a weighted-average GDP decline assumption of 15% in 2020, average unemployment of 8.6% in 2021 with a peak of 10% and a peak-to-trough HPI decline of 22%
  - The IFRS 9 models have also been supplemented with post-model adjustments in relation to the Group's expected payment holiday outcomes and economic dynamics that may not be fully captured in inputs or models
  - The Group now has considerable on-balance sheet provisions of £735m; total coverage ratio of 102bps includes 23bps for Mortgages, 537bps for Credit Cards, 824bps for Personal Loans & Overdrafts, and 391bps for Business
  - No deterioration in asset quality to date with lower arrears across most portfolios reflecting Government support and forbearance: Mortgage arrears of 0.4%, Credit Cards of 0.8%, Personal Loans of 0.4% and Business of 0.3%
- Underlying profit before tax of £124m is down 77% YoY primarily due to the significant impairment charge recognised
- Statutory loss after tax of £141m is inclusive of £292m of exceptional items, including £139m of integration & transformation costs, £113m of acquisition accounting unwind and £26m of conduct charges (non-PPI related)

Well positioned for an uncertain outlook

- Resilient capital base: transitional CET1 ratio of 13.4% with c.£950m of management buffer in excess of the MDA of 9.5%;
- Strong liquidity & funding position: LCR of 140% and 107% loan-to-deposit ratio
- Strengthened our sustainability strategy: unveiled clear principles and 2030 aspirations as we seek to 'be a force for good'

Outlook and guidance

- Given the unprecedented nature of COVID-19, the exact economic outlook for the UK is clearly evolving and remains hard to predict with any high degree of certainty at present; it is therefore not appropriate at this stage to give firm medium-term guidance and so the Group's previous FY22 targets are withdrawn pending more certainty in the economic environment.
- FY21 guidance: NIM broadly flat on FY20 levels and non-interest income to remain subdued; underlying operating costs of <£875m inclusive of c.£10-15m of COVID costs; cost of risk lower than FY20 assuming no further deterioration in outlook
- Medium-term outlook: The Board continues to believe that Virgin Money has a clear path to delivering a double digit statutory RoTE over time and this will support future capital returns to shareholders; the improvement in returns will be driven by: normalisation of impairments and exceptional costs; ensuring we continue to reduce our cost base to reflect the future operating environment; optimising our balance sheet mix; and delivering a more efficient capital base over time.

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Virgin Money UK PLC will today be hosting a presentation for analysts and investors covering the 2020 full year financial results starting at 08:30 GMT (19:30 AEDT) and this will be webcast live and is available at:

https://webcast.openbriefing.com/virginmoney-fy/

A recording of the webcast will be made available on our website shortly after the meeting at:

https://www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/

Financial Performance - underlying basis

Summary income statement – underlying basis

	2020 £m	Pro forma 2019 £m	Change %
Underlying net interest income	**1,351**	1,433	(6)
Underlying non-interest income	**191**	206	(7)
Total underlying operating income	**1,542**	1,639	(6)
Underlying operating and administrative expenses	**(917)**	(947)	(3)
Underlying operating profit before impairment losses	**625**	692	(10)
Total impairment losses on credit exposures	**(501)**	(153)	227
Underlying profit on ordinary activities before tax	**124**	539	(77)
- Integration and transformation costs	**(139)**	(156)	(11)
- Acquisition accounting unwinds	**(113)**	(87)	30
- Legacy conduct costs	**(26)**	(433)	(94)
- Other items	**(14)**	(128)	(89)
Statutory/pro forma loss on ordinary activities before tax	**(168)**	(265)	(37)
Tax credit	**27**	58	(53)
Statutory/pro forma loss after tax	**(141)**	(207)	(32)

Key performance indicators[1]

	2020	Pro forma 2019	Change
Profitability:			
Net interest margin	**1.56%**	1.66%	(10)bps
Underlying return on tangible equity (RoTE)	**0.6%**	10.8%	(10.2)%pts
Underlying cost to income ratio (CIR)	**59%**	57%	2%pts
Underlying return on assets	**0.09%**	0.54%	(45)bps
Underlying earnings per share (EPS)	**1.4p**	28.1p	(26.7)p

(1) For a definition of each of the KPIs, refer to 'Measuring financial performance – glossary' on pages 127 to 128. The KPIs include statutory, regulatory and alternative performance measures.

Financial Performance - underlying basis

Key performance indicators (continued)

As at:	2020	2019	Change
Asset quality			
Cost of risk	**0.68%**	0.21%	47bps
Total provision to customer loans	**1.02%**	0.50%	52bps
Indexed loan to value ratio (LTV) of mortgage portfolio[1]	**57.3%**	57.2%	0.1%pts
Regulatory Capital:			
Common equity tier 1 (CET1) ratio (IFRS 9 transitional)	**13.4%**	13.3%	0.1%pts
CET1 ratio (IFRS 9 fully loaded)	**12.2%**	12.9%	(0.7)%pts
Total capital ratio	**20.2%**	20.1%	0.1%pts
Minimum requirement for own funds and eligible liabilities (MREL) ratio	**28.4%**	26.6%	1.8%pts
Capital Requirement Directive IV (CRD IV) leverage ratio	**4.8%**	4.3%	0.5%pts
UK leverage ratio	**4.9%**	4.9%	-%pts
Tangible net asset value (TNAV) per share	**244.2p**	249.2p	(5.0)p
Funding and Liquidity:			
Loan to deposit ratio (LDR)	**107%**	114%	(7)%pts
Liquidity coverage ratio (LCR)	**140%**	152%	(12)%pts
Net stable funding ratio (NSFR)	**131%**	128%	3%pts

(1) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance. The Clydesdale Bank PLC portfolio is indexed using the MIAC Acadametrics indices at a given date, while the Virgin Money portfolio is indexed using the Markit indices.

Summary balance sheet

	As at		
	2020 £m	2019 £m	Change %
Customer loans	**72,457**	72,979	(0.7)
of which Mortgages	**58,290**	60,079	(3.0)
of which Personal	**5,219**	5,024	3.9
of which Business	**8,948**	7,876	13.6
Other financial assets	**15,608**	16,391	(4.8)
Other non-financial assets	**2,194**	1,629	34.7
Total assets	**90,259**	90,999	(0.8)
Customer deposits	**67,511**	63,787	5.8
of which relationship deposits[1]	**25,675**	21,347	20.3
of which non-linked savings	**20,729**	20,197	2.6
of which term deposits	**21,107**	22,243	(5.1)
Wholesale funding	**14,227**	18,506	(23.1)
Other liabilities	**3,589**	3,685	(2.6)
Total liabilities	**85,327**	85,978	(0.8)
Ordinary shareholders' equity	**4,017**	4,106	(2.2)
Additional Tier 1 (AT1) equity	**915**	915	-
Equity	**4,932**	5,021	(1.8)
Total liabilities and equity	**90,259**	90,999	(0.8)
Risk Weighted Assets (RWAs)	**24,399**	24,046	1.5

(1) Current account and linked savings balances.

Chief Executive Officer's review

Supporting our stakeholders

Our primary focus has been to provide the very best support to our customers, colleagues and communities, but we have also continued to make strategic progress in a uniquely challenging environment

"I am extremely proud of the Purpose-led support we have provided to our customers, colleagues and communities throughout this year" **David Duffy, CEO**

Dear stakeholder,
Without doubt, 2020 has been a uniquely challenging year for all of us. My priority from the outset has been to make sure that Virgin Money responds to the crisis in a way that reflects our Purpose and our Virgin Values. That means offering our customers the right support to navigate through the challenges the pandemic has brought about, protecting the health and well-being of our colleagues, while at the same time safeguarding our business for the future. We are committed to providing support for all of our customers during these difficult and uncertain times.

I am proud of how my colleagues have responded to these challenges and confident that we are building an organisation that reflects our Purpose of 'Making you happier about money'.

Supporting our customers, colleagues and communities
In Mortgages, we have granted c.67k payment holidays while in Personal, we have granted c.58k payment holidays, with >90% of these customers who have matured from their payment holiday having now returned to regular payments. In Business, our relationship managers have been proactively supporting customers with advice and financing solutions, while our participation in the various government-guaranteed lending schemes has seen us lend c.£1.2bn to provide much needed liquidity to businesses. You can find out more about our divisional customer support on pages 28-33 in our Annual Report & Accounts.

Our colleagues are critical in how we have been able to support our customers and their safety has been our first priority throughout. We took a decision early in the crisis not to furlough any colleagues, and we continue to work hard to make sure those critical colleagues who need to be in our branches or offices receive the best support possible. We have more details on our colleagues on page 11 in our Annual Report & Accounts.

Our strong heritage of community support also stepped up during the pandemic, with the Virgin Money Foundation making c.£900k of funding available for local charities responding to COVID-19. Virgin Money Giving (VMG) was an official fundraising partner of the 2.6 Challenge (which took place in lieu of the postponed Virgin Money London Marathon), helping support more than 3,000 charities to raise more than £10m, and our not-for-profit VMG platform continued to support fundraising efforts across the UK.

Pre-provision operating performance impacted by UK lockdowns
We reported a resilient first half pre-provision operating performance, but the second half has been impacted by the unprecedented deterioration in the economic environment.

Our balance sheet reflects this in different ways across the portfolios with a c.3% year-on-year contraction in our Mortgage book due to disciplined pricing in the first half in a competitive (pre-COVID-19) environment and the impact of lockdown on demand in the second half. In Business, our total book has grown by c.14%, but this is solely due to the government-guaranteed lending schemes where we have lent c.£1.2bn, with our underlying non-government-guaranteed lending down slightly across the year. In Personal, our c.4% lending growth reflects a strong first half and the resilience of our balance transfer credit card portfolio in the second half. In deposits, similar to most other banks, we have seen a significant increase in the year, up c.6%, with our relationship deposits increasing 20% as consumer spending slowed dramatically and a lot of businesses simply deposited government-guaranteed lending proceeds as cash.

As a consequence, the Group's total income reduced 6% year-on-year reflecting lower lending volumes, lower activity based fees and the margin impact of the base rate cut as well as excess liquidity costs. While we continued to reduce our underlying cost base, down 3%, with c.£30m of net reductions after absorbing £14m of additional COVID-19 costs, pre-provision operating profit reduced by 10%.

Significant impairment provision drives a statutory loss
While it is clear that the near-term economic outlook is challenging, we have not yet seen significant specific provisions or credit losses in relation to the pandemic. However, the Board has chosen to apply conservative economic scenarios and weightings, supplemented by expert judgement credit risk overlays, in assessing its expected credit loss provisioning. In total, the Group has taken a substantial £501m provision charge during the year to significantly increase the Group's on-balance sheet credit provision to £735m, providing robust levels of coverage across all of our portfolios. This sizeable provision charge has led to a significantly reduced underlying profit before tax of £124m, down 77% year-on-year. Together with £292m of exceptional costs that primarily relate to our restructuring programmes and acquisition accounting unwind, the Group has reported a £141m statutory loss after tax for the year.

Robust balance sheet for an uncertain environment
Importantly our balance sheet remains robust as we enter a period of economic stress with an expected increase in credit losses. We have a defensive lending portfolio comprising 81% of prime, high-quality Mortgages, 12% of well diversified relationship-driven business lending and 7% of high-quality Personal lending. We also retain a resilient capital base with a transitional CET1 ratio of 13.4% and c.£950m of CET1 management buffer, which is in addition to our £735m of credit provisions. We continue to maintain a strong liquidity position with a Liquidity Coverage Ratio (LCR) of 140% and are prudently funded with a 107% loan-to-deposit ratio (LDR). You can find out more about our financial performance and balance sheet strength in the CFO Review on pages 7 to 17.

Business and financial review

Chief Executive Officer's review

Strategic progress during the year

During the year, we have continued to enhance our digital propositions through several major new releases to our online platforms which has enabled new features and capability, while our new API connectivity to a key mortgage intermediary sourcing system improves efficiency for our broker partners and us.

Although we did pause our rebrand activity planned for earlier in the year due to the UK lockdown, we have sought to strategically leverage our brand where possible through our extremely successful partnership that delivered the UK's first socially-distanced music festival in Newcastle over the summer and our 'Money on Your Mind' campaign. Both activities attracted widespread coverage across traditional media and social media creating great brand awareness.

In Mortgages, we launched our innovative Home Buying Coach app which supports first-time buyers through a mix of tools, calculators and content to help make buying a new home a happier experience. The app has been well received with over 10k downloads already and we expect it to be a great customer engagement tool over time.

In Personal, we launched the first-ever digital Virgin Money Current Account which is gaining good traction with customers and was rated as "Outstanding" by Moneyfacts with a perfect five-star score. More recently, we launched our market-leading basic bank account, the 'M Account', which forms a vital part of our financial inclusion strategy, and we also launched the Virgin Money Personal Loan product as another important step in our integration journey.

In Business, we were delighted to be awarded a £35 million grant from the BCR's Capability and Innovation Fund (CIF), which we will match-fund, and invest into enhancing our proposition to support us in becoming a true disruptor in the SME banking market and to offer a credible alternative to the incumbent banks under the Virgin brand.

In recognition of the progress we are making, our teams won several customer service awards this year. This includes 'Best Credit Card provider' for a third year in a row by the British Banking Award, the 'Mortgage Service Award' in the Simples Awards from Compare the Market and several awards at the UK Customer Experience Awards including a superb Gold in the 'Use of insight and feedback' category in recognition of our innovative 'Money on Your Mind' initiative.

You can find out more about our strategic progress on pages 8-13 in our Annual Report & Accounts.

Enhancing our ESG approach

The events of 2020 have underscored the moral and commercial imperative for creating a sustainable business. As society continues to adjust to these new challenges, I believe we have an opportunity – and an obligation – to play a strong role in helping customers and communities navigate the road ahead. From transitioning to a greener economy and reimagining customer's business models, to developing more inclusive products and supporting fundraising in a digital age – we are working hard to be a force for good in society.

Our sustainability agenda is an integral part of delivering our Purpose of 'Making you happier about money' and is being embedded in everything we do. We are all on a journey to learn how best to do that, and I believe our refreshed ESG strategy provides a framework to accelerate the difference we are able to make to the global issues facing our planet and the local issues facing our communities. You can find out more on our sustainability approach on pages 16-21 in our Annual Report & Accounts.

Outlook

While the outlook remains very uncertain and the range of potential outcomes is wide, Virgin Money enters this period from a position of strength. Over the coming months, we anticipate an increase in specific credit losses as unemployment starts to rise and as the government stimulus reduces, and we expect limited customer demand for lending. We recognise the very recent news of potential vaccines, but believe it is too early to incorporate this into our near-term forecasts at present. Our primary focus will remain on supporting all of our stakeholders, while progressing our strategic delivery through the completion of our transformation and rebrand activity, as well as the launch of exciting new propositions such as our new Virgin Money Business Current Account (BCA), our cashback and loyalty programmes, and a host of innovative new partnerships.

In the medium term, the Board believes that, assuming no significant further deterioration in expectations for the economic outlook or change in interest rates, Virgin Money has a clear path to delivering a double digit statutory RoTE over time, supporting future capital returns to investors. The improvement in returns will be built on: the normalisation of impairments and exceptional costs; ensuring we continue to reduce our cost base to reflect the future operating environment; optimising our balance sheet mix; and delivering a more efficient capital base over time, and we aim to come back with more specific guidance once the medium-term outlook has stabilised.

Finally, I have been inspired by the lengths our colleagues have gone to in supporting our customers and communities in difficult circumstances this year and want to thank them for their immense efforts, personal resilience and dedication. 2021 will no doubt require a similar level of commitment from us all to continue providing the right support and to deliver on our strategic ambitions. I also want to take the opportunity to extend my very best wishes to all of our customers, colleagues and investors in remaining safe and well.

David Duffy
Chief Executive Officer
24 November 2020

Chief Financial Officer's review

Cautious approach in an unprecedented environment

2020 has been a challenging year and our financial results reflect the cautious approach we have taken in assessing the economic outlook and future credit losses

"2020 has been unprecedented in the challenges it has created for the banking industry and this is reflected in our financial performance for the year." **Enda Johnson, Interim Group CFO**

CFO review contents

Analysis of:

Financial Highlights

Statutory loss after tax

£(141)m

2019: £(179)m

Underlying profit before tax

£124m

2019: £539m

Underlying RoTE

0.6%

2019: 10.8%

NIM

1.56%

2019: 1.66%

Underlying CIR

59%

2019: 57%

Cost of risk

68bps

2019: 21bps

CET1 ratio

13.4%

2019: 13.3%

Loan growth

(0.7)%

2019: +2.9%

Relationship deposit growth

+20.3%

2019: +7.1%

Chief Financial Officer's review

Review of the year

2020 has been a uniquely challenging year for the banking industry and our business, and this is reflected in our financial performance for the year. We have been primarily focused on supporting our customers, colleagues and communities, while at the same time ensuring the stability of the bank. Despite the challenges, we did continue to execute on some key integration milestones, while delaying delivery of some of our strategic, transformation activity. Importantly, we have also taken a cautious approach to our credit impairment provisioning for what is likely to be a severe economic shock with an expected rise in specific credit losses in the period to come.

Balance sheet impacted by the pandemic

The COVID-19 pandemic has had very different impacts across our various lending segments, demonstrating the value of a diverse portfolio. Total customer lending was down 0.7% in the year to £72.5bn primarily due to a reduction in the mortgage book as we maintained our discipline in a competitive market in the first half, with demand in the second half reducing substantially owing to the pandemic restrictions. This was partly offset by increased balances in Business with £1.2bn of incremental lending primarily under the government-guaranteed BBLS and CBILS lending schemes, and growth in Personal from a strong first half performance and resilience of the balance transfer credit card portfolio in the second half. Total customer deposits increased 5.8% to £67.5bn reflecting both consumer savings behaviour under lockdown and businesses depositing government-guaranteed lending proceeds for liquidity.

Pre-provision operating profit impacted by income headwinds

Our Net Interest Margin (NIM) of 1.56% (FY19: 1.66%) was delivered within our guidance range as it stabilised towards the end of the year following the base rate reductions, but which nonetheless reduced Net Interest Income (NII) 6% year-on-year. Non-interest income was also down 7% in the period largely due to lower activity-based fees and the impact of the 'high cost of credit review' in our Personal division. Total income was therefore down 6% on FY19 at £1,542m. Operating costs of £917m were 3% lower on the prior year, despite absorbing £14m of COVID-19 related costs. The challenging income environment led to an increase in our cost:income ratio to 59% and resulted in a 10% year-on-year reduction in pre-provision profit.

Significant impairment provisions drive a statutory loss

The Group took a cautious approach to assessing its IFRS 9 impairment provisions by applying deliberately conservative economic assumptions and scenario weightings, coupled with expert judgement credit risk overlays, to increase the Group's on-balance sheet provisions to £735m and a total coverage ratio of 102bps. This has led to the Group recognising £501m of impairment charges (68bps cost of risk) inclusive of write-offs in the period. This sizeable provision charge primarily explains the 77% year-on-year reduction in underlying profit to £124m compared to FY19 (£539m), with an underlying RoTE of 0.6% (FY19: 10.8%)

After exceptional costs of £292m, including £139m of integration and transformation costs and £113m of acquisition accounting unwind, the Group recorded a statutory loss after tax of £141m.

Robust capital, liquidity and funding position

Importantly though, the Group's balance sheet remains robust as we enter a period of economic stress with a transitional CET1 ratio of 13.4%. The Group therefore retains a significant CET1 management buffer in excess of its Capital Requirements Directive IV (CRD IV) minimum CET1 requirement of 9.5%, equating to c.£950m, in addition to the Group's £735m of on-balance sheet credit provisions. The Group also maintains a strong liquidity position with an LCR of 140% and a stable funding position with a loan-to-deposit ratio of 107%.

Conclusion

2020 has been a difficult year for all, but I am happy with the way our colleagues have risen to the challenge of supporting our customers and communities, while ensuring the stability of the bank. Our conservative provisioning assumptions mean we have robust coverage levels going into a period of economic stress.

In the medium term, the Group believes that, assuming no significant further deterioration in expectations for the economic outlook or change in interest rates, Virgin Money has a clear path to delivering double digit statutory returns on tangible equity over time. The improvement in returns will be built on: the normalisation of impairments and exceptional costs; ensuring we continue to reduce our cost base to reflect the future operating environment; optimising our balance sheet mix; and delivering a more efficient capital base over time.

Basis of preparation note

Statutory basis: The statutory results are set out at the end of this section on page 16.

Underlying basis: The results are adjusted to remove certain items that do not promote an understanding of historical or future trends of earnings or cash flows, and therefore allows a more meaningful comparison of the Group's underlying performance. A reconciliation from the underlying results to the statutory basis is shown on page 17 and management's rationale for the adjustments is shown on page 129.

Pro forma comparative results: We have prepared pro forma comparative results for the Group as if Virgin Money UK PLC and Virgin Money Holdings (UK) PLC had always been a combined group, in order to assist in explaining trends in financial performance. A reconciliation between the results on a comparative pro forma basis and a statutory basis is included on page 17. The pro forma comparative results are also presented on an underlying basis as there were a number of factors which had a significant effect on the comparability of the Group's financial position and results. Any reference to pro forma results relates to the prior period only as the pro forma basis is not applicable in the current period due to the combined group being in operation for the entire year.

Chief Financial Officer’s review

Income

Summary for the year ended 30 September	2020 £m	2019 £m	Change
Underlying net interest income	**1,351**	1,433	(6)%
Underlying non-interest income	**191**	206	(7)%
Total underlying operating income	**1,542**	1,639	(6)%
Net interest margin	**1.56%**	1.66%	(10)bps
Average interest earning assets	**86,826**	86,362	1%

Overview

Income was 6% lower than FY19 at £1,542m, primarily reflecting the impact of the pandemic in the second half of the year and rate changes. NII was the key driver falling 6% versus FY19 to £1,351m. NIM was 10bps lower year-on-year at 1.56% and as expected this was primarily driven by the remaining front versus back book mortgage margin compression, the impact of the base rate cut and excess liquidity costs due to elevated deposit levels.

NII and NIM

Asset yields fell 19bps in the year with mortgage pricing remaining the primary contributor. As expected, we continued to see pressure from front book pricing being below average back book rates, leading to an average reduction in yield of 14bps compared to FY19, while average balances also declined slightly during the year. We remained selective in terms of our participation in the market in the first half while the second half was impacted by the pandemic restrictions. The more recent improvement in mortgage spreads will be beneficial and should be seen in the FY21 results given the typical completion time for mortgages.

In Business, a 40bps reduction in yields was primarily due to lower LIBOR rates and the impact of the Group’s new lending being primarily lower-yielding government-guaranteed lending through the BBLS and CBILS. The strong average balance sheet growth associated with this largely offset the lower yield to drive a stable NII performance in the period.

In Personal, growth in average balances drove an NII improvement while yields expanded 19bps primarily due to the seasoning of the credit card book which performed favourably against our effective interest rate (EIR) assumptions. Elsewhere, the average yield on the Group’s liquid assets fell 27bps reflecting the BoE base rate reduction.

Liability yields decreased 9bps relative to FY19, reflecting the impact of the BoE base rate cut and proactive repricing as we continued our strategy of optimising our deposit mix. Consumer and business pandemic-related savings behaviours saw an increase in average balances across lower yielding current accounts and savings products, despite the yields on both reducing. While on a spot basis our term deposit book reduced, average balances were broadly stable reflecting the more back-ended repricing activity during the year evidenced in the lower yield.

Wholesale funding costs reduced during the year primarily due to a significant reduction in average balances following the Group’s initial Term Funding Scheme (TFS) repayments, a reduction in repo funding and lower secured residential mortgage-backed securities (RMBS) funding owing to the Group’s elevated customer deposit balances. The average yield reduced primarily due to rate reductions following the BoE base rate cut and optimisation of the funding stack.

Following the reduction in Bank Base Rate to 0.1%, and noting future market rate expectations, the Group concluded that its 5-year structural hedge had generated maximum value. During Q3 the Group’s term structural hedges were fully unwound, locking in expected NII contributions from the hedges over the next 5 years. The Group has offset future uncertainty around the path for base rates through the designation of a portion of the Group’s CET1 management buffer to the risk, by agreeing a set of predefined triggers that could result in the Group amending its policy which are reviewed monthly and by measuring different base rate sensitivities as part of its stress testing framework. Based on the current rate outlook, the Group expects no significant adverse impact on NII in FY21 to having maintained a 5-year rolling approach, but it does make the Group more rate sensitive in relation to both an increase or decrease in base rate. The prospect of negative rates in the UK remains highly uncertain not least because of the operational challenges regarding implementation, the interplay with 0% product floors and because of uncertainty on market and competitor reaction to such a move.

In FY21 we anticipate a NIM that is broadly flat on the FY20 level (1.56%), assuming no change in the interest rate environment. This reflects more favourable mortgage pricing, the structural maturity profile of our mortgage book and deposit re-pricing opportunities.

Non-interest income

Non-interest income declined 7% year-on-year to £191m. This included a £16m one-off gilt sales gain during FY20, a fair value gain of £12m (vs. a £15m loss in FY19), partly offset by the absence of c.£20m of fee income earned from the Investments business that was transferred into a joint venture (JV) with Aberdeen Asset Management PLC (AAM) in FY19.

Excluding these impacts, divisional non-interest income of £161m reduced £37m (down 19%) year-on-year. This is largely due to a reduction in Personal fee income of £31m comprising a £16m impact from the implementation of the changes required in response to the ‘high cost of credit review’ and £13m from lower credit card transaction fee income primarily due to the effects of lockdown spending reductions. Mortgage non-interest income reduced £5m due to lower originations as a result of the pandemic restrictions on the mortgage market. Business fee income was broadly stable during the period, but benefited from a one-off £4m gain in relation to a growth finance business sale participation fee, absent which it would have been down slightly reflecting lower activity based fees.

With the second-half impact on non-interest income a reflection of lower activity levels and with uncertainty as to how quickly this rebounds, coupled with a further UK lockdown currently in force at the time of writing, it is expected that non-interest income will remain subdued.

Chief Financial Officer's review

Average balance sheet	2020			2019		
	Average balance £m	Interest income/ (expense) £m	Average yield/(rate) %	Average balance £m	Interest income/ (expense) £m	Average yield/(rate) %
Interest earning assets						
Mortgages	**59,464**	**1,446**	**2.43**	60,288	1,551	2.57
Business lending[(1)]	**8,296**	**313**	**3.77**	7,542	314	4.17
Personal lending	**5,366**	**423**	**7.88**	4,670	359	7.69
Liquid assets	**11,968**	**62**	**0.52**	12,298	98	0.79
Due from other banks	**1,727**	**5**	**0.30**	1,564	13	0.86
Swap income/other	**–**	**(78)**	**n/a**	–	(11)	n/a
Other interest earning assets	**5**	**–**	**n/a**	–	–	–
Total average interest earning assets	**86,826**	**2,171**	**2.50**	86,362	2,324	2.69
Total average non-interest earning assets	**3,696**			3,545		
Total average assets	**90,522**			89,907		
Interest bearing liabilities						
Current accounts	**12,301**	**(13)**	**(0.10)**	11,570	(19)	(0.16)
Savings accounts	**27,430**	**(227)**	**(0.83)**	24,366	(214)	(0.88)
Term deposits	**22,175**	**(348)**	**(1.57)**	22,877	(370)	(1.62)
Wholesale funding	**15,972**	**(228)**	**(1.42)**	19,427	(288)	(1.48)
Other interest bearing liabilities	**180**	**(5)**	**n/a**	–	–	–
Total average interest bearing liabilities	**78,058**	**(821)**	**(1.05)**	78,240	(891)	(1.14)
Total average non-interest bearing liabilities	**7,633**			6,590		
Total average liabilities	**85,691**			84,830		
Total average equity	**4,831**			5,077		
Total average liabilities and average equity	**90,522**			89,907		
Net interest income		**1,350**	**1.56**		1,433	1.66

(1) Includes loans designated at fair value through profit or loss (FVTPL).

Costs

For the year ended 30 September	2020 £m	2019 £m	Change
Personnel expenses	**336**	365	(8)%
Depreciation and amortisation expenses	**139**	111	25%
Other operating and administrative expenses	**442**	471	(6)%
Total underlying operating and administrative expenses	**917**	947	(3)%
Underlying CIR	**59%**	57%	2%pts

Overview

Underlying operating expenses reduced 3% year-on-year to £917m with the cost:income ratio of 59% increasing slightly due to the challenging operating environment and adverse COVID-19-related income impacts during the year.

Net cost reductions of £30m in the year were inclusive of c.£14m of incremental COVID-19-related costs including £7m of investment in systems to accommodate payment holidays and BBLS, and the remainder being extra resource to support customers.

Much of the underlying cost reductions in the year came from lower personnel costs, down 8%, as the Group continued with its integration programmes to reduce headcount and remove duplicate costs.

Other operating and administrative expenses also reduced by 5% as we started to realise third-party spend savings and operational cost reductions from the integration programme progress, but this was partly offset by the COVID-19-related system costs.

Depreciation and amortisation increased primarily as a result of adoption of IFRS 16 with c.£25m of amortisation on lease right-of-use assets replacing the rent expense previously recognised

We expect to achieve further net cost reductions in FY21 underpinned by the completion of our integration programme with incremental cost savings from headcount reductions, third-party spend and property. However, we do anticipate incurring c.£10-15m of ongoing COVID-19 related costs in FY21. The Group is therefore targeting an underlying operating cost base of <£875m in FY21, down from £917m in FY20.

Chief Financial Officer's review

Impairments

	Credit provisions at 30 September 2019 £m	Credit provisions at 30 September 2020 £m	Gross lending at 30 September 2020 £bn	Coverage ratio 2020 bps	Net cost of risk 2020 bps	% of loans in Stage 2 at 30 September 2020	% of loans in Stage 3 at 30 September 2020
Mortgages	40	131	58.6	23	16	14%	0.9%
Personal	175	301	5.6	591	423	15%	1.2%
Of which credit cards	*145*	*222*	*4.5*	*537*	*355*	*12%*	*1.2%*
Of which personal loans and overdrafts	*30*	*79*	*1.1*	*824*	*721*	*28%*	*1.4%*
Business	147	303	8.7	391(1)	212	44%	3.2%
Total	**362**	**735**	**72.9**	**102**	**68**	**18%**	**1.2%**
Of which Stage 2	*168*	*465*	*12.8*	*366*			
Of which Stage 3	*115*	*134*	*0.9*	*1,574*			

(1) Government-guaranteed loan balances excluded for purposes of calculating the Business division coverage ratio.

Overview

The Group has increased its on-balance sheet credit provisions to £735m to ensure appropriate levels of provision coverage across its portfolios, with a total coverage ratio of 102bps. This resulted in the Group recording a total impairment charge of £501m in FY20 (68bps cost of risk) inclusive of write-offs.

Conservative economic weightings and overlays

The Group has taken a cautious approach to assessing its impairment provisions in order to set aside appropriate portfolio provision coverage for the anticipated economic deterioration and increase in credit losses that is expected over the coming period. The Group has updated its IFRS 9 accounting models with the latest economic scenarios from Oxford Economics and selected a conservative weighting skewed heavily towards the more adverse economic scenarios, partly to reflect the high degree of uncertainty over the path of the virus in 2021 including the potential for further lockdowns. The weightings applied were a 5% weighting to the upside scenario, 50% to the base scenario and 45% to the downside. The weighted economic scenario includes a c.15% GDP trough in 2020, peak unemployment of c.10% in calendar Q1'21 and a peak-to-trough house price decline of 22%. This resulted in a significant increase in the Group's modelled and individually assessed ECL to £549m (FY19: £313m).

To supplement the models, the Group also applied expert credit risk judgement through post-model adjustments (PMAs). These are designed to account for factors that the models cannot incorporate or where the sensitivity is not as would be expected under what is an unprecedented economic stress scenario. Through this process, the Group prudently applied PMAs of £186m (FY19: £49m) comprising overlays in relation to the Group's expected payment holiday experience and the evolving macroeconomic dynamics that may not be fully captured in inputs or models.

As expected, the IFRS 9 model updates and overlays resulted in significant portfolio stage migration, with loans classified as Stage 2 increasing from 6% of the portfolio to 18% at 30 September 2020. Importantly though, 98% of Stage 2 lending balances remain <30DPD as the stage migration largely reflects the modelled PD migration impact from the economic updates and overlays applied.

The Group has not yet seen any significant credit losses nor been required to make any significant specific provisions in relation to the pandemic impact. The impairment provisions recognised during the year reflect the Group's best estimate of the level of provisions required for future credit losses as calibrated under the Group's conservative weighted economic assumptions and following the application of expert credit risk judgement overlays.

The Group has therefore significantly increased its provision coverage levels across all of its portfolios. In Mortgages, the coverage ratio of 23bps is deemed appropriate for the high-quality portfolio of lending we possess. Our Personal lending book coverage ratio of 591bps includes 537bps of coverage for our high-quality, affluent-customer-led credit card portfolio and 824bps of coverage for our personal loans and overdrafts book, with the much larger weighting of credit cards dampening our total Personal coverage level relative to some peers' total unsecured portfolios. In Business, our coverage ratio of 391bps reflects our sub-investment grade SME lending book, while the 44% of Stage 2 lending balances (FY19: 30%) is reflective of our conservative assumptions and our early adoption of the European Banking Authority (EBA) future requirement to keep forborne assets in Stage 2 for a minimum of two years.

Payment holidays

Virgin Money continues to actively support its Mortgage and Personal customers through this difficult time with payment holidays where appropriate, although the level of new requests reduced significantly after the peak in April. Across the portfolios we have only c.1-4% of portfolio balances on a payment holiday and of those payment holidays that have matured the vast majority of customers (>90%) have returned to payments, with only a small proportion currently requiring further support. The key payment holiday statistics are set out below.

Outlook

The Group's recognition of significant impairment charges in FY20 reflects the conservative weighted economic scenarios and expert judgement overlays applied, ahead of an expected deterioration in the future economic environment. Current expectations are that, subject to no further material deterioration in the economic outlook, the Group's FY21 cost of risk will be lower than that for FY20.

Payment holidays status

Product	Total balances of payment holidays granted to date	Representing % of balances	Total balances of payment holidays still in force	Representing % of balances	% of matured payment holiday customers returning to payment	% of matured payment holiday customers requiring support or in arrears
Mortgages	£11.9bn	20%	£2.5bn	4%	98%	2%
Credit Cards	£219m	5%	£31m	1%	92%	8%
Personal Loans	£103m	11%	£26m	3%	95%	5%

Chief Financial Officer's review

Exceptional items and statutory loss

	2020 £m	2019 £m
Underlying profit on ordinary activities before tax	**124**	539
Exceptional items		
– Integration and transformation costs	**(139)**	(156)
– Acquisition accounting unwinds	**(113)**	(87)
– Legacy conduct costs	**(26)**	(433)
– Other items	**(14)**	(128)
Loss on ordinary activities before tax	**(168)**	(265)
Add Virgin Money Holdings (UK) PLC pre-acquisition loss(1)	**–**	33
Statutory loss on ordinary activities before tax	**(168)**	(232)
Tax credit	**27**	53
Statutory loss for the year	**(141)**	(179)
Underlying RoTE	**0.6%**	10.8%
Statutory RoTE	**(6.2)%**	(6.8)%
Tangible Net Asset Value (TNAV) per share	**244.2p**	249.2p

(1) In order to reconcile the 2019 pro forma loss to the statutory loss, the pre-acquisition results of Virgin Money Holdings (UK) PLC are removed.

Overview

The Group's underlying profit before tax was £124m (FY19: £539m) down significantly year-on-year primarily due to the significant impairment provision charge recognised of £501m. The Group therefore made a statutory loss after tax of £141m after deducting £292m of exceptional costs incurred during the year, as well as a tax credit of £27m. The exceptional item charges incurred in FY20 were however significantly lower than FY19 due to the non-recurrence of significant one-off acquisition costs and legacy PPI conduct charges.

Underlying RoTE of 0.6% was significantly lower than the prior year of 10.8%, reflecting the lower underlying profit due to the sizeable impairment provision. Statutory RoTE was therefore negative after reflecting the integration & transformation costs and acquisition accounting unwind charges incurred. TNAV per share reduced 5p in FY20 to 244.2p, with TNAV build of 34p from underlying pre-provision profit after tax being more than offset by 28p of impairment provision charges and a net 11p adverse impact from other movements including exceptional item charges partly offset by a pension scheme actuarial gain.

Integration and transformation costs

Due to the impact of COVID-19, the Group delayed some of its planned restructuring activity in the first half, but recommenced the majority of the programmes in the final quarter. This led to spend of £139m in the period primarily relating to the integration programmes. This spend has supported the delivery of net cost savings in FY20 and will also deliver run-rate savings into FY21. The Group expects to continue its integration and transformation programmes in FY21 and anticipates a further c.£75m of costs during the year to deliver this.

Acquisition accounting unwinds

The Group recognised fair value acquisition net accounting adjustments at the time of the Virgin Money acquisition that would be unwound through the income statement over the remaining life of the related assets and liabilities (c.5 years). £113m was charged in FY20 which included the reclassified fair value unwind related to legacy Virgin Money hedges which had previously been recognised in underlying non-interest income. The Group now expects a further c.£150m of total acquisition accounting unwind charges over the next five years, which is expected to see the majority of this charge incurred over the next 1-2 years.

Legacy conduct

The Group raised £26m of further provisions in relation to non-PPI customer redress matters in the year, relating to several outstanding legacy issues, none of which is material in its own right. No further payment protection insurance (PPI) related provisions were recognised in FY20 and the Group has made good progress in processing its outstanding PPI complaints and information requests during the year. The Group has processed all of its information requests and now has just c.30k complaints left to review, which it expects to complete by the turn of the calendar year and in line with its current provision estimate.

Other items

The Group incurred £14m of other one-off exceptional costs during the year, primarily reflecting the growth opportunity projects relating to the RBS switching scheme and set-up costs relating to the AAM JV.

Taxation

On a statutory basis, the tax credit was £27m on a pre-tax loss of £168m, an effective rate of 16%. The overall credit is less than the statutory rate of 19% due to the impact of non-deductible expenses (tax effect of £5m). The banking surcharge is not payable this period. Included within the overall credit is £37m related to changes in the corporation tax rate and a further £15m related to tax on Additional Tier 1 (AT1) distributions now reflected via the income statement (in prior periods tax related to AT1 distributions was recorded via changes in equity). These credits were offset by a reduction of £51m in the value of tax losses recognised, reflecting a fall in forecast profits against which such losses can be recognised. On an underlying basis, the Group tax charge was £24m on underlying profits of £124m, an effective rate of 19%. As outlined above, the impact of the rate change and AT1 credits is offset by the reduction in asset for losses recognised, resulting in an effective rate that matches the statutory mainstream tax rate.

Outlook

The Group expects its profitability to improve going forward as the provision charge normalises, assuming no further deterioration in the economic environment, and the exceptional charges reduce in line with expectations. The gap between underlying and statutory is also expected to decrease significantly over the medium term.

Chief Financial Officer's review

Balance sheet

As at 30 September	2020	2019	Change
Mortgages	**58,290**	60,079	(3.0)%
Personal	**5,219**	5,024	3.9%
Business	**8,948**	7,876	13.6%
of which BBLS	**809**	–	n/a
of which CBILS	**334**	–	n/a
Total customer lending	**72,457**	72,979	(0.7)%
Relationship deposits[1]	**25,675**	21,347	20.3%
Non-linked savings	**20,729**	20,197	2.6%
Term deposits	**21,107**	22,243	(5.1)%
Total customer deposits	**67,511**	63,787	5.8%
Wholesale funding	**14,227**	18,506	(23.1)%
of which TFS	**4,108**	7,342	(44.0)%
of which TFSME	**1,300**	–	n/a
LDR	**107%**	114%	(7)%pts
LCR	**140%**	152%	(12)%pts

(1) Current account and linked savings balances.

Overview

The Group's balance sheet during FY20 has been impacted by the pandemic in very different ways across our portfolios. At an aggregate level our total customer lending has reduced by 0.7% to £72.5bn primarily due to a contraction in our Mortgage book, while our total customer deposits have increased by 5.8% to £67.5bn reflecting pandemic-related consumer and business behaviours.

Customer lending and deposit balances

In our Mortgages business, balances declined 3.0% to £58.3bn as we actively chose to maintain our pricing discipline in a competitive (pre-COVID-19) environment in the first half, while the second half was impacted by the UK lockdown restrictions on the housing market. The house purchase market has picked up significantly during the second half of the year and while the Group is participating in this increased flow, the benefit will not be seen until FY21 given the typical mortgage completion timeframes.

Personal lending growth of 3.9% to £5.2bn was mainly focused on our high-quality credit card business where we continued our long-standing strategy of origination focused on affluent customers with high levels of disposable income, with good growth in our personal loan book also due to our digital originations. Our credit card lending balances have remained more resilient than the market due to our high proportion of balance transfer card balances which make up a significant proportion of our portfolio and are more stable at times of tempered demand. Credit card activity slowed significantly during lockdown with volumes c.55% lower than usual in April/May, and while spending did improve over the summer it is still not back to pre-pandemic levels and is expected to remain muted particularly if future lockdowns are imposed.

Business lending increased 13.6% to £8.9bn, although this growth was solely due to the government-guaranteed lending schemes (BBLS/CBILS/CLBILS) through which the Group lent £1.2bn to businesses to provide much needed liquidity. Underlying business lending shrank slightly by £0.1bn reflecting lower BAU demand.

Customer deposit balances grew 5.8% in the period to £67.5bn. The growth came primarily in relationship deposits which rose 20.3% to £25.7bn as consumer spending slowed dramatically under lockdown and businesses generally deposited government-guaranteed lending proceeds into cash accounts for liquidity. Elsewhere, we continued to optimise the deposit base with a 5.1% reduction in term deposits.

Wholesale funding and liquidity

The Group maintains a strong funding and liquidity position and has no reliance on short-term wholesale funding. The 12%pts reduction in the LCR over the period highlights the Group's ability to operate more efficiently, while continuing to comfortably exceed both regulatory requirements and more prudent internal risk appetite metrics. In addition to its liquid asset buffer averaging c.£12bn over the past 12 months, the Group has a significant amount of pre-positioned collateral eligible for use in a range of central bank facilities, ensuring a substantial buffer in the event of any sudden outflows.

Supplementing the customer deposit position, we ensure appropriate diversification in our funding through a number of well-established wholesale funding programmes. In January, we successfully completed the issuance of further mortgage-backed securities from the Group's Lanark programme, raising £500m equivalent. This was supported by £475m of Tier 2 subordinated debt issuance in September which strengthened the Group's capital stack, as well as €500m of senior unsecured debt issuance in June as we continue to build a buffer over our final MREL requirements.

During the period, the Group repaid £3.2bn of its TFS drawings, leaving £4.1bn outstanding. At the same time, the Group drew £1.3bn from the BoE's new TFSME, extending the duration and optimising our funding flexibility to support customers through this period of stress.

Total wholesale funding reduced to £14.2bn during the year (FY19: £18.5bn), principally as a result of the growth in customer deposits allowing us to optimise the funding stack. This resulted in a 7%pts reduction in the Group's LDR over the period to 107%.

Outlook

As we look into FY21, we expect muted lending demand reflecting the anticipated deterioration in the economy, while the trajectory for deposits is more uncertain and will depend on the extent to which consumers & businesses need to utilise the savings they have built.

Chief Financial Officer's review

Capital

As at 30 September	2020	2019	Change
CET1 ratio (IFRS 9 transitional)	**13.4%**	13.3%	0.1%pts
CET1 ratio (IFRS 9 fully loaded)	**12.2%**	12.9%	(0.7)%pts
Total capital ratio	**20.2%**	20.1%	0.1%pts
MREL ratio	**28.4%**	26.6%	1.8%pts
UK leverage ratio	**4.9%**	4.9%	–%pts
RWAs (£m)	**24,399**	24,046	1.5%
of which Mortgages (£m)	**9,484**	8,846	7.2%
of which Business (£m)	**6,716**	7,124	(5.7)%
of which Personal (£m)	**4,151**	4,042	2.7%

Overview

The Group has maintained a robust capital position with a CET1 ratio (IFRS 9 transitional basis) of 13.4% and a total capital ratio of 20.2%. The significant impairment provision charges recognised during the year have largely been offset by IFRS 9 transitional relief and Excess Expected Loss (EEL) deductions on a transitional basis. The Group's CET1 ratio on an IFRS 9 fully loaded basis did however reduce to 12.2%.

Capital requirements

Following completion of the Group's ICAAP, the PRA updated the capital requirements for the Group. The Pillar 2A CET1 requirement was reduced from 2.9% to 2.5% and the Group's fully-loaded CRD IV minimum CET1 capital requirement is now 9.5%.

CET1 capital

The Group's transitional CET1 ratio increased by 8bps in the period. Pre-provision underlying profit generated CET1 of 165bps, with the 121bps of impairment provision charges offset by 119bps of IFRS 9 transitional relief and EEL deduction. RWA growth in the period consumed 19bps of CET1 and included the adverse mortgage model changes of 29bps offset by the SME supporting factor relief of 39bps. After AT1 distributions of 28bps, the Group generated 116bps of underlying CET1 capital. The Group also incurred exceptional item charges including restructuring costs and acquisition accounting unwind totalling 82bps along with other charges of 26bps.

RWAs

RWAs increased c.£0.4bn (1.5%) during the period, largely reflecting the impact of implementing the planned Mortgage model changes that increased RWAs by c.£0.5bn, offset by a reduction in Business RWAs primarily due to the impact of the SME supporting factor relief that reduced RWAs by c.£0.7bn. RWAs in the Personal portfolio broadly tracked lending volumes, with non-credit RWAs stable.

CET1 ratio in-year movements	2020
Opening CET1 ratio (IFRS 9 transitional)	**13.3%**
Pre-provision capital generated (bps)	**165**
Impairment provision charge (bps)	**(121)**
Impairment provision regulatory adjustments[(1)] (bps)	**119**
RWA growth[(2)] (bps)	**(19)**
AT1 distributions (bps)	**(28)**
Underlying capital generated (bps)	**116**
Integration and transformation costs (bps)	**(47)**
Acquisition accounting unwind (bps)	**(35)**
Other (bps)	**(26)**
Net capital generated (bps)	**8**
Closing CET1 ratio (IFRS 9 transitional)	**13.4%**

(1) Impairment provision regulatory adjustments include IFRS 9 transitional relief of 82bps and movements in EEL of 37bps.

(2) Includes mortgage model changes of (29)bps and SME supporting factor relief of 39bps.

Robust capital position in the face of economic uncertainty

The significant impairment provisions taken during the year to increase the Group's on-balance sheet provisions to £735m means that the Group holds appropriate levels of provision coverage as we go into a period of economic stress with an expected increase in credit losses. In addition, the Group also retains a significant CET1 management buffer of c.£950m in excess of its CRD IV regulatory requirement, providing further potential loss-absorbing capacity. The Board has concluded that it is prudent to conserve capital and has not proposed an ordinary dividend for FY20, but still has an ambition to deliver a sustainable and progressive dividend over time.

MREL

The Group's MREL ratio increased to 28.4%, comfortably exceeding both its interim and expected 2022 end-state MREL requirement. This means future MREL issuance is focused on building a prudent management buffer over the expected end-state MREL requirement, with £0.5bn to £0.75bn of further MREL eligible senior unsecured issuance planned in FY21.

Outlook

Looking into 2021, the Group anticipates RWA inflation and a reduction in IFRS 9 transitional relief through ratings migrations as the economy deteriorates, but expects partial offsets through RWA efficiency opportunities including the move to IRB for credit cards, business model updates and hybrid mortgage models. The in-year transitional CET1 ratio trajectory will be impacted by the timing of the RWA inflation, but the RWA opportunities and expected EBA software intangible benefit mean we currently expect to finish the year around c.13% on a transitional CET1 ratio basis. The Group is also preparing for the ACS stress test in 2021 which will be an important input into the Group's medium term capital targets.

Chief Financial Officer's review

Guidance reflects level of economic uncertainty

FY21 financial guidance

Net Interest Margin (NIM)

Broadly flat on FY20 level

Underlying costs

<£875m (incl. £10-15m of COVID costs)

Cost of risk

Lower than FY20 level

Medium-term outlook:

The Board believes that, assuming no significant further deterioration in expectations for the economic outlook or change in interest rates, Virgin Money has a clear path to delivering double digit statutory returns on tangible equity over time. Specific medium-term guidance will be provided when there is more certainty on the forward economic trajectory.

Outlook

Given the unprecedented nature of COVID-19, the exact economic outlook for the UK is clearly evolving and remains hard to predict with any high degree of certainty at this stage. We recognise the very recent news of a potential vaccine but have determined that it is too early to incorporate this in our near-term forecasts at present.

The implications of the future reduction in the various UK government economic support measures and the impact of current lockdown restrictions are unclear at present, while the threat of further future lockdowns remains. The outcome of these will be key in determining the size of the shock to GDP, future unemployment levels and the associated shape of any recovery. The UK's Brexit negotiations are also not yet concluded and there is still a risk of a no-deal outcome that would adversely impact the economy further and could lead to a more prolonged downturn and consequent slower recovery.

However, the Group enters this period from a position of balance sheet strength and we remain agile in managing the emerging risks, while continuing to support our customers, colleagues and communities. Given the aforementioned uncertainties and fluidity of the operating environment, while it is possible for the Group to give indicative financial guidance for FY21, it is not appropriate at this stage to give firm medium-term guidance.

FY21 financial guidance

While the Group's NIM reduced in FY20 due to the continued compression in mortgage margins and the BoE base rate cut, in FY21 we anticipate a NIM that is broadly flat on the FY20 level (1.56%) assuming no change in the rate environment. This reflects more favourable mortgage pricing, the structural maturity profile of our mortgage book and deposit re-pricing opportunities.

With the second-half impact on non-interest income a reflection of lower activity levels and with uncertainty as to how quickly this rebounds, coupled with a further UK lockdown currently in force at the time of writing, it is expected that non-interest income will remain subdued.

On costs, we expect to achieve further net cost reductions in FY21 underpinned by the completion of our integration programme with incremental cost savings from headcount reductions, third-party spend and property, but we do currently anticipate incurring c.£10-15m of ongoing COVID-19 related costs in FY21. The Group is therefore targeting an underlying operating cost base of <£875m in FY21, down from £917m in FY20.

On cost of risk, the Group's recognition of significant impairment charges in FY20 reflects the conservative weighted economic scenarios and expert judgement overlays applied, ahead of an expected deterioration in the future economic environment. Current expectations are that, subject to no further material deterioration in the economic outlook, the Group's FY21 cost of risk will be lower than FY20.

Medium-term expectations

In the medium term, the Group believes that, assuming no significant further deterioration in expectations for the economic outlook or change in interest rates, Virgin Money has a clear path to delivering double digit statutory returns on tangible equity over time. The improvement in returns will be built on: the normalisation of impairments and exceptional costs; ensuring we continue to reduce our cost base to reflect the future operating environment; optimising our balance sheet mix; and delivering a more efficient capital base over time.

On capital, while in the near term we expect to continue operating with a significant buffer (currently 390bps) in excess of our MDA threshold of 9.5%, over the medium term as economic conditions stabilise we intend to operate a dynamic CET1 ratio target. This will comprise an appropriate management buffer in excess of our MDA threshold that will be calibrated to ensure that the Group remains well capitalised taking into account regulatory developments including next year's ACS stress test, the prevailing risk environment and an ability to withstand stresses at all times.

The Group also understands the importance of capital returns to our shareholders, and we believe that the delivery of our strategy will allow Virgin Money to consistently generate significant capital over time that can be redeployed into both returns accretive growth and returns to shareholders.

Enda Johnson
Interim Group Chief Financial Officer
24 November 2020

Chief Financial Officer's review

Summary income statement (statutory basis)

For the year ended 30 September	2020 £m	2019 £m	Change %
Net interest income	**1,283**	1,514	(15)
Non-interest income	**160**	235	(32)
Total operating income	**1,443**	1,749	(17)
Operating and administrative expenses	**(1,104)**	(1,729)	(36)
Operating profit before impairment losses	**339**	20	1,595
Impairment losses on credit exposures	**(507)**	(252)	101
Statutory loss on ordinary activities before tax	**(168)**	(232)	(28)
Tax credit	**27**	53	(49)
Statutory loss after tax	**(141)**	(179)	(21)

The Group has recognised a statutory loss after tax of £141m (30 September 2019: loss of £179m). The statutory loss in 2020 was due to the significant increase in impairment provision charges due to COVID-19, coupled with several ongoing exceptional items including integration and transformation costs, and acquisition accounting unwind charges. In 2019 the statutory loss largely reflected the significant one-off costs relating to the acquisition of Virgin Money Holdings (UK) PLC and PPI conduct charges. The Group continues to expect that the difference between underlying and statutory profit will reduce over time as we deliver our strategy and the exceptional charges related to the integration reduce.

Key Performance Indicators[1]

	12 months to 30 Sep 2020	12 months to 30 Sep 2019	Change
Profitability			
Statutory RoTE	**(6.2)%**	(6.8)%	0.6%pts
Statutory CIR	**76%**	99%	(23)%pts
Statutory return on assets	**(0.16)%**	(0.23)%	0.07%pts
Statutory basic loss per share	**(15.3)p**	(17.9)p	2.6p

(1) For a definition of each of the KPIs, refer to 'Measuring financial performance – glossary' on pages 127 to 128. The KPIs include statutory, regulatory and alternative performance measures.

Chief Financial Officer's review

Reconciliation of statutory to underlying results

The statutory basis presented within this section reflects the Group's results as reported in the financial statements, incorporating Virgin Money Holdings (UK) PLC from 15 October 2018. The pro forma comparative basis includes the consolidated results of Virgin Money Holdings (UK) PLC as if the acquisition had occurred on 1 October 2018. The underlying results reflect the Group's results prepared on an underlying basis as presented to the CEO, Executive Leadership Team and 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. The table below reconciles the statutory results to the underlying results, and full details on the adjusted items to the underlying results are included on page 129.

2020 income statement	Statutory results £m	Integration and transformation costs £m	Acquisition accounting unwinds £m	Legacy conduct £m	Other £m	Underlying basis £m
Net interest income	**1,283**	–	**68**	–	–	**1,351**
Non-interest income	**160**	–	**28**	–	**3**	**191**
Total operating income	**1,443**	–	**96**	–	**3**	**1,542**
Total operating and administrative expenses before impairment losses	**(1,104)**	**139**	**11**	**26**	**11**	**(917)**
Operating profit before impairment losses	**339**	**139**	**107**	**26**	**14**	**625**
Impairment losses on credit exposures	**(507)**	–	**6**	–	–	**(501)**
(Loss)/profit on ordinary activities before tax	**(168)**	**139**	**113**	**26**	**14**	**124**
Financial performance measures						
RoTE	**(6.2%)**	**3.3%**	**2.6%**	**0.6%**	**0.3%**	**0.6%**
CIR	**76.5%**	**(8.1)%**	**(6.6)%**	**(1.5)%**	**(0.8)%**	**59.5%**
Return on assets	**(0.16)%**	**0.12%**	**0.10%**	**0.02%**	**0.01%**	**0.09%**
Basic EPS	**(15.3)p**	**7.9p**	**6.5p**	**1.5p**	**0.8p**	**1.4p**

2019 income statement	Statutory results £m	Include Virgin Money pre-acquisition results £m	Pro forma results £m	Integration and transfor-mation costs £m	Acquisition accounting unwinds £m	Legacy conduct £m	Other £m	Underlying basis £m
Net interest income	1,514	22	1,536	–	(23)	–	(80)	1,433
Non-interest income	235	9	244	–	–	–	(38)	206
Total operating income	1,749	31	1,780	–	(23)	–	(118)	1,639
Total operating and administrative expenses before impairment losses	(1,729)	(60)	(1,789)	156	7	433	246	(947)
Operating profit/(loss) before impairment losses	20	(29)	(9)	156	(16)	433	128	692
Impairment losses on credit exposures	(252)	(4)	(256)	–	103	–	–	(153)
(Loss)/profit on ordinary activities before tax	(232)	(33)	(265)	156	87	433	128	539
Financial performance measures								
RoTE	(6.8)%	(0.7)%	(7.5)%	3.5%	2.0%	9.9%	2.9%	10.8%
CIR	99%	1%	100%	(10)%	1%	(26)%	(8)%	57%
Return on assets	(0.23)%	(0.03)%	(0.26)%	0.15%	0.09%	0.43%	0.13%	0.54%
Basic EPS	(17.9)p	(1.7)p	(19.6)p	9.3p	5.1p	25.7p	7.6p	28.1p

Risk Management

Introduction

Effective risk management is critical to realising the Group's strategic priorities of pioneering growth, with delighted customers and colleagues, while operating with super straightforward efficiency, discipline and sustainability. The safety and soundness of the Group is aligned to Our Purpose and is a fundamental requirement to enable our customers and stakeholders to be 'happier about money'.

The Group's approach to and management of risk is defined in the Group's Risk Management Framework (RMF). Integral to the RMF is the identification of principal risks, the process by which the Group sets its risk appetite which is the nature and extent of risk it is willing to assume to achieve its strategic objectives. The framework identifies ten principal risks: operational risk; people risk; financial risk; model risk; credit risk; technology risk; regulatory and compliance risk; conduct risk; financial crime risk; and strategic and enterprise risk. Climate risk is recognised as a cross-cutting risk type that manifests through other principal risks.

Risk appetite is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity, to achieve its strategic objectives. The Risk Appetite Statement (RAS) articulates the Group's risk appetite to stakeholders and provides a view on the risk-taking activities the Board is comfortable with, guiding decision-makers in their strategic and business decisions.

COVID-19 is impacting individuals, businesses and communities and has increased the Group's risk profile. The measures introduced to support the economy create new operational, conduct, enforceability and financial risks for the Group. These risks are being managed and will be monitored over time.

Further detail on the Group's risks and how they are managed is available in the 2020 Annual Report & Accounts.

Credit risk

At a time of unprecedented challenge for the UK economy, our lending portfolios remain well positioned.

While 2020 has undoubtedly been a difficult year, the shape and credit quality of our lending portfolio meant we were well positioned to face the economic challenges brought about by COVID-19. We started the year with a well-diversified portfolio, with 82% of our lending portfolio from a low LTV mortgage book, 11% from a business lending portfolio in solidly performing sectors, and the remaining 7% from a high quality personal lending portfolio, and this mix remained largely constant through the year. We adhered to our principles of managing our lending portfolio with a controlled risk appetite and prudent approach to underwriting with additional changes to our underwriting criteria introduced in response to the economic events.

The emergence of COVID-19 towards the end of the first half of the year and the resulting lockdown inevitably put pressure on all businesses and individuals, however the additional support available in the form of government backed lending and payment holidays has undoubtedly eased the immediate pressures. Nevertheless, our assessment of the economic environment is cautious given the risks to the downside which remain and we have applied prudent macroeconomic forecasts and conservative weightings to those forecasts which has caused us to reassess the likelihood of future loss in our lending portfolio and resulted in us increasing our provision for future expected credit losses, both at the half year and year end. Accordingly, we have recorded an underlying impairment charge of £501m in the year to 30 September 2020, an increase of £348m from the prior year charge of £153m. We have kept this position under close watch throughout the year and updated our view on a quarterly basis.

A key indicator of the underlying quality of the lending portfolio is the movement in staging over time and the levels of arrears in the portfolios. Arrears levels have remained largely stable across all portfolios as government interventions and payment holiday support has been deployed. Whist we have seen a deterioration in staging with 81% of the Group's lending portfolio now in stage 1 at 30 September 2020 (2019: 93%), this is principally due to probability of default (PD) migration rather than arrears, with the level of the portfolio < 30 DPD remaining stable at 98.5% (2019: 98.6%). Stage 3 balances have similarly remained stable. In summary, whilst an element of migrations to stage 2 reflect a level of financial difficulty for certain customers, stage migrations in the year have generally been reflective of more negative macroeconomic forecasts rather than a deterioration in the underlying quality of our book. Furthermore, a significant proportion of customers who have taken advantage of the COVID-19 payment holidays available have already resumed their normal payment patterns and we will continue to closely monitor these customers going forward.

In setting our provision for expected future credit losses at the year end, we have adopted prudent macroeconomic forecasts and weightings and deployed these within our credit models. Where it has not been possible to fully quantify new or emerging risks in modelled outcomes, or we have assessed limitations in our models, expert judgement has been applied to determine an appropriate level of additional post-model adjustments (PMAs); the level of PMAs is inevitably higher this year at £186m (2019: £49m) due largely to the impact of COVID-19 variables which, given the unprecedented nature of the economic shock, could not be fully incorporated into the latest models. In combination, these factors ensure the Group has suitably provided against expected future losses, with a provision of £735m at 30 September 2020 (2019: £362m). This increased level of provision results in overall coverage of 1.02% (2019: 0.50%), which we consider to be balanced and appropriate for our portfolio at the present time.

Notwithstanding the level of prudence we have exercised in measuring ECLs this year, and the recent announcement regarding positive progress in the development of a COVID-19 vaccine, the economic outlook remains challenging. We will continue to monitor and assess the quality of our credit portfolios as we navigate through these difficult times.

The Credit risk report which now follows has been structured into the sections below in order to further explain our considerations:

- **Managing risk within our portfolios:** addresses the various frameworks, policies, approaches and mitigations deployed to manage and oversee credit risk;
- **Measuring credit risk within our portfolios:** covers the Group's approach to ECL methodologies and calculations as well as the approach to credit estimates and judgements, including PMAs;
- **Portfolio performance:** summarises the key credit performance measures and influencing factors set out at Group level, supported by commentary on each of the three divisions: Mortgages, Personal, and Business, and
- **Supporting our customers in times of need:** informs the various support mechanisms the Group has deployed to support customers.

A range of technical tables and analysis is also included.

Group credit highlights

	30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
Underlying impairment charge on credit exposures	**501**	153
Impairment provisions: Modelled	**496**	266
PMA	**186**	49
Individually assessed	**53**	47
Impairment provisions held on credit exposures	**735**	362

Credit risk

Managing risk within our credit portfolios

Risk appetite

The Group controls its levels of credit risk by placing limits on the amount of risk it is willing to take in order to achieve its strategic objectives. This involves a defined set of qualitative and quantitative limits in relation to its credit risk concentrations to one borrower, or group of borrowers, and to geographical, product and industry segments. The management of credit risk within the Group is achieved through ongoing approval and monitoring of individual transactions, regular asset quality reviews and the independent oversight of credit decisions and portfolios.

The COVID-19 pandemic continues to present significant risks to the Group's credit portfolios. However, the Group remains focused on supporting customers and colleagues through the exceptional challenges that have crystallised over the past few months. The FY2021 RAS will continue to consider the impact of COVID-19, remaining agile, focused and responsive, to ensure we are addressing new and developing risks in a safe and controlled manner.

Measurement

The Group uses a range of statistical models, supported by both internal and external data, to measure credit risk exposures. These models underpin the IRB approval for the mortgage and business portfolios and the standardised approach for the personal portfolios. Further information on the measurement and calculation of ECL and the Group's approach to the impairment of financial assets can be found on page 22.

The Group's portfolios are subject to regular stress testing. Stress test scenarios are regularly prepared to assess the adequacy of the Group's impairment provision and the impact on RWAs and capital. Management will consider how each stress scenario may impact on different components of the credit portfolio. The primary method applied uses migration matrices, modelling the impact of PD rating migrations and changes in portfolio default rates to changes in macroeconomic factors to obtain a stressed position for the credit portfolios. Loss given default (LGD) is stressed based on a range of factors, including property price movements.

Mitigation

The Group maintains a dynamic approach to credit management and takes necessary steps if individual issues are identified or if credit performance has, or is expected to, deteriorate due to borrower, economic or sector-specific weaknesses.

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

There is regular analysis of the borrower's ability to meet their interest and capital repayment obligations with early support and mitigation steps taken where required. Credit risk mitigation is also supported, in part, by obtaining collateral and corporate and personal guarantees where appropriate.

Other mitigating measures are described below.

Credit assessment and mitigation

Credit risk is managed in accordance with lending policies, the Group's risk appetite and the RMF. Lending policies and performance against risk appetite are reviewed regularly.

The Group uses a variety of lending criteria when assessing applications for mortgage and personal customers. The approval process uses credit scorecards, as well as manual underwriting, and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group also assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place quantitative thresholds, such as maximum limits on the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application.

For residential mortgages, the Group's policy is to accept only standard applications with a LTV less than 95%. The Group has maximum percentage LTV limits which depend upon the loan size. Product types such as BTL and residential interest-only mortgages are controlled by transactional limits covering both LTV and value.

For business customers, credit risk is further mitigated by focusing on business sectors where the Group has specific expertise and through limiting exposures on higher value loans and to certain sectors. When making credit decisions for business customers the Group will routinely assess the primary source of repayment, most typically the cash generated by the customer through its normal trading cycle. Secondary sources of repayment are also considered and while not the focus of the lending decision, collateral will be taken when appropriate. The Group seeks to obtain security cover and, where relevant, guarantees from borrowers.

Specialist expertise

Credit quality is managed and monitored by skilled teams including, where required, specialists who provide dedicated support for customers experiencing financial difficulty. Credit decisions utilise credit scoring techniques and manual underwriting, as appropriate. These tasks are performed by skilled and competent specialists acting within agreed delegated authority levels set in accordance with their experience and capabilities.

Credit strategy and policy

Credit risks associated with lending are managed through the application of detailed lending policies and standards which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms.

Significant credit risk strategies and policies are reviewed and approved annually by the Credit Risk Committee. For complex credit products and services, the Chief Credit Officer and Credit Risk Committee provide a policy framework which identifies, quantifies and mitigates risks including, but not limited to, those that have arisen as a result of the impacts of COVID-19. These policies and frameworks are delegated to, and disseminated under, the guidance and control of the Board and senior management, with appropriate oversight through governance committees.

Specialist teams oversee credit portfolio performance as well as adherence to credit risk policies and standards. Activities include targeted risk-based reviews, providing an assessment of the effectiveness of internal controls and risk management practices. Bespoke assignments are also undertaken in response to emerging risks and regulatory requirements. Independent assurance reviews are regularly undertaken by Internal Audit.

Credit risk

Portfolio oversight

The Group's credit portfolios, and the key benchmarks, behaviours and characteristics by which those portfolios are managed, are regularly reviewed. This entails the production and analysis of regular portfolio monitoring reports for review by senior management.

Controls over rating systems

The Group has a Model Risk Oversight team that sets common minimum standards. The standards are designed to ensure risk models and associated rating systems are developed consistently and are of sufficient quality to support business decisions and meet regulatory requirements. The Group performs an annual self-assessment of its ratings systems to ensure ongoing CRR compliance supported by all three lines of defence.

The Group also utilises other instruments and techniques across its wider balance sheet. These are summarised below:

Derivatives

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

Master netting agreements

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

Collateral

Collateral held as security and other credit enhancements can be summarised as follows:

Residential mortgages

Residential property is the Group's main source of collateral on mortgage lending and means of mitigating loss in the event of the default risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional or indexed (subject to policy rules and confidence levels) valuations.

Commercial property

Commercial property is the Group's main source of collateral on business lending and means of mitigating loss in the event of default. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate). All commercial property collateral is subject to an independent, professional valuation when taken and thereafter subject to periodic review in accordance with policy requirements.

Non-property related collateral

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

The Group provides asset-backed lending in the form of asset and receivables finance. Security for these exposures is held in the form of direct recourse to the underlying asset financed.

Further detail on collateral can be found on pages 32-33.

Monitoring

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

Credit Risk Committee: The Credit Risk Committee ensures that the credit RMF and associated policies remain effective. The Committee has oversight of the quality, composition and concentrations of the credit risk portfolio and considers strategies to adjust the portfolio to react to changes in market conditions.

RAS measures: Measures are monitored monthly and reviewed bi-annually, at a minimum, or where specific action is merited, for example RAS was amended at pace in response to COVID-19. Regular review ensures that the measures accurately reflect the Group's risk appetite, strategy and concerns relative to the wider macro environment. All measures are subject to extensive engagement with the Executive Leadership Team and the Board and are subject to endorsement from executive governance committees prior to Board approval. Regulatory engagement is also scheduled as appropriate.

Risk concentration: Concentration of risk is managed by counterparty, product, geographical region and industry sector. In addition, single name exposure limits exist to control exposures to a single counterparty. Concentrations are also considered through the RAS process, focusing particularly on comparing the portfolio against market benchmarks.

Single large exposure excesses: All excesses are reported to the Transactional Credit Committee and the Chief Credit Officer. Any exposure which continues, or is expected to continue, beyond 30 days will also be submitted to the Transactional Credit Committee with proposals to correct the exposure within an agreed period, not to exceed 12 months.

Forbearance
Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group. The Group's forbearance policies and definitions comply with the guidance established by the EBA for financial reporting. Forbearance concessions include the granting of more favourable terms and conditions than those provided either at drawdown of the facility, or which would not ordinarily be available to other customers with a similar risk profile. Forbearance parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice, as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions.

Measuring risk within our credit portfolios
The Group adopts two approaches to the measurement of credit risk:

Individually assessed approach
A charge is taken to the consolidated income statement when an individually assessed provision has been recognised or a direct write-off has been applied to an asset balance.

Collectively assessed approach
The Group uses a combination of strategies and statistical models that utilise internal and external data to measure the exposure to credit risk within the portfolios and to calculate the level of ECL. This is supplemented by management judgement in the form of PMAs where necessary.

At each reporting date, the Group assesses financial assets measured at amortised cost, as well as loan commitments and financial guarantees not measured at fair value through profit or loss, for impairment. The impairment loss allowance is calculated using an ECL methodology and reflects: (i) an unbiased and probability weighted amount; (ii) the time value of money which discounts the impairment loss; and (iii) reasonable and supportable information that is available without undue cost or effort about past events, current conditions and forecasts of future economic conditions.

The calculated ECL is determined using the following classifications:

Classification	ECL calculation period	Description
Stage 1	12 months	A loan that is not credit-impaired on initial recognition and has not experienced a significant increase in credit risk (SICR).
Stage 2	Lifetime	If a significant increase in credit risk has occurred since initial recognition, the loan is moved to stage 2 but is not yet deemed to be credit-impaired.
Stage 3	Lifetime	If the loan is credit-impaired it is moved to stage 3.

In addition to the above stages, purchased or originated credit-impaired (POCI) financial assets are those which are assessed as being credit-impaired upon initial recognition. Once a financial asset is classified as POCI, it remains there until derecognition irrespective of its credit quality. POCI financial assets are included within those financial assets in Stage 3 with corresponding values disclosed by way of footnote to the relevant tables. The Group regards the date of acquisition as the origination date for purchased portfolios.

A Stage 2 ECL is required where a SICR has been identified, such as a deterioration in PD since origination, subject to the 30 days past due (DPD) backstop, with Stage 3 required where there is credit impairment subject to the 90 DPD backstop.

ECL methodology is based upon the combination of PD, LGD and exposure at default (EAD) estimates that consider a range of factors that impact on credit risk and the level of impairment loss provisioning. The Group uses reasonable and supportable forecasts of future economic conditions in estimating the ECL allowance. The methodology and assumptions used in the ECL calculation are reviewed regularly and updated as necessary.

ECLs under IFRS 9 use economic forecasts, models and judgement to provide a forward-looking assessment of the required provisions. PMAs have been used to address known limitations in the Group's models or data. Due to the current severe economic conditions, government and Group interventions to support customers, and uncertainty arising from COVID-19, the Group has not relied upon modelled outcomes alone. Following detailed analysis, expert credit judgement has been applied, resulting in additional PMAs to ensure the ECL calculation reflects the full set of plausible circumstances including data limitations, customer support measures, rapidly changing customer behaviours and the emerging nature of COVID-19 risks.

Further detail on the accounting policy applied to ECLs can be found in note 3.2 to the financial statements.

Portfolio performance

How our portfolios have performed
Credit risk exposures are classified into mortgage, personal and business portfolios. In terms of loans and advances, credit risk arises both from amounts loaned and commitments to extend credit to customers. To ensure appropriate credit limits exist, especially for business lending, a single large exposure policy is in place and forms part of the risk appetite measures that are monitored and reported on a monthly basis. The overall composition and quality of the credit portfolio is monitored and regularly reported to the Board and, where required, to the relevant supervisory authorities.

Exposures are also managed in accordance with the large exposure reporting requirements of the CRR. Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

Credit risk

Maximum exposure to credit risk (audited)

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

	30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
Cash and balances with central banks (note 3.4)	**9,107**	10,296
Financial instruments at fair value through other comprehensive income (FVOCI) (note 3.7)	**5,080**	4,328
Due from other banks	**927**	1,018
Other financial assets at fair value (note 3.5)	**203**	267
Derivative financial assets (note 3.6)	**318**	366
Loans and advances to customers (note 3.1)	**72,430**	73,095
	88,065	89,370
Financial guarantees (note 5.1)	**95**	113
Other credit commitments (note 5.1)	**16,775**	15,158
Maximum credit risk exposure	**104,935**	104,641

All Treasury-related financial assets are classed as Stage 1 financial assets under IFRS 9.

Included within cash and balances with central banks is £7.2bn of cash held with the BoE (2019: £8.4bn). Due from other banks is all with senior investment grade counterparties. Financial instruments at FVOCI and the credit rating of counterparties are discussed in note 3.7.

Concentration of lending assets

The following tables show the levels of concentration of the Group's loans and advances.

Gross loans and advances to customers[(1)]	30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
Property – mortgage	**58,652**	60,391
Instalment loans to individuals and other personal lending (including credit cards)	**5,550**	5,280
Agriculture, forestry, fishing and mining	**1,634**	1,494
Manufacturing	**884**	793
Wholesale and retail	**961**	766
Property – construction	**339**	167
Financial, investment and insurance	**97**	104
Government and public authorities	**19**	30
Other commercial and industrial	**4,789**	4,221
	72,925	73,246
Impairment provisions on credit exposures	**(735)**	(362)
Fair value hedge adjustment	**240**	211
	72,430	73,095

(1) The Group has a portfolio of fair valued business loans of £190m (2019: £253m) loans and advances to customers (note 3.1) which are classified separately as financial assets at fair value through profit or loss on the balance sheet. At 30 September 2020 the most significant concentrations of exposure were in agriculture, forestry, fishing and mining (29%), real estate (28%), health and social work (18%), and government and public authorities (9%).

Credit risk

Contingent liabilities and credit-related commitments	30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
Property – mortgage	**3,088**	2,642
Instalment loans to individuals and other personal lending (including credit cards)	**9,674**	9,069
Agriculture, forestry, fishing and mining	**375**	302
Manufacturing	**692**	582
Wholesale and retail	**563**	472
Property – construction	**136**	119
Financial, investment and insurance	**173**	103
Government and public authorities	**348**	350
Other commercial and industrial	**1,821**	1,632
	16,870	15,271

Key credit metrics

	30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
Impairment provisions held on credit exposures		
Mortgage lending	**131**	40
Personal lending	**301**	175
Business lending	**303**	147
Total impairment provisions	**735**	362

	30 Sep 2020 (audited) £m	Pro forma 30 Sep 2019 (unaudited) £m
Underlying impairment charge on credit exposures		
Mortgage lending	**95**	4
Personal lending	**223**	124
Business lending	**183**	25
Total underlying impairment charge	**501**	153
Asset quality measures:		
Underlying impairment charge(1) to average customer loans (cost of risk)	**0.68%**	0.21%
Stage 3 assets to customer loans	**1.19%**	1.09%
Total provision to customer loans(2)	**1.02%**	0.50%
Stage 3 provision to Stage 3 loans	**15.62%**	14.32%

(1) Inclusive of gains/losses on assets held at fair value and elements of fraud loss but excludes the acquisition accounting impact on impairment losses shown on page 129.

(2) This includes the government-backed portfolio of Bounceback Loans (BBLs), Coronavirus Business Interruption Loans (CBILs) and Coronavirus Large Business Interruption Loans (CLBILs).

Group credit performance

Total loans and advances to customers decreased by £0.3bn in the year, reflecting the Group's focus on supporting existing customers, muted demand for new borrowing and the impact of changing customer behaviours as lending was paid down more rapidly. Mortgage lending decreased by £1.7bn, offset by a £1.1bn increase in business lending and a £0.3bn increase in personal lending.

The Group's impairment provision increased by £373m to £735m during the year, primarily due to the Group's assessment of the impact of COVID-19 on future credit losses. This assessment adopts multiple forward-looking, macroeconomic scenarios with higher probability weights applied to a worsening economic outlook. In addition, PMAs have been applied where required.

The Group's underlying impairment charge has increased from £153m to £501m during the year mainly due to the use of revised economic scenarios in credit impairment models and the application of judgement based PMAs to reflect emerging COVID-19 risks. Increases are most evident in the personal and business portfolios, reflecting their heightened sensitivity to significant deterioration in unemployment and GDP forecasts.

As at 30 September 2020 the Group's cost of risk was 68bps (30 September 2019: 21bps), further reflecting the pessimistic economic outlook.

Underlying credit portfolio performance remains stable, as evidenced by the proportion of Stage 3 loans to total customer loans of 1.19% (2019: 1.09%). There has been no material deterioration in asset quality measures, arrears and default levels remain low, and forbearance levels remain static. This is due to a combination of customer support measures, controlled risk appetite and a continued focus on responsible lending decisions. Customer support measures include participating in government-backed loan schemes and offering payment holidays, augmented by other temporary fiscal stimulus such as furlough and HMRC payment deferrals. Further commentary on the types of customer support provided can be found in the divisional commentary on pages 28-33 in the Group's Annual Report & Accounts. The proportion of total provisions to total customer loans has increased to 1.02% (30 September 2019: 0.50%) reflecting the expectation that additional losses will emerge as the level of COVID-19 support subsides and the economy hardens.

Credit risk

Mortgage credit performance

	30 Sep 2020	30 Sep 2019
Gross loans and advances	**£58.7bn**	£60.4bn
Impairment charge	**£95m**	£4m
Cost of risk	**16bps**	1bps
Provision to customer loan ratio/£	**23bps/£131m**	7bps/£40m
% Loans in Stage 2	**13.9%**	3.0%
% Loans in Stage 3	**0.9%**	0.8%
% Forborne loans	**1.08%**	0.98%
90+ DPD	**0.43%**	0.32%
LTV of mortgage portfolio	**57.3%**	57.2%

Portfolio and impairment (Pages 23, 34-35)
The Group's mortgage lending has reduced from £60.4bn to £58.7bn in the year to 30 September 2020, reflective of underlying contraction in the portfolio. This aligns with the divisional strategy to maintain disciplined pricing in a competitive environment and reflects the effect of lockdown on the UK housing market, particularly in the second half of the financial year. Demand for new mortgage lending was muted and the Group focused on providing much needed support for existing customers.

The impairment provision has increased by £91m to £131m as at 30 September 2020. This gives rise to a provision to customer loan coverage ratio of 23bps, an increase of 16bps from 2019. Consistent with the other portfolios, this reflects the adoption of a prudent approach to setting impairment provisions in expectation of future economic deterioration and heightened credit losses due to the impact of COVID-19.

The mortgage portfolio continues to evidence strong underlying credit quality, with no material deterioration in asset quality measures. This is supported by prudent risk appetite setting, robust credit underwriting disciplines and a continued focus on responsible lending.

It remains unclear how the residential property market and mortgage customers will react post COVID-19, and the extent to which house prices could be impacted. This could affect customers' ability to pay and the level of security provided, which is a significant factor in limiting losses. Regional and social differences may begin to emerge as the UK recovers from the impact of COVID-19 with certain households potentially disproportionately affected. This level of granular detail cannot be fully reflected within the macroeconomic forecasts and models and requires a detailed level of judgement and expertise to estimate the potential impact on ECL.

The impairment charge has increased by £91m to £95m in the year to 30 September 2020. £29m of this increase relates to the adoption of more conservative forward-looking macroeconomic scenarios with higher probability weights applied to a worsening economic outlook. Further analysis, with appropriate expert judgement, determined that PMAs should also be applied to address impacts on calculation inputs or model sensitivities. This resulted in a further £62m increase in ECL, £43m of which relates to the longer-term implications for customers who have taken a payment holiday. Analysis indicates that a proportion of these customers are expected to experience difficulty in returning to their contractual repayment profile leading to a level of forbearance, delinquency or potentially default. Further PMAs have also been raised to address the risk of high house prices relative to income, heightened sensitivity for BTL customers and for certain customers with a high indebtedness index.

IFRS 9 staging (Pages 34-41)
Despite the application of more negative economic forecasts and additional PMAs, 85.2% of mortgage lending remains classed as Stage 1 (2019: 96.2%). The reduction during the year reflects the expected COVID-19 impact on customers. This has led to a corresponding increase of 10.9% in Stage 2 to 13.9% (2019: 3.0%). Stage migrations reflect updated macroeconomic forecasts, triggering a more negative outlook and increasing the volume of mortgage customer accounts exhibiting SICR. The migration to Stage 2 also recognises, through PMAs, that some customers with payment holidays will have experienced a SICR.

Mortgage IFRS 9 PDs are driven by underlying internal credit scores adjusted for forward-looking macroeconomics. Of the Stage 2 mortgage balances, 87% are as a result of PD deterioration influenced by revised macroeconomic forecasts. The changes in PD grades observed at 30 September 2020 do not reflect any deterioration in credit scores but rather the migration to more conservative macroeconomic forecasts. While there has been a reduction from 92% (2019) to 81% of assets classed as 'Strong', the proportion of assets classed as 'Good' has increased to 14% (2019: 5%), with the result that over 95% of the mortgage portfolio still remains 'Good' or better.

The proportion of mortgages classified as Stage 3 remains modest and stable at 0.9% (2019: 0.8%).

Asset quality, collateral and LTV (Pages 32)
The mortgage portfolio remains very well secured with 83% of mortgages, by loan value, having an indexed LTV less than 75%, with an average portfolio LTV of 57.3% (2019: 57.2%). The proportion of the portfolio over 90% LTV has remained stable at 1.9% (2019: 2.1%) and the proportion over 80% LTV has increased only slightly to 11.1% as at 30 September 2020 (30 September 2019: 10.7%).

90+ DPD arrears as at September 2020 of 0.43% (2019: 0.32%) remains low and less than the market average of 0.8%. Mild deterioration in arrears was observed prior to COVID-19, in line with industry experience. Further deterioration in delinquency has occurred due to COVID-19 as customers have moved through arrears however a moratorium on repossessions has prevented action being taken resulting in a small number of loans being in arrears longer than would typically be expected under normal circumstances. The underlying arrears for the year continues to evidence a stable portfolio, with improving bureau scores and reduced customer indebtedness, accepting that payment holidays will have benefitted customers and there will be challenges ahead.

Payment holidays (Page 28)
20% of mortgage customers, by balance, applied for and were granted a payment holiday. Of the payment holidays which have matured by 30 September 2020, 98% of customers have resumed payment in line with previously contracted terms with only 2% requiring further support or having moved into arrears. Only 4% of customers, by balance, have an active payment holiday in force at 30 September 2020. The Group will continue to support customers in line with their needs and revised regulatory guidance.

Forbearance (Page 29-30)
A key indicator of underlying mortgage portfolio health is the level of forbearance granted. As at 30 September 2020, forbearance totalled £636m (5,621 customers), an increase from the 30 September 2019 position of £589m (5,061 customers). This represents 1.08% of total mortgage balances (2019: 0.98%). Forbearance remains an important metric, reflecting the volume and value of concessions granted to customers on a non-commercial basis. The increase in forbearance is driven by additional volumes of tailored arrangements. The majority of customers benefitting from these arrangements are expected to return to fully performing status when the temporary support arrangements expire. Payment holidays granted in line with regulation have not been classified as forbearance.

Personal credit performance

	30 Sep 2020			30 Sep 2019		
	Credit cards	Loans & overdrafts	Total personal	Credit cards	Loans & overdrafts	Total personal
Gross loans and advances	**£4.5bn**	**£1.1bn**	**£5.6bn**	£4.2bn	£1.1bn	£5.3bn
Impairment charge	**£153m**	**£70m**	**£223m**	£107m	£17m	£124m
Cost of risk	**355bps**	**721bps**	**423bps**	290bps	192bps	271bps
Provision to customer loan ratio/£	**537bps/£222m**	**824bps/£79m**	**591bps/£301m**	342bps/£145m	322bps/£30m	339bps/£175m
% Loans and advances in Stage 2	**11.6%**	**28.0%**	**14.8%**	8.9%	4.4%	8.0%
% Loans and advances in Stage 3	**1.2%**	**1.4%**	**1.2%**	1.3%	1.4%	1.3%
% Forborne loans	**0.63%**	**0.88%**	**0.67%**	0.53%	1.10%	0.70%
90+ DPD	**0.38%**	**0.52%**	**0.41%**	0.54%	0.67%	0.57%

Portfolio and impairment (Pages 23, 34-35)
Of the £5.6bn total personal lending, the majority is credit cards at £4.5bn, with the balance comprising personal loans and overdrafts. The modest year-on-year growth in the portfolio reflects the changed environment, more muted demand for credit and customers' prudent action in response to COVID-19, paying down lending where they have been able to do so. Arrears levels remain stable as customers continue to behave responsibly and benefit from the various forms of government support, including payment holidays. Most customers who have sought a payment holiday have now reverted to normal terms. Further detail is provided on page 28.

The impairment provision has increased by £126m to £301m as at 30 September 2020, driving an increase in the provision coverage ratio of 252bps to 591bps. £36m of the increase results from the modelled application of more negative macroeconomic forecasts, with the remaining increase due to additional PMAs. £23m of the PMAs reflect the longer-term implications for customers who have taken a payment holiday. Analysis indicates that a proportion of these customers are expected to experience difficultly in returning to the contractual repayment profile leading to a level of forbearance, delinquency and potentially default currently masked by support measures. £17m relates to an assumption that the sale or future recovery value of unsecured written-off debt will potentially reduce and result in an adjustment being required to loss given default assumptions in the ECL calculation, and £14m relates to the assumption that improvements in customer risk profiles through bureau data inputs are temporary and therefore not reflective of the longer-term expectations. The majority of the residual PMA increase is to address a lack of sensitivity in the modelled outcome, particularly for the personal loan portfolio.

Cost of risk for the year of 423bps (2019: 271bps) is reflective of this higher allowance.

IFRS 9 staging (Pages 34-41)
The adoption of more negative economic forecasts and additional PMAs has driven movement from Stage 1 to Stage 2, with Stage 2 increasing by 6.8% to 14.8% (2019: 8.0%) requiring additional allowance for lifetime loss. 84% of the portfolio remains in Stage 1.

Personal portfolio PD is most sensitive to the rate of unemployment, which is forecast to peak at c.10%. The increased forecast assumption results in a deterioration in PD, influencing the migration of customer loans into Stage 2. Of the Stage 2 Personal balances, 77% are as a result of PD deterioration influenced by revised macroeconomic forecasts (2019: 41%). Stage 3 personal lending remains modest and stable at 1.2% (2019: 1.3%).

Asset quality
Asset quality has been assisted by the credit strategies deployed during the year to control and, where determined, tighten origination controls. The total credit cards arrears balance of 1.4% is supported by payment holidays and prudent customer behaviours (2019: 1.7%). The majority of payment holidays have now matured, and customers have returned to normal payment terms. New lending continues to focus on segments with lower levels of economic volatility with portfolio level exposures to non-homeowners, lower age demographics and self-employed remaining low.

Lending performance also remains strong with 90+ DPD measures at a cyclical low point of 0.41% (2019: 0.57%).

Payment holidays (Page 28)
5% of credit card customers were granted a payment holiday. Where those holidays have matured, 92% of customers have reverted to repay in line with previously contracted terms and 8% have either sought additional support or fallen into arrears. Of the 11% of personal loan customers granted a payment holiday, 95% of those which have matured have reverted to normal terms with 5% seeking further support or in arrears. 1% of credit cards customers and 3% of personal loan customers had an active payment holiday arrangement in place at 30 September 2020. The Group will continue to support customers in line with their needs and revised regulatory guidance.

Credit risk

Forbearance (Pages 29-30)
Limited forbearance is exercised in relation to personal loans and overdrafts, with a modest reduction to £8.4m (0.88% of the personal lending portfolio) from £11.5m (1.10%) at 30 September 2019. As at 30 September 2020, credit cards forbearance totalled £27m (6,309 customers), an increase from the 30 September 2019 position of £24m (5,522 customers). This represents 0.63% of total credit cards balances (2019: 0.53%). The increase in credit cards forbearance is driven by additional volumes of payment arrangements. The level of impairment coverage on forborne loans has increased to 47.2% from 41.3% at 30 September 2019 reflecting a more prudent approach to ECL. Payment holidays granted in line with regulation have not been classified as forbearance.

Business credit performance

	30 Sep 2020	30 Sep 2019
Gross loans and advances	**£8.7bn**[(1)]	£7.6bn
Impairment charge	**£183m**	£25m
Cost of risk	**212bps**	30bps
Provision to customer loan ratio/£[(2)]	**391bps/£303m**	193bps/£147m
% Loans in Stage 2	**44.2%**	30.2%
% Loans in Stage 3	**3.2%**	3.6%
% Forborne loans	**5.92%**	6.38%
90+ DPD	**0.27%**	0.47%

(1) Inclusive of government backed loan schemes.
(2) Coverage ratio excludes government-backed loan schemes.

Portfolio and impairment (Pages 23, 34-35)
Business lending has increased by £1.1bn during the year to £8.7bn as at 30 September 2020 (2019: £7.6bn). This includes lending under government-backed loan schemes, which contributed to £1.2bn of portfolio growth in the year. Further information can be found on p129.

There has been no significant deterioration in underlying asset quality measures. The Group entered the pandemic with a defensively positioned portfolio biased away from sectors expected to experience disruption such as Hospitality and Retail, towards sectors expected to be resilient, such as Agriculture and Health & Social Care.

The impairment provision has increased by £156m to £303m as at 30 September due to the expectation of greater pressures on the portfolio in 2021 from COVID-19 and Brexit. The impairment charge for the year to 30 September 2020 was £183m giving a cost of risk of 212bps.

The resultant coverage ratio of provisions to customer loans of 391bps increased by 198bps from 2019, reflective of the composition of the Group's generally sub-investment grade SME portfolio. Historically selective risk appetite choices have limited exposures to more sensitive sectors such as Hospitality, Retail, Travel, Construction and Commercial Real Estate. Even in the absence of increased default or arrears experience, the prudent economic forecasts applied caused PDs across the business portfolio to worsen with the accompanying increase in coverage reflective of the impact of COVID-19 through increased PDs including further migrations from 12-month to lifetime loss coverage.

The Group does not hold any level of PMA for business lending as at 30 September 2020. The policies and frameworks in place to identify business customers experiencing financial difficulty are operating effectively, meaning internal rating systems respond appropriately as levels of customer difficulty heighten. The overall level of modelled provision for business loans is assessed as sufficient in the context of the portfolio shape and strength, and considering the extensive number of sector and segment reviews undertaken in recent months. Regular customer and portfolio level analysis is completed to ensure early identification of business customers likely to experience financial difficulty. This enables prompt relationship manager engagement with customers and appropriate early support interventions.

IFRS 9 staging (Pages 34-41)
The application of the revised, more negatively biased, forecast economic scenarios has resulted in heightened portfolio stage migration with 44.2% of balances in Stage 2 (2019: 30.2%). This reflects the Group's prudent assumptions and the early adoption of the EBA requirements to retain forborne assets in Stage 2 for a minimum of two years. Business migration to Stage 2 can result from a range of triggers. Since 30 September 2019, there has been a notable shift with economic forecasts weighing more heavily and 75% of balances in Stage 2 now associated with a deterioration in PD as a result of forward-looking economic forecasts, most notably GDP. As at 30 September 2019, deterioration was more typically associated with discrete internal ratings downgrades and only 2% of Stage 2 migrations were a consequence of forward-looking economic indicators. Business loans in Stage 3 remain modest and stable at 3.2% (2019: 3.6%).

The PDs for business lending combine both internal ratings information and forward-looking economic forecasts. These economic forecasts, which include double-digit GDP falls in 2020 and a relatively weak recovery, are the material drivers of the PD and stage migrations across the year. The deteriorations in PD and staging have not been driven to any material extent by observed evidence of impairment through either internal downgrades or the emergence of arrears or defaults. While the proportion of assets classed as 'Strong' has reduced to 11% (FY19: 32%), assets classed as 'Good' have increased to 73% (2019: 62%), and over 84% of the business portfolio still remains 'Good' or better.

Asset quality
Asset quality is notably influenced by the support provided to customers, including government-backed loan schemes, and the Group's prudent risk appetite and risk frameworks which seek to ensure early identification of customers in difficulty. The early identification and escalation of customers evidencing deteriorating positions ensures the Group is intervening early and providing appropriate types of support to changing customer circumstances.

Arrears measures are stable to improving, with 90+ DPD of 0.27% as at 30 September 2020 (2019: 0.47%). During the year, the proportion of business customer accounts classed as categorised (watch, default and impaired), by value, has increased from 8.13% to 8.61% of the total business book. The Group has clear strategies in place to work with each customer and the marginal increase reflects the lack of significant increase in the proportion of customers evidencing financial distress.

Payment holidays (Page 28)
23% of eligible customers took advantage of a repayment holiday and, of those which have matured, 98% have returned to regular payment by 30 September 2020. Only 1% of business customer balances, equating to £108m, have an active payment holiday in force at 30 September 2020. Of the initial population granted a holiday, 2% have sought further support or have fallen into arrears. The Group will continue to support customers in line with their needs and revised regulatory guidance.

Forbearance (Page 31)
Business portfolio forbearance has increased from £509m (368 customers) at 30 September 2019 to £539m (368 customers) at 30 September 2020. Forbearance remains an important metric, reflecting the volume and value of concessions granted to customers on a non-commercial basis. Moves in forbearance reflect the proportion of business customers requiring support on non-standard terms and evidencing financial difficulty. As a percentage of the business portfolio, forborne balances have reduced to 5.92% (2019: 6.38%) while impairment coverage, in line with actions taken on expected credit losses, has increased to 14.3% (2019: 10.87%). The majority of forbearance arrangements relate to term extensions allowing customers a longer term to repay their obligations in full than initially contracted. Payment holidays granted in line with regulation have not been classified as forbearance.

Supporting our customers in times of need
During the year, the Group participated in the various UK Government-backed loan schemes for businesses, in addition to offering payment holidays to mortgage, personal and business customers.

Government backed loan schemes
The following loan schemes were introduced by the government in April and May 2020, with changes made to their operation announced in September 2020:

Bounce Back Loans (BBLs): loans of between £2,000 and £50,000 are available under this scheme with a fixed rate of lending available for up to ten years, with no repayments due in the first year. Changes to the scheme included customers applying to pay interest only for six months (up to a maximum of three applications) with the additional potential for a six-month payment holiday for both capital and interest payments (this can only be requested where the customer has already made six repayments of principal). The government guarantees 100% of the lending.

Coronavirus Business Interruption Scheme (CBILs): loans of over £50,000 to a maximum of £5m are available under this scheme. They attract a variable rate of lending with no arrangement fees or interest paid by the borrower in the first 12 months. The government pays the fees and interest and guarantees 80% of the lending. The maximum loan term is six years.

Coronavirus Large Business Interruption Scheme (CLBILs): loans of over £50,000, up to a maximum of £200m (in aggregate) are available under this scheme with a variable rate of lending and terms of between three months and three years. The government guarantees 80% of the lending.

The Group has the following lending under these schemes as at 30 September 2020:

(Unaudited)	No of customers	Drawn balance (£m)	Average loan size (£m)	% of total Business lending
BBLs	28,077	809	0.03	9%
CBILs	907	334	0.37	3%
CLBILs	3	20	6.59	Immaterial

The deadline for applications for loans under the schemes is 31 January 2021.

Payment holidays
The Group continues to actively support customers through COVID-19, offering payment holidays where appropriate, although the level of new requests has reduced significantly since the peak in April 2020. Following the announcement of further national COVID-19 restrictions at the end of October 2020, the Group will continue to align with all applicable FCA guidance in respect of payment holidays and anticipates extending their availability to impacted customers requesting a payment holiday prior to the 31 January 2021 deadline.

	Payment holidays granted to date		Payment holidays currently in force at end September 2020		Of matured payment holidays	
(Audited)	Total balances £m	% of Total balances	Total balances £m	% of Total balances	% Resumed repayment	% Further treatment/ arrears
Mortgages	11,908	20%	2,525	4%	98%	2%
Credit cards	219	5%	31	1%	92%	8%
Personal	103	11%	26	3%	95%	5%
Business	2,072	23%	108	1%	98%	2%

Forbearance

The Group makes every effort to treat customers fairly and aligns its forbearance practices to that principle. While forbearance alone is not necessarily an indicator of impaired status, it is a trigger for a review of the customer's credit profile and forbearance is only granted when there is a realistic prospect of the customer repaying all facilities in full. If there is any concern over future cash flows and the Group incurring a loss, then forborne loans will also be classified as impaired in accordance with the Group's impairment policy.

As a consequence of the Group's decision to early adopt the EBA probationary rules relative to forbearance, exposures classified as forborne and performing at the date forbearance is granted continue to be reported as subject to forbearance for a minimum period of two years from that date (the probation period). Exposures classified as forborne, which are non-performing when customers were granted forbearance, cannot exit non-performing status for a minimum of 12 months from the date forbearance was granted and cannot exit forbearance status for a further two years from the date of returning to performing status (three years in total). Forbearance frameworks are reviewed on a regular basis to ensure the operational processes remain appropriate and, where required, system changes are made to enhance forbearance data capture.

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

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

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

Customers who requested COVID-19 related support, including payment holidays, and who were not the subject of any wider SICR triggers, or who were otherwise assessed as having the ability in the medium term to be viable and meet risk appetite criteria, were not considered to have been granted forbearance.

Where the Group has identified customers who require remedial action to return them within risk appetite over the medium term, or who were showing signs of financial stress before COVID-19, such customers are considered to have been granted forbearance with exposures categorised as Stage 2 and subject to a lifetime ECL assessment.

Mortgage and Personal forbearance

The Group utilises various forbearance measures for mortgage and personal customers, specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action.

Debt management for mortgage customers in financial difficulty

To support customers who are encountering financial difficulties, cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled by various methods. These include the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance, including the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

Help is provided through specialist teams, such as the Financial Care Team, where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies when they have multiple credit facilities, including those at other lenders that require restructuring.

One component of the Group's approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

Credit risk

The following table summarises the level of forbearance in respect of the Group's mortgage and credit card portfolios at each balance sheet date. All balances subject to forbearance are classed as either Stage 2 or Stage 3 for ECL purposes.

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
As at 30 September 2020 (audited)	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Mortgages					
Formal arrangements	**1,194**	**145**	**0.25**	**7.2**	**4.94**
Temporary arrangements	**792**	**100**	**0.17**	**5.2**	**5.21**
Payment arrangement	**1,475**	**141**	**0.24**	**2.8**	**1.96**
Payment holiday	**1,454**	**157**	**0.26**	**2.3**	**1.45**
Interest only conversion	**379**	**64**	**0.11**	**0.4**	**0.58**
Term extension	**163**	**13**	**0.02**	**0.1**	**0.89**
Other	**28**	**3**	**0.01**	**–**	**1.13**
Legal	**136**	**13**	**0.02**	**1.0**	**7.87**
Total mortgage forbearance	**5,621**	**636**	**1.08**	**19.0**	**2.98**
Personal – credit cards					
Payment arrangement	**6,309**	**27**	**0.63**	**12.5**	**47.23**
Total cards forbearance	**6,309**	**27**	**0.63**	**12.5**	**47.23**
As at 30 September 2019 (audited)					
Mortgages					
Formal arrangements	1,352	157	0.26	4.4	2.83
Temporary arrangements	913	119	0.20	3.1	2.62
Payment arrangement	1,118	113	0.19	1.6	1.41
Payment holiday	981	114	0.19	0.7	0.58
Interest only conversion	358	54	0.09	0.3	0.57
Term extension	174	16	0.03	0.1	0.64
Other	35	3	0.00	–	0.50
Legal	130	13	0.02	0.3	2.46
Total mortgage forbearance	5,061	589	0.98	10.5	1.79
Personal – credit cards					
Payment arrangement	5,522	24	0.53	9.5	41.30
Total cards forbearance	5,522	24	0.53	9.5	41.30

The increase in mortgage forbearance is primarily driven by payment arrangements, typically where an account is in arrears and the agreement to adjust payments gives a path to clear the overdue amounts. Short-term payment holidays have also increased with the vast majority returning to fully performing status at the end of the agreed term.

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 2020, there were 57 repossessions of which 21 were voluntary (12 months to 30 September 2019: 66 including 14 voluntary).

The increase in credit cards forbearance is the result of payment arrangements being extended to customers where COVID-19 payment holidays were not deemed to be a suitable solution.

Other Personal lending forbearance

The Group currently exercises limited forbearance strategies in relation to current accounts and personal loans. The Group has assessed the total loan balances subject to forbearance on other types of personal lending to be £8.4m as at 30 September 2020 (30 : £11.5m), representing 0.88% of the personal lending portfolio (2019: 1.10%).

Impairment provisions on forborne balances totalled £3.4m as at 30 September 2020 (2019: £3.6m) providing overall coverage of 40.59% (2019: 31.58%).

Business forbearance

Forbearance is considered to exist for business customers where one or more concession is granted on a non-commercial basis. The Group reports business forbearance at a customer level and at a value which incorporates all facilities and the related impairment allowance, irrespective of whether each individual facility is subject to forbearance. Authority to grant forbearance measures for business customers is held by the Group's Strategic Business Services unit and is exercised, where appropriate, on the basis of detailed consideration of the customer's financial position and prospects.

Where a customer is part of a larger group, forbearance is exercised and reported across the Group at the individual entity level. Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forborne.

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. All balances subject to forbearance are classed as either Stage 2 or Stage 3 for ECL purposes.

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of customers	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
As at 30 September 2020 (audited)					
Term extension	**199**	**211**	**2.31**	**27.5**	**13.05**
Deferral of contracted capital repayments	**92**	**115**	**1.26**	**23.1**	**20.08**
Reduction in contracted interest rate	**2**	**1**	**0.01**	**0.1**	**6.75**
Alternative forms of payment	**1**	**–**	**–**	**–**	**64.36**
Debt forgiveness	**2**	**4**	**0.05**	**0.2**	**4.66**
Refinancing	**15**	**6**	**0.07**	**1.8**	**29.37**
Covenant breach/reset/waiver	**57**	**202**	**2.22**	**24.4**	**12.10**
Total business forbearance	**368**	**539**	**5.92**	**77.1**	**14.30**
As at 30 September 2019 (audited)					
Term extension	187	153	1.93	14.9	9.70
Deferral of contracted capital repayments	98	134	1.68	15.0	11.16
Reduction in contracted interest rate	3	1	0.02	–	3.37
Alternative forms of payment	2	7	0.08	0.4	5.37
Debt forgiveness	2	4	0.05	–	1.06
Refinancing	16	10	0.12	1.5	15.03
Covenant breach/reset/waiver	60	200	2.50	23.6	11.82
Total business forbearance	368	509	6.38	55.4	10.87

The number of business customers granted forbearance as at 30 September 2020 remained at 368, with the associated gross carrying value increasing by £30m (6%). Customers within the forbearance portfolio have received £23m of COVID-19 related support loans: £17m CBIL and £6m BBL. In addition, business customers have been supported with 63 Capital Repayment Holidays (CRH) accounting for £147m of the exposure, with two customers (£29m exposure) being granted a second CRH. There are only seven newly forborne connections (£1.7m exposure) where the impact of COVID-19 is the primary driver of trading deterioration.

The table incudes a portfolio of financial assets at fair value. The gross value of fair value loans subject to forbearance as at 30 September 2020 is £7m (30 September 2019: £8m), representing 0.08% of the total business portfolio (30 September 2019: 0.11%). The credit risk adjustment on these amounts totalled £0.7m (30 September 2019: £0.6m), a coverage of 9.77% (30 September 2019: 6.94%).

The contractual amount outstanding on loans and advances that were written off during the reporting period or still subject to enforcement activity was £4.1m.

Collateral

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

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

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

It is the Group's policy to dispose of repossessed properties with the proceeds used to reduce or repay the outstanding balance. The Group does not occupy repossessed properties for its own business use.

Mortgage lending by average LTV (audited)

The LTV ratio of mortgage lending, coupled with the relationship of the debt to customers' income, is integral to the credit quality of these loans. The table below sets out the indexed LTV analysis of the Group's mortgage stock:

September 2020	Stage 1			Stage 2			Stage 3(2)			Total		
LTV (1)	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL £m
Less than 50%	18,495	37%	2	2,705	33%	6	214	41%	4	21,414	37%	12
50% to 75%	23,215	46%	5	3,754	46%	40	192	37%	6	27,161	46%	51
76% to 80%	2,896	6%	1	641	8%	12	33	7%	2	3,570	6%	15
81% to 85%	2,336	5%	2	437	6%	12	21	4%	2	2,794	5%	16
86% to 90%	2,131	4%	2	428	5%	15	19	4%	2	2,578	4%	19
91% to 95%	798	2%	1	170	2%	8	9	2%	1	977	2%	10
96% to 100%	56	0%	0	21	0%	1	6	1%	1	83	0%	2
Greater than 100%	43	0%	1	10	0%	1	22	4%	4	75	0%	6
	49,970	100%	14	8,166	100%	95	516	100%	22	58,652	100%	131

(1) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance. Currently the Clydesdale Bank PLC portfolio is indexed using the MIAC Acadametrics indices at a given date, while the Virgin Money Holdings (UK) PLC portfolio is indexed using the Markit indices. The Group view is a combined summary of the two portfolios.

(2) Stage 3 includes £86m of purchased or originated credit impaired (POCI) gross loans and advances.

September 2019	Stage 1			Stage 2			Stage 3(1)			Total		
LTV (1)	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL £m
Less than 50%	21,644	37%	1	682	38%	1	195	42%	3	22,521	37%	5
50% to 75%	26,778	46%	2	816	45%	4	177	38%	8	27,771	46%	14
76% to 80%	3,518	6%	1	117	7%	1	23	5%	2	3,658	6%	4
81% to 85%	2,635	5%	1	75	4%	1	22	5%	3	2,732	5%	5
86% to 90%	2,382	4%	1	73	4%	1	12	3%	2	2,467	4%	4
91% to 95%	1,016	2%	0	29	2%	1	9	2%	2	1,054	2%	3
96% to 100%	79	0%	0	5	0%	0	7	1%	1	91	0%	1
Greater than 100%	68	0%	0	8	0%	0	21	4%	4	97	0%	4
	58,120	100%	6	1,805	100%	9	466	100%	25	60,391	100%	40

(1) Stage 3 includes £101m of POCI gross loans and advances.

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

The following table shows the total non-property collateral held by sector at 30 September 2020 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high credit quality) and netting. The exposure amount shown below is the total gross exposure (before any credit risk mitigation and after credit conversion factors have been applied where applicable) for arrangements which have some form of associated collateral held against it and is not the total exposure for each asset class, as this is disclosed elsewhere in this section.

2020 (audited)	Cash £m	Guarantee £m	Netting £m	Debt securities £m	Other physical collateral	Receivables	Total £m	Exposure £m
Exposure classes								
Corporates	8	926	76	–	487	648	2,145	2,359
Total IRB approach	8	926	76	–	487	648	2,145	2,359
Central governments or central banks	5,410	–	–	–	–	–	5,410	7,420
Regional governments or local authorities	–	–	155	–	–	–	155	155
Public sector entities	–	–	–	–	–	–	–	–
Financial institutions	–	–	–	295	–	–	295	360
Corporates	–	170	–	–	–	–	170	170
Secured by mortgages on residential real estate	–	–	–	–	–	–	–	–
Secured by mortgages on commercial real estate	–	–	–	–	–	–	–	–
Exposures in default	–	1	–	–	–	–	1	1
Total standardised approach	5,410	171	155	295	–	–	6,031	8,106
Total	5,418	1,097	231	295	487	648	8,176	10,465

2019 (audited)	Cash £m	Guarantee £m	Netting £m	Debt securities £m	Other physical collateral	Receivables	Total £m	Exposure £m
Corporates	12	–	69	–	–	–	81	203
Total IRB approach	12	–	69	–	–	–	81	203
Central governments or central banks	3,809	–	–	–	–	–	3,809	5,695
Regional governments or local authorities	–	–	110	–	–	–	110	110
Institutions	–	–	–	304	–	–	304	360
Corporates	4	6	–	–	–	–	10	10
Secured by mortgages on residential real estate	–	–	–	–	–	–	–	2
Secured by mortgages on commercial real estate	–	–	–	–	–	–	–	1
Exposures in default	–	–	–	–	–	–	–	–
Total standardised approach	3,813	6	110	304	–	–	4,233	6,178
Total	3,825	6	179	304	–	–	4,314	6,381

The increase in cash collateral held and corresponding exposure is due to movements within the liquid asset portfolio and similar transactions outstanding at 30 September 2020 (including TFS drawings), reflected within central governments or central banks. The debt securities collateral held continues to be in relation to a repo where UK Gilts were placed as security.

Lending backed by government guarantees in response to COVID-19 can be seen within the Guarantee column.

Following PRA approval during the year, the Group moved to recognise Asset Finance and Invoice Finance collateral, being other physical collateral and receivables respectively, as being eligible collateral from a credit risk mitigation perspective in relation to the foundation internal ratings-based (FIRB) approach.

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

Credit quality of loans and advances as at 30 September 2020 (audited)

The following tables highlight the distribution of the Group's gross loans and advances, ECL and coverage by IFRS 9 stage allocation.

Gross loans and advances[1] ECL and coverage

As at September 2020	Mortgages		Personal – Cards		Personal – Loans & Overdrafts		Personal – Combined		Business[2]		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
Stage 1	49,970	85.2%	3,893	87.2%	767	70.6%	4,660	84.0%	4,589	52.6%	59,219	81.2%
Stage 2 < 30 DPD	7,976	13.6%	512	11.4%	298	27.4%	810	14.6%	3,845	44.1%	12,631	17.3%
Stage 2 > 30 DPD	190	0.3%	7	0.2%	6	0.6%	13	0.2%	10	0.1%	213	0.3%
Stage 2 – total	8,166	13.9%	519	11.6%	304	28.0%	823	14.8%	3,855	44.2%	12,844	17.6%
Stage 3[3]	516	0.9%	52	1.2%	15	1.4%	67	1.2%	279	3.2%	862	1.2%
	58,652	**100.0%**	**4,464**	**100.0%**	**1,086**	**100.0%**	**5,550**	**100.0%**	**8,723**	**100.0%**	**72,925**	**100.0%**
ECLs												
Stage 1	14	10.7%	48	21.6%	22	27.8%	70	23.3%	52	17.1%	136	18.5%
Stage 2 < 30 DPD	84	64.1%	141	63.5%	44	55.7%	185	61.4%	176	58.1%	445	60.6%
Stage 2 > 30 DPD	11	8.4%	6	2.7%	3	3.8%	9	3.0%	–	0.0%	20	2.7%
Stage 2 – total	95	72.5%	147	66.2%	47	59.5%	194	64.4%	176	58.1%	465	63.3%
Stage 3[3]	22	16.8%	27	12.2%	10	12.7%	37	12.3%	75	24.8%	134	18.2%
	131	**100.0%**	**222**	**100.0%**	**79**	**100.0%**	**301**	**100.0%**	**303**	**100.0%**	**735**	**100.0%**
Coverage												
Stage 1	0.03%		1.34%		3.22%		1.64%		1.42%		0.24%	
Stage 2 < 30 DPD	1.06%		29.73%		16.67%		25.03%		4.60%		3.56%	
Stage 2 > 30 DPD	5.98%		76.86%		74.28%		75.83%		5.12%		9.73%	
Stage 2 – total	1.17%		30.40%		17.64%		25.81%		4.61%		3.66%	
Stage 3[3]	4.31%		57.48%		79.43%		62.05%		26.77%		15.74%	
	0.23%		**5.37%**		**8.24%**		**5.91%**		**3.91%**		**1.03%**	

(1) Excludes loans designated at fair value through profit and loss, balances due from customers on acceptances, accrued interest and deferred and unamortised fee income.

(2) Business coverage has been adjusted to exclude government-backed loans.

(3) Stage 3 includes POCI for gross loans and advances of £86m for Mortgages and £4m Personal; and ECL of £Nil for Mortgages and (£2m) for Personal.

Gross loans and advances[1] ECLs and coverage

As at September 2019	Mortgages		Personal						Business		Total	
			Cards		Loans & Overdrafts		Combined					
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
Stage 1	58,120	96.2%	3,806	89.8%	981	94.2%	4,787	90.7%	5,018	66.2%	67,925	92.7%
Stage 2 < 30 DPD	1,637	2.7%	353	8.3%	39	3.7%	392	7.4%	2,280	30.1%	4,309	5.9%
Stage 2 > 30 DPD	168	0.3%	25	0.6%	7	0.7%	32	0.6%	5	0.1%	205	0.3%
Stage 2 – total	1,805	3.0%	378	8.9%	46	4.4%	424	8.0%	2,285	30.2%	4,514	6.2%
Stage 3[2]	466	0.8%	54	1.3%	15	1.4%	69	1.3%	272	3.6%	807	1.1%
	60,391	**100.0%**	**4,238**	**100.0%**	**1,042**	**100.0%**	**5,280**	**100.0%**	**7,575**	**100.0%**	**73,246**	**100.0%**
ECLs												
Stage 1	6	15.0%	42	29.0%	11	36.7%	53	30.3%	20	13.6%	79	21.8%
Stage 2 < 30 DPD	5	12.5%	65	44.8%	6	20.0%	71	40.6%	72	49.0%	148	40.9%
Stage 2 > 30 DPD	4	10.0%	12	8.3%	4	13.3%	16	9.1%	–	0.0%	20	5.5%
Stage 2 – total	9	22.5%	77	53.1%	10	33.3%	87	49.7%	72	49.0%	168	46.4%
Stage 3[2]	25	62.5%	26	17.9%	9	30.0%	35	20.0%	55	37.4%	115	31.8%
	40	**100.0%**	**145**	**100.0%**	**30**	**100.0%**	**175**	**100.0%**	**147**	**100.0%**	**362**	**100.0%**
Coverage												
Stage 1	0.01%		1.11%		1.30%		1.11%		0.40%		0.12%	
Stage 2 < 30 DPD	0.29%		18.49%		15.55%		18.22%		3.13%		3.41%	
Stage 2 > 30 DPD	2.26%		46.91%		67.99%		51.18%		2.27%		9.68%	
Stage 2 – total	0.47%		20.35%		23.16%		20.64%		31.30%		3.69%	
Stage 3[2]	5.36%		48.15%		67.90%		50.72%		19.99%		14.25%	
	0.07%		**3.42%**		**3.22%**		**3.39%**		**1.93%**		**0.50%**	

(1) Excludes loans designated at fair value through profit and loss, balances due from customers on acceptances, accrued interest and deferred and unamortised fee income.
(2) Stage 3 includes POCI for gross loans and advances of £103m for Mortgages and £8m Personal; and ECL of (£1m) for Mortgages and (£2m) for Personal.

Stage 2 balances

There can be a number of reasons that require a financial asset to be subject to a Stage 2 lifetime ECL calculation other than reaching the 30 DPD backstop. The following table highlights the relevant trigger point leading to a financial asset that is not >30 DPD being in Stage 2:

At 30 September 2020	Mortgages		Personal Cards		Personal Loans & Overdrafts		Personal Combined		Business		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
PD deterioration	7,085	87%	342	66%	293	96%	635	77%	2,883	75%	10,603	82%
Forbearance	174	2%	14	3%	3	1%	17	2%	353	9%	544	4%
AFD or Watch List(1)	13	0%	–	–	–	–	–	–	586	15%	599	5%
> 30 DPD	190	2%	7	1%	6	2%	13	2%	10	0%	213	2%
Other(2)	704	9%	156	30%	2	1%	158	19%	23	1%	885	7%
	8,166	**100%**	**519**	**100%**	**304**	**100%**	**823**	**100%**	**3,855**	**100%**	**12,844**	**100%**
ECLs												
PD deterioration	65	68%	86	59%	42	89%	128	66%	103	58%	296	64%
Forbearance	3	3%	5	3%	2	5%	7	4%	31	18%	41	9%
AFD or Watch List(1)	–	–	–	–	–	–	–	–	37	21%	37	8%
> 30 DPD	11	12%	6	4%	3	6%	9	5%	–	–	20	4%
Other(2)	16	17%	50	34%	–	–	50	25%	5	3%	71	15%
	95	**100%**	**147**	**100%**	**47**	**100%**	**194**	**100%**	**176**	**100%**	**465**	**100%**

At 30 September 2019	Mortgages		Personal Cards		Personal Loans & Overdrafts		Personal Combined		Business		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
PD deterioration	809	45%	137	36%	35	76%	172	41%	1,512	66	2,493	55%
Forbearance	214	12%	6	2%	3	7%	9	2%	292	13%	515	11%
AFD or Watch List(1)	13	1%	–	–	–	–	–	–	446	20%	459	10%
> 30 DPD	168	9%	25	7%	7	15%	32	8%	5	0%	205	5%
Other(2)	601	33%	210	55%	1	2%	211	49%	30	1%	842	19%
	1,805	**100%**	**378**	**100%**	**46**	**100%**	**424**	**100%**	**2,285**	**100%**	**4,514**	**100%**
ECLs												
PD deterioration	3	33%	25	32%	5	50%	30	35%	33	46%	66	39%
Forbearance	1	11%	1	1%	1	10%	2	2%	17	24%	20	12%
AFD or Watch List(1)	–	–	–	–	–	–	–	–	19	26%	19	11%
> 30 DPD	4	45%	12	16%	4	40%	16	18%	–	–	20	12%
Other(2)	1	11%	39	51%	–	–	39	45%	3	4%	43	26%
	9	**100%**	**77**	**100%**	**10**	**100%**	**87**	**100%**	**72**	**100%**	**168**	**100%**

(1) Approaching Financial Difficulty (AFD) and Watch markers are early warning indicators of customers who may be approaching financial difficulties. If these indicators are not reversed they may lead to a requirement for more proactive management by the Group.

(2) Other includes eCRS (internal rating scale) changes as well as a number of smaller value drivers.

Credit risk exposure, by internal PD rating, by IFRS 9 stage allocation (audited)

The distribution of the Group's credit exposures by internal PD rating is analysed below.

		Gross carrying amount			
		Stage 1 £m	Stage 2 £m	Stage 3[1] £m	Total £m
As at 30 September 2020					
Mortgages	**PD range**				
Strong	0 – 0.74	**44,038**	**3,785**	**–**	**47,823**
Good	0.75 – 2.49	**5,246**	**2,879**	**–**	**8,125**
Satisfactory	2.50 – 99.99	**686**	**1,502**	**–**	**2,188**
Default	100	**–**	**–**	**516**	**516**
Total		**49,970**	**8,166**	**516**	**58,652**
Personal					
Strong	0 – 2.49	**4,144**	**183**	**–**	**4,327**
Good	2.50 – 9.99	**500**	**478**	**–**	**978**
Satisfactory	10.00 – 99.99	**16**	**162**	**–**	**178**
Default	100	**–**	**–**	**67**	**67**
Total		**4,660**	**823**	**67**	**5,550**
Business					
Strong	0 – 0.74	**791**	**152**	**–**	**943**
Good	0.75 – 9.99	**3,674**	**2,733**	**–**	**6,407**
Satisfactory	10.00 – 99.99	**124**	**970**	**–**	**1,094**
Default	100	**–**	**–**	**279**	**279**
Total		**4,589**	**3,855**	**279**	**8,723**
As at 30 September 2019					
Mortgages	**PD range**				
Strong	0 – 0.74	55,057	833	–	55,890
Good	0.75 – 2.49	2,648	455	–	3,103
Satisfactory	2.50 – 99.99	415	517	–	932
Default	100	–	–	466	466
Total		58,120	1,805	466	60,391
Personal					
Strong	0 – 2.49	4,197	50	–	4,247
Good	2.50 – 9.99	553	231	–	784
Satisfactory	10.00 – 99.99	37	143	–	180
Default	100	–	–	69	69
Total		4,787	424	69	5,280
Business					
Strong	0 – 0.74	2,225	175	–	2,400
Good	0.75 – 9.99	2,791	1,938	–	4,729
Satisfactory	10.00 – 99.99	2	172	–	174
Default	100	–	–	272	272
Total		5,018	2,285	272	7,575

(1) Stage 3 includes POCI of £86m (2019: 103m) for Mortgages and £4m (2019: £8m) for Personal.

Reconciliation of movement in gross balances and impairment loss allowance (audited)

The following tables explain the changes in the loss allowance and gross carrying value of the portfolios between 30 September 2019 and 30 September 2020. Values are calculated using the individual customer account balances, and the stage allocation is taken as at the end of each month. The monthly position of each account is aggregated to report a net closing position for the period, thereby incorporating all movements an account has made during the year.

	Stage 1		Stage 2		Stage 3[1]			
September 2020	Gross loans £m	ECL £m	Gross loans £m	ECL £m	Gross loans £m	ECL £m	Total gross loans £m	Total provisions £m
Virgin Money UK PLC								
Opening balance at 1 October 2019	67,925	79	4,514	168	807	115	73,246	362
Transfers from Stage 1 to Stage 2	(14,972)	(81)	9,513	436	–	–	(5,459)	355
Transfers from Stage 2 to Stage 1	5,032	37	(2,813)	(190)	–	–	2,219	(153)
Transfers to Stage 3	(102)	(1)	(328)	(84)	384	129	(46)	44
Transfers from Stage 3	44	–	76	9	(93)	(18)	27	(9)
Changes to model methodology	24	(8)	(24)	(6)	–	–	–	(14)
New assets originated or purchased	18,380	96	1,349	90	150	15	19,879	201
Repayments and other movements	(3,454)	67	2,304	150	40	(49)	(1,110)	168
Repaid or derecognised	(13,658)	(53)	(1,747)	(108)	(267)	(63)	(15,672)	(224)
Write-offs	–	–	–	–	(159)	(159)	(159)	(159)
Cash recoveries	–	–	–	–	–	25	–	25
Individually assessed impairment charge	–	–	–	–	–	139	–	139
Closing balance at 30 September 2020	**59,219**	**136**	**12,844**	**465**	**862**	**134**	**72,925**	**735**
Mortgages								
Opening balance at 1 October 2019	58,120	6	1,805	9	466	25	60,391	40
Transfers from Stage 1 to Stage 2	(10,390)	(10)	4,976	75	–	–	(5,414)	65
Transfers from Stage 2 to Stage 1	3,525	3	(1,260)	(17)	–	–	2,265	(14)
Transfers to Stage 3	(63)	–	(69)	(6)	86	13	(46)	7
Transfers from Stage 3	38	–	24	3	(34)	(6)	28	(3)
Changes to model methodology	–	–	–	–	–	–	–	–
New assets originated or purchased	6,981	1	16	–	3	–	7,000	1
Repayments and other movements	(2,018)	15	2,784	32	32	(6)	798	41
Repaid or derecognised	(6,223)	(1)	(110)	(1)	(34)	(4)	(6,367)	(6)
Write-offs	–	–	–	–	(3)	(3)	(3)	(3)
Cash recoveries	–	–	–	–	–	–	–	–
Individually assessed impairment charge	–	–	–	–	–	3	–	3
Closing balance at 30 September 2020	**49,970**	**14**	**8,166**	**95**	**516**	**22**	**58,652**	**131**

(1) Stage 3 includes POCI for gross loans and advances of £86m for Mortgages and £4m Personal; and ECL of £nil for Mortgages and (£2m) for Personal.

Credit risk

September 2020	Stage 1 Gross loans £m	Stage 1 ECL £m	Stage 2 Gross loans £m	Stage 2 ECL £m	Stage 3 Gross loans £m	Stage 3 ECL £m	Total gross loans £m	Total provisions £m
Personal								
Opening balance at 1 October 2019	4,787	53	424	87	69	35	5,280	175
Transfers from Stage 1 to Stage 2	(1,326)	(47)	1,356	270	–	–	30	223
Transfers from Stage 2 to Stage 1	723	29	(768)	(151)	–	–	(45)	(122)
Transfers to Stage 3	(23)	(1)	(110)	(65)	135	96	2	30
Transfers from Stage 3	2	–	3	2	(6)	(5)	(1)	(3)
Changes to model methodology	24	(8)	(24)	(6)	–	–	–	(14)
New assets originated or purchased	1,621	26	5	1	1	–	1,627	27
Repayments and other movements	(925)	23	(45)	62	36	(52)	(934)	33
Repaid or derecognised	(223)	(5)	(18)	(6)	(40)	(36)	(281)	(47)
Write-offs	–	–	–	–	(128)	(128)	(128)	(128)
Cash recoveries	–	–	–	–	–	23	–	23
Individually assessed impairment charge	–	–	–	–	–	104	–	104
Closing balance at 30 September 2020	**4,660**	**70**	**823**	**194**	**67**	**37**	**5,550**	**301**
Business								
Opening balance at 1 October 2019	5,018	20	2,285	72	272	55	7,575	147
Transfers from Stage 1 to Stage 2	(3,256)	(24)	3,181	91	–	–	(75)	67
Transfers from Stage 2 to Stage 1	784	5	(785)	(22)	–	–	(1)	(17)
Transfers to Stage 3	(16)	–	(149)	(13)	163	20	(2)	7
Transfers from Stage 3	4	–	49	4	(53)	(7)	–	(3)
Changes to model methodology	–	–	–	–	–	–	–	–
New assets originated or purchased	9,778	69	1,328	89	146	15	11,252	173
Repayments and other movements	(511)	29	(435)	56	(28)	9	(974)	94
Repaid or derecognised	(7,212)	(47)	(1,619)	(101)	(193)	(23)	(9,024)	(171)
Write-offs	–	–	–	–	(28)	(28)	(28)	(28)
Cash recoveries	–	–	–	–	–	2	–	2
Individually assessed impairment charge	–	–	–	–	–	32	–	32
Closing balance at 30 September 2020	**4,589**	**52**	**3,855**	**176**	**279**	**75**	**8,723**	**303**

Credit risk

September 2019	Stage 1 Gross loans £m	Stage 1 ECL £m	Stage 2 Gross loans £m	Stage 2 ECL £m	Stage 3[(1)] Gross loans £m	Stage 3[(1)] ECL £m	Total gross loans £m	Total provisions £m
Virgin Money UK PLC								
Opening balance at 1 October 2018	29,456	53	2,897	86	564	85	32,917	224
Transfers from Stage 1 to Stage 2	(6,552)	(60)	6,570	257	–	–	18	197
Transfers from Stage 2 to Stage 1	3,619	17	(3,650)	(98)	–	–	(31)	(81)
Transfers to Stage 3	(153)	(2)	(496)	(82)	650	125	1	41
Transfers from Stage 3	41	–	128	6	(175)	(18)	(6)	(12)
Changes to model methodology	(1,752)	(5)	(32)	(6)	–	–	(1,784)	(11)
New assets originated or purchased	57,236	152	1,004	65	46	7	58,286	224
Repayments and other movements	(984)	(23)	(268)	17	92	(12)	(1,160)	(18)
Repaid or derecognised	(12,986)	(53)	(1,639)	(77)	(233)	(15)	(14,858)	(145)
Write-offs	–	–	–	–	(137)	(199)	(137)	(199)
Cash recoveries	–	–	–	–	–	28	–	28
Individually assessed impairment charge	–	–	–	–	–	114	–	114
Closing balance at 30 September 2019	67,925	79	4,514	168	807	115	73,246	362
Mortgages								
Opening balance at 1 October 2018	23,572	3	689	3	279	23	24,540	29
Transfers from Stage 1 to Stage 2	(3,851)	(4)	3,835	22	–	–	(16)	18
Transfers from Stage 2 to Stage 1	2,393	1	(2,401)	(9)	–	–	(8)	(8)
Transfers to Stage 3	(92)	(1)	(185)	(4)	276	11	(1)	6
Transfers from Stage 3	29	–	72	1	(105)	(4)	(4)	(3)
Changes to model methodology	–	–	–	–	–	–	–	–
New assets originated or purchased	44,730	8	3	–	138	–	44,871	8
Repayments and other movements	(2,412)	–	(48)	(3)	(31)	(1)	(2,491)	(4)
Repaid or derecognised	(6,249)	(1)	(160)	(1)	(83)	(2)	(6,492)	(4)
Write-offs	–	–	–	–	(8)	(3)	(8)	(3)
Cash recoveries	–	–	–	–	–	–	–	–
Individually assessed impairment charge	–	–	–	–	–	1	–	1
Closing balance at 30 September 2019	58,120	6	1,805	9	466	25	60,391	40

(1) Stage 3 includes POCI for gross loans and advances of £103m for Mortgages and £8m Personal; and ECL of (£1m) for Mortgages and (£2m) for Personal.

Credit risk

September 2019	Stage 1 Gross loans £m	Stage 1 ECL £m	Stage 2 Gross loans £m	Stage 2 ECL £m	Stage 3 Gross loans £m	Stage 3 ECL £m	Total gross loans £m	Total provisions £m
Personal								
Opening balance at 1 October 2018	1,143	15	38	12	22	18	1,203	45
Transfers from Stage 1 to Stage 2	(931)	(48)	970	194	–	–	39	146
Transfers from Stage 2 to Stage 1	403	12	(422)	(70)	–	–	(19)	(58)
Transfers to Stage 3	(28)	(1)	(95)	(56)	125	91	2	34
Transfers from Stage 3	3	–	2	1	(7)	(6)	(2)	(5)
Changes to model methodology	32	(1)	(32)	(6)	–	–	–	(7)
New assets originated or purchased	4,429	85	2	–	1	1	4,432	86
Repayments and other movements	(20)	(5)	(24)	17	36	(4)	(8)	8
Repaid or derecognised	(244)	(4)	(15)	(5)	(8)	(6)	(267)	(15)
Write-offs	–	–	–	–	(100)	(165)	(100)	(165)
Cash recoveries	–	–	–	–	–	27	–	27
Individually assessed impairment charge	–	–	–	–	–	79	–	79
Closing balance at 30 September 2019	4,787	53	424	87	69	35	5,280	175
Business								
Opening balance at 1 October 2018	4,741	35	2,170	71	263	44	7,174	150
Transfers from Stage 1 to Stage 2	(1,770)	(8)	1,765	41	–	–	(5)	33
Transfers from Stage 2 to Stage 1	823	4	(827)	(19)	–	–	(4)	(15)
Transfers to Stage 3	(33)	–	(216)	(22)	249	23	–	1
Transfers from Stage 3	9	–	54	4	(63)	(8)	–	(4)
Changes to model methodology	(1,784)	(4)	–	–	–	–	(1,784)	(4)
New assets originated or purchased	8,077	59	999	65	44	6	9,120	130
Repayments and other movements	1,448	(18)	(196)	3	(50)	(7)	1,202	(22)
Repaid or derecognised	(6,493)	(48)	(1,464)	(71)	(142)	(7)	(8,099)	(126)
Write-offs	–	–	–	–	(29)	(31)	(29)	(31)
Cash recoveries	–	–	–	–	–	1	–	1
Individually assessed impairment charge	–	–	–	–	–	34	–	34
Closing balance at 30 September 2019	5,018	20	2,285	72	272	55	7,575	147

Transfer from Stage 1 to Stage 2 (non-credit impaired)
A lifetime ECL calculation is required where an asset has been assessed as experiencing a significant increase in credit risk (SICR), as determined by the Group's staging criteria. The non-credit impaired movements are classed as Stage 2.

Transfer from Stage 2 to Stage 1
A 12-month ECL calculation is required where an asset, that had previously been classed as Stage 2, reverts back to the conditions observed at the initial credit assessment.

Transfer to Stage 3
A lifetime ECL calculation is required where an asset has been assessed as experiencing a SICR, as determined by the Group's staging criteria. The credit impaired movements are classed as Stage 3.

Transfer from Stage 3
Where an asset, that had previously been classed at Stage 3, has either (i), reverted back to the conditions observed at the initial credit assessment where a 12-month ECL should be calculated or (ii) no longer meets the criteria for Stage 3 but does meet the criteria for Stage 2, it is transferred to that category.

Changes in model methodology
ECL value changes resulting from a change to an underlying model methodology.

New assets originated or purchased
The balance and ECL calculated on newly opened or originated assets. Assets where the term has ended, and a new facility has been provided are reported as new assets.

Repayments and other movements
Movements due to customer repayment and other minor movements not captured under any other category.

Credit risk

Repaid or derecognised (excluding write-offs)
ECL impact from customer repayment or derecognition of all or part of an asset, other than that resulting from a write-off.

Write-offs
ECL impact due to the reduction of all, or part, of an asset balance due to a write-off approved by the Group. ECL release may appear higher than the asset balance on some occasions as a result of the initial ECL lifetime being released, in addition to the individually assessed provision applied for the asset balance write-off.

Cash recoveries
ECL impact of payments received on assets that had previously been written off.

Individually assessed impairment charge
The income statement charge where an individually assessed provision has been recognised or a direct write-off has been applied to an asset balance and reported separately from the Stage 3 provision.

Scenarios, weightings and macroeconomic assumptions

The Group's ECL allowance as at 30 September 2020 was £735m (30 September 2019: £362m).

Macroeconomic assumptions
A range of future macroeconomic conditions is used in the scenarios over the five-year forecast period, reflecting the best estimate of future conditions under each scenario. The Group has identified the following key macroeconomic conditions as the most significant inputs for IFRS 9 modelling purposes: UK GDP growth, inflation, house prices, base rates, and unemployment rates. These are assessed and reviewed on a quarterly basis to ensure appropriateness and relevance to the ECL calculation. The output of the models is then supplemented by PMAs when it is considered that not all the risks identified in a product segment have been accurately reflected within the models.

The shock to the economy as a result of COVID-19 has been faster and more severe than any in history. This has put increased emphasis on the IFRS 9 models and the impact of the forward-looking multiple macroeconomic scenarios on ECLs. As a result, the Group has re-assessed the possible IFRS 9 scenarios to select appropriate scenarios and weightings. The scenario weightings are considered and debated by an internal review panel and then recommended and approved for use in the IFRS 9 models by ALCO. The three scenarios selected, together with the weightings applied, have been updated to reflect the current economic environment:

Scenario	2020 (%)	2019 (%)
Upside	**5**	20
Base	**50**	60
Downside	**45**	20

The 'Upside' scenario has been reduced to a 5% weighting as it is considered to be overly optimistic in the current economic environment and the medium-term outlook. The decrease in the level of weighting applied to the 'Base' scenario is reflective of the severity of the impact of COVID-19 on the UK economy and the subsequent view that a larger share of the weightings should be focused on the downside scenario.

Upside (5%)
This reflects the unprecedented collapse of GDP (20% year-on-year, based on Q2 of the calendar year). The resultant effect is a predicted annual reduction of 10.8% in GDP in 2020. Public sector borrowing is expected to exceed 14% of GDP in the fiscal year 2020/21, lifting public debt to c. 110% of GDP in the near term before falling back to stabilise at c. 97% (the pre-crisis long run forecast was c. 80%).

Base (50%)
Growth in GDP is limited to an average of just 0.5% per annum for the next five years, which translates into around 4% lower than in the upside scenario by the end of the forecast period. Unemployment peaks at 8.8% and recovers slowly while property prices, and in particular commercial property prices, suffer sharp falls and only recover to pre-crisis levels towards the end of the scenario.

Downside (45%)
Demand shock from lockdown is compounded by financial crisis, with the slow pace of lifting lockdown restrictions weighing on sentiment, as investment decisions are delayed. The size of the deficit leads to the re-introduction of austerity measures, with output declining by c. 24% peak to trough and unemployment surging to 12%.

Within each portfolio, the following are the macroeconomic inputs which are more sensitive and therefore more likely to drive the move from Stage 1 to Stage 2 under a stress scenario:

Mortgages: Unemployment, House Price Index (HPI) and Base Rate.

Personal: Unemployment and Inflation.

Business: GDP, Unemployment and Base Rate.

Five-year simple averages and graphical illustrations for the most sensitive inputs of unemployment, GDP and HPI are:

	Unemployment %	GDP %	HPI %
at 30 September 2020			
Upside	**4.4**	**1.3**	**1.7**
Base	**6.5**	**0.5**	**(1.6)**
Downside	**7.4**	**(0.4)**	**(6.2)**
at 30 September 2019			
Upside	3.4	2.7	5.8
Base	3.8	1.8	2.9
Downside	5.8	0.2	(4.6)

The full range of the key macroeconomic assumptions is included in the table on page 45.

The use of estimates, judgements and sensitivity analysis

The following are the main areas where estimates and judgements are applied to the ECL calculation:

The use of estimates

Asset lifetimes

The calculation of the ECL allowance is dependent on the expected life of the Group's portfolios. The Group assumes the remaining contract term as the maximum period to consider credit losses wherever possible. For the Group's credit card and overdraft portfolios, behavioural factors such as observed retention rates and other portfolio level assumptions are taken into consideration in determining the estimated asset life.

Economic scenarios

The calculation of the Group's impairment provision is sensitive to changes in the chosen weightings as highlighted above. The effect on the closing modelled provision of each portfolio as a result of applying a 100% weighting to each of the selected scenarios is shown below:

	Probability Weighted (1) £m	Upside £m	Base £m	Downside £m
30 September 2020				
Mortgages	**46**	**7**	**28**	**76**
Personal of which:	**190**	**162**	**183**	**204**
Cards	**165**	**139**	**158**	**179**
Personal loans and overdrafts	**25**	**23**	**25**	**25**
Business	**260**	**156**	**214**	**324**
Total	**496**	**325**	**425**	**604**

	Probability Weighted £m	Upside £m	Base £m	Downside £m
30 September 2019				
Mortgages	16	14	14	25
Personal of which	156	150	153	172
Cards	131	125	128	146
Personal loans and overdrafts	25	25	25	26
Business	94	75	88	134
Total	266	239	255	331

(1) In addition to the modelled provision shown in the table, the Group holds £186m relative to PMAs (2019: £49m) and £53m of individually assessed provision (2019: £47m).

One of the criteria for moving an exposure between stages is the PD which incorporates macroeconomic factors. As a result, the stage allocation will be different in each scenario and so the probability-weighted ECL cannot be recalculated using the scenario ECL provided and the scenario weightings.

Certain asset classes are less sensitive to specific macroeconomic factors, showing lower relative levels of sensitivity. To ensure appropriate levels of ECL, the relative lack of sensitivity is compensated for through the application of post model adjustments, further detail of which can be found below.

The use of judgement

SICR

Considerable judgement is required in determining the point at which a SICR has occurred, as this is the point at which a 12-month ECL is replaced by a lifetime ECL. The Group has developed a series of triggers that indicate where a SICR has occurred when assessing exposures for the risk of default occurring at each reporting date compared to the risk at origination. There is no single factor that influences this decision, rather a combination of different criteria that enables the Group to make an assessment based on the quantitative and qualitative information available. This includes the impact of forward-looking macroeconomic factors but excludes the existence of any collateral implications.

Indicators of a SICR include deterioration of the residual lifetime PD by set thresholds which are unique to each product portfolio, non-default forbearance programmes, and watch list status. The Group adopts the backstop position that a SICR will have taken place when the financial asset reaches 30 DPD. Customers who requested COVID-19 related support, including payment holidays, and who were not the subject of any wider SICR triggers or who were otherwise assessed as having the ability in the medium term to be viable and meet our risk appetite criteria, were not considered to have been granted forbearance or to have a SICR.

The Group does not have a set absolute threshold by which the PD would have to increase by in establishing that a SICR has occurred, and has established an approach with the required SICR threshold trigger varying on a portfolio basis according to the origination PD.

The table below illustrates this with reference to the Group's business and credit Card portfolios:

		Origination PD	SICR Trigger
Business	Low origination PD	0.04%	0.23%
	High origination PD	10.09%	13.20%
Credit cards	Low origination PD	1.00%	23.86%
	High origination PD	11.00%	28.11%

Changes to the overall SICR thresholds can also impact staging, driving accounts into higher stages with the resultant impact on the ECL allowance:

	2020 (£m)	2019 (£m)
A 10% movement in the mortgage portfolio from Stage 1 to Stage 2	**+18**	+ 7
A 10% movement in the credit card portfolio from Stage 1 to Stage 2	**+56**	+ 52
A 10% movement in the business portfolio from Stage 1 to Stage 2	**+11**	+13
A PD stress which increases PDs upwards by 20% for all portfolios	**+151**	+ 54

Definition of default

The PD of a credit exposure is a key input to the measurement of the ECL allowance. Default occurs when there is evidence that a customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The Group utilises the 90 DPD backstop for default purposes.

PMAs

The ECL provision is further impacted by judgements in the form of PMAs, which are judgements that increase the collectively assessed modelled output where the Group considers that not all of the known or potential future risks identified in a particular product segment have been accurately reflected within the models.

At 30 September 2020, £186m of PMAs (2019: £49m) are included within the balance sheet ECL provision of £735m (2019: £362m) and categorised as:

	2020 Total £m	2019 Total £m
Mortgages	75	14
Personal	111	19
Business	–	16
Total	186	49

PMAs account for 57% of the mortgage ECL provision of £131m (2019: 35% of £40m) and 37% of the personal ECL provision of £301m (2019: 7% of £175m). The Group does not hold PMAs in relation to the Business portfolio. PMAs are assigned between Stages 1 and 2. PMAs are discussed in more detail in the divisional commentary on pages 25 - 28.

The key macroeconomic factors used in the scenarios and their weighted averages are[1]:

Scenario	VMUK weighting	Economic measure[2]	2020	2021	2022	2023	2024
Upside	5%	Base rate	0.2%	0.1%	0.1%	0.2%	0.4%
		Unemployment	5.5%	5.1%	3.9%	3.7%	3.6%
		GDP	(10.8%)	10.2%	3.5%	1.9%	1.8%
		Inflation	0.7%	1.2%	1.7%	1.8%	1.7%
		HPI	(4.2%)	(1.8%)	6.7%	4.0%	3.8%
Base	50%	Base rate	0.2%	0.1%	0.1%	0.2%	0.3%
		Unemployment	6.1%	7.8%	6.3%	6.3%	6.0%
		GDP	(14.0%)	7.9%	4.6%	2.1%	1.8%
		Inflation	(0.6%)	(0.2%)	2.0%	2.3%	1.2%
		HPI	(7.3%)	(8.5%)	1.5%	1.9%	4.1%
Downside	45%	Base rate	0.2%	(0.5%)	(0.5%)	(0.3%)	(0.3%)
		Unemployment	6.7%	10.0%	7.2%	6.8%	6.5%
		GDP	(16.9%)	5.0%	5.7%	2.0%	1.9%
		Inflation	(0.2%)	(1.4%)	1.0%	2.4%	0.8%
		HPI	(11.2%)	(15.6%)	(6.7%)	(2.2%)	4.8%
Weighted average		Base rate	0.2%	(0.2%)	(0.2%)	(0.1%)	0.0%
		Unemployment	6.3%	8.6%	6.6%	6.4%	6.1%
		GDP	(15.1%)	6.7%	5.1%	2.1%	1.9%
		Inflation	(0.4%)	(0.7%)	1.5%	2.3%	1.1%
		HPI	(8.9%)	(11.4%)	(1.9%)	0.2%	4.4%

(1) Economic assumptions are on a calendar year basis unless otherwise stated.

(2) The percentages shown for base rate, unemployment and inflation are averages. Those for GDP and HPI are year on year.

Other credit risks

The Group is exposed to credit risk on its other banking and Treasury-related activities, which are subject to mitigation and monitoring. No material ECL provisions are currently held for these exposures.

Offsetting of financial assets and liabilities

The Group reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions as detailed in note 3.6 to the financial statements. The amounts offset on the balance sheet, as shown below, represent derivatives and variation margin collateral with central clearing houses which meet the criteria for offsetting under IAS 32. The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. loans and advances).

The Group enters into derivatives with various counterparties which are governed by industry-standard master netting agreements. The Group holds and provides collateral in respect of derivatives transactions covered by these agreements. The right to offset balances under these master netting agreements only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

Credit risk

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

	Gross amounts £m	Gross amounts offset on balance sheet £m	Net amounts presented on balance sheet[(1)] £m	Net amounts not offset on balance sheet: Subject to master netting agreements £m	Net amounts not offset on balance sheet: Cash collateral pledged/ received £m	Net amount £m
2020 (audited)						
Assets						
Derivative financial instruments[(2)]	**423**	**(105)**	**318**	**(127)**	**(12)**	**179**
Liabilities						
Derivative financial instruments[(2)]	**1,063**	**(813)**	**250**	**(127)**	**(83)**	**40**
Securities sold under repurchase agreement	**–**	**–**	**–**	**–**	**–**	**–**
2019 (audited)						
Assets						
Derivative financial instruments[(2)]	478	(112)	366	(70)	(8)	288
Liabilities						
Derivative financial instruments[(2)]	739	(466)	273	(70)	(190)	13
Securities sold under repurchase agreement	1,554	–	1,554	(1,554)	–	–

(1) Cash collateral amounts are limited to the net balance sheet exposure in order to exclude any over collateralisation. In addition to cash collateral, the Group holds securities collateral in respect of derivative transactions subject to master netting agreements of £522m (2019: £57m), which is not recognised on the balance sheet.

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

Financial risk

Strong foundations supporting resilience and growth

The financial risk framework underpins the Group's robust balance sheet, ensuring strategy is resilient and responsive to external pressures, including the impact of COVID-19 and changing regulatory obligations.

Financial risk covers several categories of risk which impact the manner in which the Group can support its customers in a safe and sound manner. They include capital risk, funding risk, liquidity risk, market risk, and pension risk. During the year, model risk was removed as a sub-category of financial risk and promoted to principal risk status. Further information can be found on page 169 in the Group's Annual Report & Accounts.

Risk appetite

The primary objective for the management of financial risks is to control the risk profile within approved risk limits, to maintain the confidence of the Group's customers and other stakeholders. Financial risks are also managed to protect current and future earnings from the impact of market volatility. The Group applies a prudent approach to financial risks in order to safeguard the ongoing strength and resilience of the balance sheet. These activities are all undertaken in a manner consistent with the Group's obligations under ring-fencing legislation and prudential rules.

Financial risk appetite is approved by the Board, with authority delegated to ALCO for subsequent implementation and monitoring. The Board has established a range of capital risk appetite measures including CET1, leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet, the Group's overall funding profile and compliance with the Overall Liquidity Adequacy Rule (OLAR). Board-approved risk appetite covers both regulatory and internal liquidity requirements and the need to maintain access to liquidity resources sufficient to accommodate outflows of funds in a range of stress scenarios over a one-month and three-month period.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and manage the liquidity and interest rate risks arising from these activities. The Group establishes an appetite for these risks based on an overriding principle that the Group will not engage in proprietary risk taking.

The Group's pension risk appetite is a component of the Group-wide RAS framework for the management of balance sheet risks and is considered in the context of potential capital impacts as a result of volatility in the Scheme's valuations.

Capital risk

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 pioneering growth. Capital risk is the risk that the Group has insufficient quantity or quality of capital to support its operations.

Exposures

Capital risk exposures arise when the Group has insufficient capital resources to support its business activities or to meet regulatory capital requirements under normal operating conditions or stressed scenarios.

Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and the FCA, which are implemented through the CRD IV CRR regulatory framework. Pillar 1 capital requirements for the year ended 30 September 2020 are calculated in respect of credit risk, operational risk, market risk, counterparty credit risk and credit valuation adjustments. The capital requirements for retail mortgages are calculated using an advanced internal ratings based (AIRB) approach while the business portfolios use a foundation internal ratings based (FIRB) approach. In March 2020, the Group received approval to move the specialised lending portfolio from the standardised approach to an IRB slotting basis. All other requirements are calculated using the standardised approach.

The Group obtained IRB accreditation for certain portfolios in October 2018. The PRA has since released a final policy statement outlining its approach to implementing definition of default per EBA guidelines. Further to this, there are recommended changes to both PD and LGD model components relating directly to the calculation of risk-weighted capital requirements. In July 2020, the PRA announced their timeline to evaluate the approach of UK banks to the change in the definition of default calculation. Implementation for residential mortgage portfolios is expected to be in 2021 and by 1 January 2022 for all other exposure classes, subject to PRA approval.

A rigorous approach is taken to assessing risks that are not adequately covered by Pillar 1, including interest rate risk and pension risk. The Group also undertakes analysis of a range of stress scenarios to test the impact on capital arising from severe yet plausible scenarios. These approaches to capital are thoroughly documented in the Group's ICAAP which is subject to review, challenge and approval by the Board.

The Group IRB framework looks at the customer and business PD along with loss severity (EAD and LGD). The outputs are used in the calculation of RWA, EL and IFRS 9 ECL. The IRB parameters and rating assessments are actively embedded in the following day-to-day processes:

- Credit approval – IRB models and parameters are used to assess the customer risk and IRB outputs are used to inform cut-off models that drive the lending decisions;
- Pricing – IRB outputs and estimates are used in the assessment of new products and portfolio pricing reviews;
- Risk appetite – IRB parameters are included in the assessment of models and are analysed to inform the Group's risk capacity and appetite; and
- Asset quality – IRB parameters are monitored to understand the product and segment performance of the Group's portfolios.

Regulatory capital developments

The regulatory landscape for capital is subject to a number of changes which leads to uncertainty on eventual outcomes.

Reconciling capital requirements and macroprudential buffers

On 6 July 2020, the PRA published Policy Statement 15/20, which updates the Pillar 2A capital framework for the additional resilience associated with higher macroprudential buffer requirements in a standard risk environment. The PRA will make changes to Pillar 2A, where applicable, on or before 16 December 2020.

Financial risk

Capital Requirements Directive V (CRD V) and Capital Requirements Regulation II (CRR II)

On 16 July 2020, Her Majesty's Treasury (HMT) issued a consultation on aspects of CRD V that must be implemented before the end of the transition period for the UK leaving the EU. Items being consulted on include macro-prudential tools (O-SII buffer, Systemic Risk Buffer), holding companies and equal pay framework and enforcement. On 15 October 2020, HMT published a summary of responses to the consultation and laid draft legislation in Parliament.

On 31 July 2020, the PRA issued CP12/20 'CRD V' which set out proposed changes to the PRA's rules, supervisory statements and statements of policy to meet the objectives of CRD V. This consultation was focused on Pillar 2, remuneration, intermediate parent undertakings, governance, and third-country branch reporting.

On 20 October 2020, the PRA issued CP17/20 'CRD V: Further implementation'. This consultation is focused on: the approval and supervision of holding companies; measures to enhance supervisory requirements for interest rate risk in the banking book (IRRBB); revisions to the capital buffers framework; amendments to the definition of the maximum distributable amount that constrains a firm's distributions when it uses its capital buffers; and clarifying the quality of capital required to meet Pillar 2. It also covers CRR measures in respect of the process through which variable capital requirements may be applied to firms' real estate exposures, and the methods that may be used for prudential consolidation.

Based on the CRD V and CRR II requirements published in the EU Official Journal and the subsequent HMT/PRA releases, the Group does not anticipate a material impact on capital ratios.

Basel III revisions

The Basel Committee published its final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches to credit and operational risks and the introduction of a new RWA output floor. The reforms are subject to a transition period from 2023 to 2028.

IRB approach to UK mortgage risk weights

In September 2020, the PRA issued Consultation Paper 14/20 'Internal Ratings Based UK mortgage risk weights: Managing deficiencies in model risk capture'. The proposals help address the PRA's view of prudential risks from "inappropriately low" IRB UK mortgage risk weights with the aim of:

- reducing the difference in standardised approach and IRB mortgage risk weights for current UK mortgages;
- placing a limit on future divergence; and
- reducing the variability of mortgage risk weights between those firms on the IRB approach for given levels of mortgage LTVs.

Key proposals from this are the introduction of the following floors:

- an individual mortgage risk weight of at least 7%; and
- an exposure-weighted average risk weight of at least 10% for an IRB UK mortgage portfolio as a whole.

Following consultation, the PRA's final policy is expected to take effect from 1 January 2022.

COVID-19 regulatory capital developments

There have been a number of regulatory capital developments in the UK and Europe in response to COVID-19. Key items relevant to the Group are set out below.

Government backed loan schemes

During the year, the Group participated in the various government backed loan schemes for businesses, in addition to offering payment holidays to both business and retail customers. Impacts to the Group's financial risk profile are discussed in this section and further details on loan schemes are provided in the credit risk section.

Revised timelines

In order to provide operational capacity for banks to respond to the immediate financial stability priorities resulting from the impact of COVID-19, both the PRA and Basel communicated revised timelines across key regulatory initiatives. The implementation of the Basel III revisions has been delayed by one year to 1 January 2023, and includes revisions to: the standardised approach to credit risk; IRB approach; operational risk framework, market risk framework; Pillar 3 disclosures and the introduction of output floors.

In addition, the PRA advised that the proposals in Consultation Paper 21/19 'Credit risk: PD and LGD estimation' will be delayed by one year to 1 January 2022 and the hybrid IRB models will also be delayed until the same date.

On 26 March 2020, the PRA wrote to CEOs of UK banks setting out guidance in respect of:

- consistent and robust IFRS 9 accounting and the regulatory definition of default;
- the treatment of borrowers who breach covenants due to COVID-19; and
- the regulatory capital treatment of IFRS 9.

The PRA has subsequently provided a number of updates to banks in this regard as the COVID-19 situation evolves.

CRR 'Quick Fix' package

On 24 June 2020, the European Parliament adopted regulation to facilitate lending to households and businesses in the EU in light of COVID-19. This package, known as the 'CRR Quick Fix', came into force on 27 June 2020 and made a number of beneficial amendments to the CRR that apply to the Group, including changes to IFRS 9 transitional arrangements and SME supporting factors.

On 14 October 2020, the EBA published its final draft Regulatory Technical Standards (RTS) specifying the prudential treatment of software assets. The RTS replaces the current upfront full deduction with a simple approach based on a prudential amortisation of software assets calibrated over a maximum period of three years. The RTS will become effective on the day following its publication in the Official Journal of the European Union.

Financial risk

Mitigation
The Group's capital risk policy standard provides the framework for the management of capital within the Group. The objectives of the policy standard are to efficiently manage the capital base to optimise shareholder returns while maintaining robust capital adequacy, meeting regulatory requirements, managing the rating agencies' assessment of the Group, and ensuring that excessive leverage is not taken.

The Group is able to accumulate additional capital through retention of profit over time, which may be increased by: income growth and cost cutting; raising new equity via, for example, a rights issue; reducing or cancelling distributions on capital instruments; and raising AT1 and Tier 2 capital. The availability and cost of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demands for capital through management actions including adjusting lending strategy.

Capital optimisation remains a key strategic priority of the Group. Work is progressing to ensure that the approach to models and IRB portfolios supports the overall strategy and delivers robust outcomes for the management of risks.

Monitoring
The capital plan is approved by the Board annually, and ALCO monitors the actual and forecast position monthly. This ensures that performance trends are reviewed and that there is transparency of the impact on capital ratios, risk appetite and the future outlook.

Capital position
The Group's capital position as at 30 September 2020 is summarised below:

Regulatory capital (unaudited)[1]	2020 £m	2019 £m
Statutory total equity	**4,932**	5,021
CET1 capital: regulatory adjustments[2]		
AT1 capital instruments	**(915)**	(915)
Defined benefit pension fund assets	**(470)**	(257)
Prudent valuation adjustment	**(6)**	(5)
Intangible assets	**(477)**	(501)
Goodwill	**(11)**	(11)
Deferred tax asset relying on future profitability	**(151)**	(146)
Cash flow hedge reserve	**80**	26
Excess expected losses	**–**	(88)
AT1 coupon accrual	**(21)**	(20)
IFRS 9 transitional adjustments	**310**	100
Total regulatory adjustments to CET1	**(1,661)**	(1,817)
Total CET1 capital	**3,271**	3,204
AT1 capital		
AT1 capital instruments	**915**	915
Total AT1 capital	**915**	915
Total Tier 1 capital	**4,186**	4,119
Tier 2 capital		
Subordinated debt	**749**	721
Total Tier 2 capital	**749**	721
Total regulatory capital	**4,935**	4,840

(1) This table shows the capital position on a CRD IV 'fully loaded' basis and transitional IFRS 9 basis.

(2) A number of regulatory adjustments to CET1 capital are required under CRD IV regulatory capital rules.

Financial risk

Regulatory capital flow of funds (unaudited)[1]	CRD IV 2020 £m	CRD IV 2019 £m
CET1 capital[2]		
CET1 capital at 1 October	**3,204**	2,113
Share capital and share premium	**1**	3
Retained earnings and other reserves (including special purpose entities)	**(91)**	(210)
Acquisition of Virgin Money Holdings (UK) PLC	**–**	1,567
Prudent valuation adjustment	**(1)**	(2)
Intangible assets	**24**	(89)
Goodwill	**–**	(11)
Deferred tax asset relying on future profitability	**(5)**	(47)
Defined benefit pension fund assets	**(213)**	(119)
Cash flow hedge reserve	**54**	(13)
Excess expected losses	**88**	(88)
IFRS 9 transitional relief	**210**	100
Total CET1 capital at 30 September	**3,271**	3,204
AT1 capital		
AT1 capital at 1 October	**915**	450
AT1 capital issued and transferred from Virgin Money Holdings (UK) PLC	**–**	465
Total AT1 capital at 30 September	**915**	915
Total Tier 1 capital at 30 September	**4,186**	4,119
Tier 2 capital		
Tier 2 capital at 1 October	**721**	626
Credit risk adjustments[3]	**–**	(152)
Capital instruments issued: subordinated debt	**472**	247
Capital instruments purchased: subordinated debt	**(444)**	–
Tier 2 capital at 30 September	**749**	721
Total capital at 30 September	**4,935**	4,840

(1) The table shows the capital position on a CRD IV ‘fully loaded’ basis and transitional IFRS 9 basis.
(2) CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
(3) The transition to IFRS 9 reporting has removed the requirement for Tier 2 credit risk adjustments.

The Group's CET1 capital increased by £67m in the year, primarily driven by regulatory adjustments for expected losses (ELs) and transitional relief of £298m, offset by the loss for the year of £141m and AT1 distributions of £79m.

During the year, there were also increases in Tier 2 capital. The Group issued an additional £475m of Tier 2 capital in September 2020 in the form of Fixed Rate Reset Callable Tier 2 Notes due 2030. In addition, during the year the Group purchased £445m of Fixed Reset Callable Subordinated Tier 2 Notes due 2026. The balances do not agree directly to the regulatory capital flow of funds statement above due to differences between the accounting and regulatory carrying values.

Minimum Pillar 1 capital requirements (unaudited)	2020 £m	2019 £m
Credit risk	**1,720**	1,685
Operational risk	**205**	209
Counterparty credit risk	**14**	15
Credit valuation adjustment	**14**	15
Total Pillar 1 regulatory capital requirements	**1,953**	1,924

RWA movements (unaudited)

	12 months to 30 September 2020					12 months to 30 September 2019(1)				
RWA flow statement	IRB RWA £m	STD RWA £m	Other RWA £m	Total £m	Capital required £m	IRB RWA £m	STD RWA £m	Other RWA £m	Total £m	Capital required £m
RWA at 1 October	**15,104**	**5,953**	**2,989**	**24,046**	**1,924**	–	18,104	1,998	20,102	1,608
Asset size	**(48)**	**187**	**–**	**139**	**11**	183	531	10	724	58
Asset quality	**464**	**(65)**	**–**	**399**	**33**	484	(61)	–	423	34
Model updates(2)	**149**	**–**	**–**	**149**	**12**	(396)	–	–	(396)	(32)
Methodology and policy	**(287)**	**(48)**	**–**	**(335)**	**(27)**	250	–	–	250	20
Acquisitions and disposals	**–**	**–**	**–**	**–**	**–**	4,330	2,870	962	8,162	654
IRB accreditation	**457**	**(473)**	**–**	**(16)**	**(1)**	10,247	(15,592)	–	(5,345)	(428)
Other(3)	**7**	**88**	**(78)**	**17**	**1**	6	101	19	126	10
RWA at 30 September	**15,846**	**5,642**	**2,911**	**24,399**	**1,953**	15,104	5,953	2,989	24,046	1,924

(1) The comparative has been restated in line with current year presentation following a change in flow logic.

(2) Model updates include the mortgage quarterly PD calibrations.

(3) 'Other' includes operational risk, CVA and counterparty credit risk.

Methodology and policy movements have been driven primarily by SME Supporting Factor changes, which were implemented by the CRR Quick Fix package and took effect from 27 June 2020, resulting in a £695m reduction in RWA. The other material change is the inclusion of a new mortgage LGD model, approved by the regulator and deployed into the heritage Virgin Money rating system in March 2020. This resulted in an uplift of £511m in RWA due to increased risk sensitivity and improved downturn estimation.

Of the remaining reduction of £151m, £94m relates to the recognition of eligible collateral in relation to the asset finance and invoice finance portfolios, following approval by the PRA. In addition, there was a £68m reduction due to a change in the credit conversion factor applied to personal current accounts and business credit cards.

IRB accreditation movements were driven by PRA approval received in March 2020 to move the specialised lending portfolio from the standardised approach to IRB slotting. This was first reported in June 2020.

Financial risk

Pillar 1 RWA and capital requirements by business line (unaudited)

	At 30 September 2020			At 30 September 2019		
Capital requirements for calculating RWA	Capital required £m	RWA £m	Exposure £m	Capital required £m	RWA £m	Exposure £m
Corporates	**509**	**6,362**	**9,468**	501	6,258	8,587
Retail	**759**	**9,484**	**62,683**	708	8,846	64,067
Total IRB approach	**1,268**	**15,846**	**72,151**	1,209	15,104	72,654
Central governments or central banks	**–**	**–**	**12,264**	1	9	11,663
Regional governments or local authorities	**1**	**13**	**219**	1	13	175
Public sector entities	**–**	**5**	**409**	–	5	335
Multilateral development banks	**–**	**–**	**1,268**	–	–	1,034
Financial institutions	**15**	**186**	**898**	16	195	948
Corporates	**17**	**210**	**233**	28	347	376
Retail	**327**	**4,090**	**5,453**	319	3,993	5,324
Secured by mortgages on immovable property	**12**	**144**	**433**	40	498	875
Exposures in default	**5**	**62**	**58**	5	59	55
Collective investments undertakings	**–**	**–**	**–**	–	1	1
Equity exposures	**1**	**14**	**13**	1	11	9
Items associated with particularly high risk	**–**	**–**	**–**	1	11	7
Covered bonds	**12**	**144**	**1,442**	11	141	1,415
Other items	**62**	**774**	**746**	53	670	754
Total standardised approach	**452**	**5,642**	**23,436**	476	5,953	22,971
Total credit risk	**1,720**	**21,488**	**95,587**	1,685	21,057	95,625
Operational risk	**205**	**2,557**	**–**	209	2,606	
Counterparty credit risk	**14**	**179**	**–**	15	191	
Credit valuation adjustment	**14**	**175**	**–**	15	192	
Total Pillar 1 regulatory capital requirements	**1,953**	**24,399**	**–**	1,924	24,046	

Financial risk

The exposure amounts disclosed in the Pillar 1 RWA and capital requirements by business line table are post-credit conversion factors and pre-credit mitigation.

Additional breakdown analysis of the IRB portfolios can be seen within the 'EU CR6 – IRB Approach – Credit risk by exposure class and PD range' table in the Group's Pillar 3 disclosures.

Capital position and CET1 (unaudited)	2020 £m	2019 £m
RWA[1]		
Retail mortgages	**9,484**	8,846
Business lending	**6,716**	7,124
Other retail lending	**4,151**	4,042
Other lending	**343**	481
Other[2]	**794**	564
Total credit risk	**21,488**	21,057
Operational risk	**2,557**	2,606
Counterparty credit risk	**179**	191
Credit valuation adjustment	**175**	192
Total RWA	**24,399**	24,046

(1) RWA are calculated under the AIRB approach for the mortgage portfolio and the FIRB approach for the business portfolio. In March 2020, the Group received approval to move the specialised lending portfolio from a standardised approach to IRB slotting, with this change first being reported in June 2020. All other portfolios are calculated under the standardised approach, via either sequential IRB implementation or Permanent Partial Use.

(2) The items included in the Other exposure class that attract a capital charge include items in the course of collection, fixed assets, prepayments, other debtors and deferred tax assets that are not deducted.

IFRS 9 transitional arrangements (unaudited)

This table shows a comparison of capital resources, requirements and ratios with and without the application of transitional arrangements for IFRS 9.

	30 September 2020 (£m)	
Available capital (amounts)[1]	IFRS 9 Transitional basis	IFRS 9 Fully loaded basis
CET1 capital	**3,271**	**2,961**
Tier 1 capital	**4,186**	**3,876**
Total capital	**4,935**	**4,720**
RWA (amounts)		
Total RWA	**24,399**	**24,246**
Capital ratios		
CET1 (as a percentage of RWA)	**13.4%**	**12.2%**
Tier 1 (as a percentage of RWA)	**17.2%**	**16.0%**
Total capital (as a percentage of RWA)	**20.2%**	**19.5%**
Leverage ratio		
Leverage ratio total exposure measure	**86,490**	**86,181**
Leverage ratio	**4.8%**	**4.5%**

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

The adoption of IFRS 9 by the Group on 1 October 2018 resulted in an increase in credit impairment losses, due to the move from an incurred loss to an ECL methodology. The CRR includes transitional arrangements, which allow for the regulatory capital impact of these higher losses to be phased in over a five year period from adoption. The table above presents the Group's key capital metrics, as reported (i.e. including transitional relief), and on a fully loaded basis (with no transitional relief).

The CRR Quick Fix amendments package, which applies from 27 June 2020, introduced changes to provide additional relief from the economic impacts of COVID-19. Under this package, relevant provisions raised from 1 January 2020 through to 2021 have a CET1 add-back percentage of 100%, reducing to 75% in 2022, 50% in 2023 and 25% in 2024.

Financial risk

Capital requirements

The Group measures the amount of capital it is required to hold by applying CRD IV as implemented in the UK by the PRA and supplemented through additional regulation under the PRA Rulebook. The table below summarises the amount of capital in relation to RWA the Group is currently required to hold, excluding any PRA buffer.

Minimum requirements (unaudited)	As at 30 September 2020	
	CET1	Total capital
Pillar 1[(1)]	**4.5%**	**8.0%**
Pillar 2A[(2)]	**2.5%**	**4.4%**
Total capital requirement	**7.0%**	**12.4%**
Capital conservation buffer	**2.5%**	**2.5%**
UK countercyclical capital buffer	**0.0%**	**0.0%**
Total (excluding PRA buffer)[(3)]	**9.5%**	**14.9%**

(1) The minimum amount of total capital under Pillar 1 of the regulatory framework is determined as 8% of RWA, of which at least 4.5% of RWA are required to be covered by CET1 capital.

(2) On 7 May 2020, the PRA announced that Pillar 2A capital requirements for banks would be converted from an RWA percentage to a fixed amount. This change was made on the basis that the PRA does not believe that RWA are a good approximation for the evolution of the risks captured in Pillar 2A in a stress.

(3) 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; and

– a buffer relating to the results of the BoE stress tests.

The Group continues to maintain a significant buffer of 3.9% (equivalent to £950m) over its CRD IV minimum CET1 requirement of 9.5%.

The Group's total capital Pillar 2A requirement has reduced from 5.3% at September 2019 to 4.4% at September 2020 following revisions made by the PRA during the year.

The regulatory capital buffer framework is intended to ensure firms maintain a sufficient amount of capital above their regulatory minimum in order to withstand periods of stress. The UK has implemented the provisions on capital buffers outlined in the CRD to create combined capital buffers including a Capital Conservation Buffer (CCB), a Countercyclical Capital Buffer (CCyB), a Global Systemically Important Institution (G-SII) Buffer, and a Systemic Risk Buffer (SRB) for ring-fenced banks. The Group's capital planning process considers the impact of all relevant capital buffers.

The UK CCyB is dependent upon the BoE's view of credit conditions in the economy and may be set between 0% and 2.5%. On 11 March 2020, as part of a package of measures to support the economy from the impact of COVID-19, the Financial Policy Committee (FPC) announced a reduction in the UK CCyB to 0% with immediate effect. The FPC expects to maintain the 0% rate for at least 12 months, so that any subsequent increase would not take effect until March 2022 at the earliest.

Currently, the Group does not meet the criteria for designation as a systemically important institution, or the threshold for systemic risk. Therefore, the Group is not subject to either a G-SII buffer of SRB.

MREL

An analysis of the Group's current MREL position is provided below:

	As at	
	30 Sep 2020	30 Sep 2019
Total capital resources[(1)]	**4,935**	4,840
Eligible senior unsecured securities issued by Virgin Money UK PLC[(2)]	**2,002**	1,550
Total MREL resources	**6,937**	6,390
Risk-weighted assets	**24,399**	24,046
MREL Ratio	**28.4%**	26.6%

(1) This table shows the capital position on a CRD IV 'fully loaded' basis and transitional IFRS 9 basis.

(2) Excludes instruments with less than one year to maturity.

In June 2018, the BoE published its updated approach to setting a MREL. MREL is subject to phased implementation and will be fully implemented from 1 January 2022, at which time the Group's indicative MREL is expected to be two times the sum of its Pillar 1 and Pillar 2A capital requirements, subject to final regulatory guidance. During the transitional period from 1 January 2020 until 31 December 2021, the Group is subject to an interim MREL of 18% of RWAs.

During 2020, the Group issued £0.9bn of debt that contributes to its MREL (£450m senior unsecured term funding and £475m subordinated debt). Combined with previous issuances made over the last few years, the Group's MREL ratio of 28.4% comfortably exceeds its interim MREL and is in line with its expected end-state MREL.

This means future MREL issuance is focused on building a prudent management buffer over the expected end-state MREL.

Dividend

The Board has recommended not to pay a final dividend for the financial year ended 30 September 2020.

Leverage

Leverage ratio (unaudited)	2020 £m	2019 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**3,271**	3,204
AT1 capital	**915**	915
Total Tier 1	**4,186**	4,119
Exposures for the leverage ratio		
Total assets	**90,259**	90,999
Adjustment for off-balance sheet items	**2,892**	2,728
Adjustment for derivative financial instruments	**81**	(35)
Adjustment for securities financing transactions	**2,072**	1,934
Adjustment for qualifying central bank claims	**(8,088)**	–
Other adjustments	**(726)**	(882)
Leverage ratio exposure	**86,490**	94,744
CRD IV leverage ratio(1)	**4.8%**	4.3%
UK leverage ratio(2)	**4.9%**	4.9%
Average UK leverage ratio exposure	**85,713**	n/a
Average UK leverage ratio(3)	**4.6%**	n/a

(1) IFRS 9 transitional capital arrangements have been applied to the leverage ratio calculation.
(2) The Group's leverage ratio on a modified basis, excluding qualifying central bank claims and loans under the UK BBLS from the exposure measure.
(3) The fully loaded average leverage exposure measure is based on the daily average of on-balance sheet items and three month-end average of off-balance sheet items. The average leverage ratio is based on the average of the month-end Tier 1 capital position. Under the UK leverage ratio framework, the Group was only required to start reporting average balances from December 2019.

The UK leverage ratio framework, which came into force on 1 January 2016, is relevant to PRA regulated banks and building societies with consolidated retail deposits equal to or greater than £50bn. The reporting date from which the Group met this threshold was 31 December 2019 and as a result, the average UK leverage ratio exposure and average UK leverage ratio are disclosed in the Group's Annual Report & Accounts for the first time.

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

The leverage ratio is the ratio of Tier 1 capital to total exposures, defined as:

- capital: Tier 1 capital defined on a CRD IV fully loaded and IFRS 9 transitional basis; and
- exposures: total on- and off-balance sheet exposures (subject to credit conversion factors) as defined in the delegated act amending CRR article 429 (Calculation of the Leverage Ratio), which includes deductions applied to Tier 1 capital.

Other regulatory adjustments consist of adjustments that are required under CRD IV to be deducted from Tier 1 capital. The removal of these from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

On 4 May 2020, the PRA published a modification by consent for banks subject to the UK Leverage Ratio Part of the PRA Rulebook to exclude loans under the BBLS from the leverage ratio total exposure measure. Bounce back loans have therefore been excluded from the UK leverage exposure value used in the leverage ratio calculation.

The Group's CRD IV leverage ratio of 4.8% (30 September 2019: 4.3%) exceeds the Basel Committee's proposed minimum of 3% and the Group's UK leverage ratio of 4.9% (30 September 2019: 4.9%) exceeds the UK minimum ratio of 3.25%.

Following the FPC announcement on 11 March 2020 to reduce the Group's CCyB rate to 0%, the leverage ratio buffer also reduced to 0%.

On 14 November 2018, the PRA published a policy statement – 'UK leverage ratio: Applying the framework to systemic ring-fenced bodies and reflecting the systemic risk buffer,' confirming that from 1 January 2019 the UK leverage ratio framework will apply on a sub-consolidated basis to ring-fenced bodies in scope.

Financial risk

Funding and liquidity risk

Funding risk occurs where the Group is unable to raise or maintain funds of sufficient quantity and quality to support the delivery of the business plan or sustain lending commitments. Prudent funding risk management reduces the likelihood of liquidity risks occurring, increases the stability of funding sources, minimises concentration risks and controls future balance sheet growth.

Liquidity risk occurs when the Group is unable to meet its current and future financial obligations as they fall due or at acceptable cost, or when the Group reduces liquidity resources below internal or regulatory stress requirements.

Exposures

The Group is predominantly funded by personal and business customers. Customer funding is augmented by the Group's ongoing wholesale funding programmes, medium-term secured funding issuance (e.g. the Group's securitisation programme), regulated covered bonds and unsecured medium-term notes. The Group also has access to the BoE TFS.

Funding risk exposures arise from an unsustainable or undiversified funding base, for example, a reliance on short-term wholesale deposits. The risk may result in deviation from funding strategy, requiring funding to be originated rapidly at excessive cost, or require a reduction in lending growth, which are outcomes that may adversely affect customers or shareholders.

The Group's primary liquidity risk exposure arises through the redemption of retail deposits where customers have the ability to withdraw funds with limited or no notice. Exposure also arises from the refinancing of customer and wholesale funding at maturity and the ability to fund new and existing committed lending obligations including mortgage pipeline and credit card facilities.

Measurement

Funding and liquidity risks are subject to a range of measures contained within the Group's RAS and a series of limits agreed by ALCO. These measures provide a short-and long-term view of risks under both normal and stressed conditions. The measures focus on: cash outflows and inflows under stress; concentration risks; refinancing risks; asset encumbrance; and readiness of mitigating actions.

The Group's funding plan establishes an acceptable level of funding risk which is approved by the Board and is consistent with risk appetite and the Group's strategic objectives. The development of the Group's funding plan is informed by the requirements of the Group's financial risk policy standards. A series of metrics is used across the Group to measure risk exposures, including funding ratios, limits to concentration risk and maximum levels of encumbrance.

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. The volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The High-Quality Liquid Asset (HQLA) requirement is quantified as the outflow of funds under a series of stress scenarios less the impact of inflows from assets. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market-wide stresses. Liquidity within the Group is managed in accordance with the ILAAP, which is approved by the Board.

The Treasury function is responsible for the development and execution of strategy subject to oversight from the Risk function. In relation to funding and liquidity risk, the primary management committee is the ALCO. 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.

Monitoring

Liquidity is actively monitored by the Group, with reporting conducted through ALCO and the Executive Risk Committee. In a stress situation or in adverse conditions, the level of monitoring and reporting is increased commensurate with the nature of the stress event, as demonstrated in response to COVID-19.

Monitoring and control processes are in place against internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a routine basis for early signs of liquidity risk in the market or specific to the Group. These indicators cover a mixture of quantitative and qualitative measures including daily variation of customer balances, measurement against stress requirements and monitoring of the macroeconomic environment.

Mitigation

The Group holds a portfolio of HQLA that can be utilised to raise funding in times of stress. The size of the HQLA portfolio is calibrated based on a view of potential outflows under both systemic and idiosyncratic stress events. In addition, the Group can use the repo market to generate funds and can also participate in BoE operations through the Sterling Monetary Framework (SMF). The Group has several sources of funding which are well-diversified in terms of the type of instrument and product, counterparty, term structure and market. In addition to customer funding, wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify funding sources. These funding programmes are a source of strength for the Group and leverage the Group's high-quality mortgage book as collateral for secured funding.

As a participant in the BoE SMF, the Group has access to funding via the TFS. Following its launch in April 2020, the Group has also been able to access additional funding from TFSME, which was established to provide cost-effective funds to banks to support additional lending to the real economy and incentivise lending to SMEs during a period of economic disruption caused by COVID-19.

The funding plan includes an assessment of the Group's capacity for raising funds from its primary sources, thereby mitigating funding risk. Refinancing risks are carefully managed and are subject to controls overseen by ALCO. The Group's funding plan includes embedded TFS and TFSME repayment profiles designed to manage refinancing risk.

The Group recovery plan has been established for management of an escalated liquidity requirement, if the Group experiences either restricted access to wholesale funding or a significant increase in the withdrawal of funds. The plan identifies triggers for escalation, assesses capacity, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

The Group operates a Funds Transfer Pricing system. A key purpose of Funds Transfer Pricing is to ensure that liquidity risk is a factor in the pricing of loans and deposits.

Financial risk

Sources of funding

The table below provides an overview of the Group's sources of funding as at 30 September 2020.

	2020 (audited) £m	2019 (audited) £m
Total assets	**90,259**	90,999
Less: other liabilities(1)	**(3,390)**	(3,471)
Funding requirement	**86,869**	87,528
Funded by:		
Customer deposits	**67,710**	64,000
Debt securities in issue	**8,758**	9,591
Due to other banks	**5,469**	8,916
of which:		
Secured loans	**5,397**	7,308
Securities sold under agreements to repurchase	**–**	1,554
Transaction balances with other banks	**15**	12
Deposits with other banks	**57**	42
Equity	**4,932**	5,021
Total funding	**86,869**	87,528

(1) Other liabilities includes customer deposits at fair value through profit or loss, derivative financial instruments, deferred tax liabilities, provisions for liabilities and charges, and other liabilities as per the balance sheet line item.

The Group's funding objective is to prudently manage the sources and tenor of funds in order to provide a sound base from which to support sustainable customer growth. At 30 September 2020, the Group had a funding requirement of £86,869m (2019: £87,528m) with the majority being used to support loans and advances to customers. The Group's funding mix did not materially change throughout the year and continues to be predominantly retail funded. During the year, the Group has been active in the securitisation and senior debt markets.

Customer deposits

The majority of the Group's funding requirement was met by customer deposits of £67,710m (2019: £64,000m). Customer deposits comprise interest bearing deposits, term deposits and non-interest bearing demand deposits from a range of sources including personal and business customers. The increase of £3,710m during the year demonstrates the impact of COVID-19, as societal restrictions coupled with a fall in UK consumer confidence linked to the recessionary environment have driven increases in customer deposits within current accounts and easy access saving products.

Equity

Equity of £4,932m (2019: £5,021m) was also used to meet the Group's funding requirement. Equity comprises ordinary share capital, retained earnings, other equity investments and a number of other reserves. For full details on equity refer to note 4.1 within the consolidated financial statements.

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 LCR moved from 152% to 140% during the year and remains comfortably above regulatory and internal risk appetite. The management of liquidity resources throughout the year recognises the reduced risk exposure from transformation activities and increased availability of contingent funding through the BoE TFSME.

Liquidity coverage ratio	2020 (audited) £m	2019 (audited) £m
Eligible liquidity buffer	**10,675**	11,243
Net stress outflows	**7,609**	7,409
Surplus	**3,066**	3,834
Liquidity coverage ratio	**140%**	152%

Financial risk

The liquid asset portfolio provides a buffer against sudden and potentially sharp outflows of funds. Liquid assets must therefore be 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).

The volume and quality of the Group's liquid asset portfolio is considered through a series of internal stress tests across a range of time horizons and stress conditions, including most recently the Group's view of liquidity risk due to impacts of COVID-19 and the UK's withdrawal from the EU. The Group ensures a liquidity surplus is held, during normal market conditions, above the most severe of these scenarios. Stress cash outflow assumptions have been established for individual liquidity risk drivers and are approved annually by the Board as part of the ILAAP.

The key risk driver assumptions applied to the scenarios are:

Liquidity Risk Driver	Internal Stress Assumption
Retail funding	Severe unexpected withdrawal of retail deposits by customers arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments. Lending outflows, over and above contractual obligations, are honoured as the Group preserves ongoing division viability.
Intra-day	Other participants in the payment system withhold or delay payments or customers increase transactions resulting in reduced liquidity.
Liquid assets	The liquidity portfolio value is reduced, reflecting stressed market conditions.

The Group monitors the movements in its credit ratings and the related requirement to post collateral for payment systems and clearing houses. These figures are not considered material compared to the volume of unencumbered liquid assets.

As at 30 September 2020, the Group held eligible liquid assets well in excess of 100% of net stress outflows, as defined through internal risk appetite.

Liquid asset portfolio(1)	2020 (audited) £m	2019 (audited) £m	Change (audited) %	Average 2020 (audited) £m	Average 2019 (audited) £m
Level 1					
Cash and balances with central banks	**6,255**	7,469	(16%)	**6,430**	7,266
UK government treasury bills and gilts	**1,232**	1,076	14%	**1,301**	870
Other debt securities	**3,262**	2,867	14%	**3,186**	2,604
Total level 1	**10,749**	11,412	(6%)	**10,917**	10,740
Level 2(2)	**29**	29	–	**33**	103
Total LCR eligible assets	**10,778**	11,441	(6%)	**10,950**	10,843

(1) Excludes encumbered assets.

(2) Includes Level 2A and Level 2B.

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.

Further information can be found in notes 3.4 (cash and balances with central banks) and 3.7 (FVOCI) to the consolidated financial statements.

Cash and balances with central banks of £9,107m, as per note 3.4, includes: £2,572m of assets that are encumbered to support the issuance of Scottish bank notes (excluding notes not in circulation) and to support payments systems; £220m of mandatory central bank deposits; and £61m excluded from LCR to cover operating expenses.

Financial assets at FVOCI of £5,080m, as per note 3.7, include: £826m of encumbered UK government treasury bills and gilts, £312m of which is encumbered to support Operational Continuity in Resolution and £513m of which is encumbered to support structured funding programmes.

The CRR II amendments to the CRR will introduce a binding net stable funding ratio (NSFR) requirement from 28 June 2021. Based on current interpretations of European regulatory requirements and guidance, the ratio as at 30 September 2020 is 131% (2019: 128%).

Encumbered assets by asset category

The Group manages the level of asset encumbrance to ensure appropriate assets are maintained to support potential future planned and stressed funding requirements. Encumbrance limits are set in the Group RAS and calibrated to ensure that after a stress scenario is applied that increases asset encumbrance, the balance sheet can recover over an acceptable period of time. Examples of reasons for asset encumbrance include, among others, supporting the Group's secured funding programmes to provide stable term funding to the Group, the posting of assets in respect of drawings under the TFS, use of assets as collateral for payments systems in order to support customer transactional activity, and providing security for the Group's issuance of Scottish bank notes.

Encumbered assets by asset category (audited)

	Assets encumbered with non-central bank counterparties				Other assets					
						Assets not positioned at the central bank				
September 2020	Covered bonds £m	Securi-tisations £m	Other £m	Total £m	Positioned at the central bank (including encumbered) £m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total £m
Loans and advances to customers	**2,551**	**7,253**	**–**	**9,804**	**15,604**	**26,736**	**17,406**	**3,070**	**62,816**	**72,620**
Cash and balances with central banks	**–**	**–**	**–**	**–**	**2,994**	**6,113**	**–**	**–**	**9,107**	**9,107**
Due from other banks	**337**	**424**	**93**	**854**	**–**	**–**	**73**	**–**	**73**	**927**
Derivative financial instruments	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**318**	**318**	**318**
Financial instruments at fair value through other comprehensive income	**–**	**–**	**826**	**826**	**–**	**4,254**	**–**	**–**	**4,254**	**5,080**
Other assets	**–**	**–**	**910**	**910**	**–**	**–**	**301**	**996**	**1,297**	**2,207**
Total assets	**2,888**	**7,677**	**1,829**	**12,394**	**18,598**	**37,103**	**17,780**	**4,384**	**77,865**	**90,259**

	Assets encumbered with non-central bank counterparties				Other assets					
						Assets not positioned at the central bank				
September 2019	Covered bonds £m	Securi-tisations £m	Other £m	Total £m	Positioned at the central bank (including encumbered) £m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total £m
Loans and advances to customers	2,896	8,571	–	11,467	19,929	19,933	18,589	3,430	61,881	73,348
Cash and balances with central banks	–	–	–	–	3,219	7,077	–	–	10,296	10,296
Due from other banks	156	550	171	877	–	–	131	10	141	1,018
Derivatives financial instruments	–	–	–	–	–	–	–	366	366	366
Financial instruments at fair value through other comprehensive income	41	34	555	630	–	3,697	–	1	3,698	4,328
Other financial assets	–	–	409	409	–	–	173	1,061	1,234	1,643
Total assets	3,093	9,155	1,135	13,383	23,148	30,707	18,893	4,868	77,616	90,999

The Group's total non-central bank asset encumbrance decreased by £989m to £12,394m as at 30 September 2020. This was primarily due to a reduction in RMBS funding partially offset by an increase in derivatives margin requirements. Current levels of encumbrance include the impact of use of Term Funding Schemes which are subject to a repayment profile to manage refinancing risk, and the TFSME scheme launched this year.

Assets and liabilities by maturity

The following tables represent a breakdown of the Group's balance sheet, according to the contractual maturity of the assets and liabilities. Many of the longer-term monetary assets are variable rate products, with behavioural maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk. The Group has disclosed certain term facilities within loans and advances to customers with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

2020 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity(1) £m	Total £m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**785**	**2,058**	**1,820**	**10,880**	**52,460**	**4,427**	**72,430**
Cash and balances with central banks	**7,547**	**–**	**–**	**–**	**–**	**1,560**	**9,107**
Due from other banks	**814**	**113**	**–**	**–**	**–**	**–**	**927**
Financial assets at fair value through profit or loss							
Loans and advances to customers	**–**	**7**	**17**	**61**	**105**	**–**	**190**
Derivative financial instruments	**1**	**9**	**114**	**80**	**114**	**–**	**318**
Other financial assets	**–**	**–**	**–**	**–**	**–**	**13**	**13**
Financial assets at fair value through other comprehensive income	**–**	**732**	**251**	**2,318**	**1,779**	**–**	**5,080**
Other assets	**–**	**32**	**327**	**2**	**1**	**1,832**	**2,194**
Total assets	**9,147**	**2,951**	**2,529**	**13,341**	**54,459**	**7,832**	**90,259**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**44,676**	**4,677**	**11,080**	**7,277**	**–**	**–**	**67,710**
Debt securities in issue	**–**	**385**	**1,261**	**5,407**	**1,705**	**–**	**8,758**
Due to other banks	**68**	**–**	**1,493**	**3,908**	**–**	**–**	**5,469**
Financial liabilities at fair value through profit or loss	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Derivative financial instruments	**1**	**4**	**33**	**76**	**136**	**–**	**250**
Other liabilities	**2,319**	**81**	**89**	**76**	**79**	**496**	**3,140**
Total liabilities	**47,064**	**5,147**	**13,956**	**16,744**	**1,920**	**496**	**85,327**
Off-balance sheet items							
Financial guarantees	**–**	**18**	**15**	**16**	**46**	**–**	**95**
Other credit commitments	**16,775**	**–**	**–**	**–**	**–**	**–**	**16,775**
Total off-balance sheet items	**16,775**	**18**	**15**	**16**	**46**	**–**	**16,870**

(1) The 'no specified maturity' balance within loans and advances to customers relates to credit cards.

Financial risk

2019 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity[1] £m	Total £m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	1,097	1,804	1,738	9,777	54,462	4,217	73,095
Cash and balances with central banks	8,722	–	–	–	–	1,574	10,296
Due from other banks	225	793	–	–	–	–	1,018
Financial assets at fair value through profit or loss							
Loans and advances to customers	–	6	26	96	125	–	253
Derivative financial instruments	–	8	34	226	98	–	366
Other financial assets	–	–	–	–	–	14	14
Financial assets at fair value through other comprehensive income	–	125	784	1,735	1,684	–	4,328
Other assets	–	66	176	–	–	1,387	1,629
Total assets	10,044	2,802	2,758	11,834	56,369	7,192	90,999
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	40,512	5,558	10,168	7,762	–	–	64,000
Debt securities in issue	–	574	1,258	5,168	2,591	–	9,591
Due to other banks	45	1,361	181	7,329	–	–	8,916
Financial liabilities at fair value through profit or loss							
Customer deposits	–	2	2	–	–	–	4
Derivative financial instruments	–	7	14	64	188	–	273
Other liabilities	2,277	78	99	–	–	740	3,194
Total liabilities	42,834	7,580	11,722	20,323	2,779	740	85,978
Off-balance sheet items							
Financial guarantees	–	23	24	18	48	–	113
Other credit commitments	15,158	–	–	–	–	–	15,158
Total off-balance sheet items	15,158	23	24	18	48	–	15,271

(1) The 'no specified maturity' balance within loans and advances to customers relates to credit cards.

Financial risk

Cash flows payable under financial liabilities by contractual maturity

2020 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**44,676**	**4,720**	**11,211**	**7,423**	**–**	**–**	**68,030**
Debt securities in issue	**–**	**423**	**1,380**	**5,919**	**1,693**	**–**	**9,415**
Due to other banks	**68**	**1**	**1,507**	**3,907**	**–**	**–**	**5,483**
Financial liabilities at fair value through profit or loss							
Trading derivative financial instruments	**–**	**32**	**39**	**27**	**24**	**–**	**122**
Hedging derivative liabilities							
Contractual amounts payable	**–**	**5**	**25**	**159**	**48**	**–**	**237**
Contractual amounts receivable	**–**	**–**	**–**	**(79)**	**–**	**–**	**(79)**
Other liabilities	**2,319**	**81**	**89**	**76**	**79**	**496**	**3,140**
Total liabilities	**47,063**	**5,262**	**14,251**	**17,432**	**1,844**	**496**	**86,348**

2019 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	40,512	5,590	10,321	8,014	–	–	64,437
Debt securities in issue	–	602	1,402	5,704	2,611	–	10,319
Due to other banks	45	1,375	240	7,380	–	–	9,040
Financial liabilities at fair value through profit or loss							
Customer deposits	–	2	2	–	–	–	4
Trading derivative financial instruments	–	15	14	36	28	–	93
Hedging derivative liabilities							
Contractual amounts payable	–	7	36	197	619	–	859
Contractual amounts receivable	–	–	(1)	(81)	(532)	–	(614)
All other liabilities	2,277	78	99	–	–	740	3,194
Total liabilities	42,834	7,669	12,113	21,250	2,726	740	87,332

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal and future coupon payments.

The table below shows the residual maturity of the Group’s debt securities in issue.

Analysis of debt securities in issue by residual maturity (unaudited)

	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total 2020	Total 2019
Covered bonds	**–**	**10**	**623**	**1,295**	**1,928**	1,912
Securitisation	**372**	**1,214**	**2,419**	**–**	**4,005**	5,051
Medium term notes	**6**	**7**	**1,645**	**410**	**2,068**	1,897
Subordinated debt	**7**	**30**	**720**	**–**	**757**	731
Total debt securities in issue	**385**	**1,261**	**5,407**	**1,705**	**8,758**	9,591
Of which issued by Virgin Money UK PLC	**13**	**37**	**2,365**	**410**	**2,825**	2,257

Financial risk

External credit ratings

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

Material risk for the Group	Outlook as at	As at	
	30 Sep 2020[(1)]	30 Sep 2020	30 Sep 2019
Virgin Money UK PLC			
Moody's	Stable	Baa3	Baa3
Fitch	Negative	BBB+	BBB+
Standard & Poor's	Negative	BBB-	BBB-
Clydesdale Bank PLC			
Moody's[(2)]	Stable	Baa1	Baa1
Fitch	Negative	A-	A-
Standard & Poor's	Negative	BBB+	BBB+

(1) For detailed background on the latest credit opinion by Standard & Poor and Fitch, please refer to the respective rating agency websites.

(2) Long-term deposit rating.

On 21 October 2019, Fitch and Moody's withdrew the long- and short-term ratings of Virgin Money Holdings (UK) PLC and Virgin Money PLC following completion of the FSMA Part VII transfer.

On 12 November 2019, Moody's changed the outlook on the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC to 'stable' from 'positive'. This followed a revision in Moody's outlook for the UK Sovereign from 'stable' to 'negative', reflecting their view that UK institutions have weakened and the UK's economic and fiscal strength is likely to be weaker going forward. Moody's adjusted the ratings outlook for 15 banks and building societies, including the Group.

On 1 April 2020, Fitch placed the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC on 'rating watch negative', reflecting the downside risks resulting from the economic and financial market implications resulting from COVID-19. On 10 July 2020, Fitch affirmed the ratings of Virgin Money UK PLC and Clydesdale Bank PLC, removed the 'rating watch negative' and changed the outlook to 'negative'. The negative outlook reflects Fitch's view that risks remain clearly tilted to the downside in the medium term but that the Group's ratings are not immediately at risk from the impact of the economic downturn, due mainly to the bank's sufficient capital buffers and sound asset quality metrics at the entry point of the crisis, and relatively large and stable deposit funding.

On 23 April 2020, Standard & Poor's changed the outlook on the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC to 'negative' (from 'stable' and 'positive', respectively), as part of a broader action on the European banking sector. The outlook revisions reflects Standard & Poor's view that the economic stress triggered by COVID-19 is likely to put pressure on the Group's asset quality and earnings and may delay MREL issuance.

As at 24 November 2020, there have been no other changes to the Group's long-term credit ratings or outlooks since the report date.

Market risk

Market risk is the risk of loss associated with adverse changes in the value of assets and liabilities held by the Group as a result of movements in market factors such as foreign exchange risk, interest rates (duration risk), customer behaviour (optionality risk), and the movement in rate spreads across types of assets or liabilities (basis risk and credit spread risk). The Group's balance sheet is predominantly UK based and is denominated in GBP, therefore foreign exchange risk is not a material risk for the Group.

Exposures

The Group's principal exposure comes from structural interest rate risk. It comprises the sensitivity of the Group's current and future NII and economic value to movements in market interest rates. The major contributors to interest rate risk are:

- the mismatch, or duration, between repricing dates of interest bearing assets and liabilities;
- basis risk or assets and liabilities repricing to different reference rates, for example, customer asset and liability products repricing against BoE base rate and Sterling Overnight Index Average (SONIA); and
- customer optionality, e.g. the right to repay borrowing in advance of contractual maturity dates.

The focus of the Group's activity is to provide high-quality banking services to its customers. These services include the provision of foreign exchange products and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in the price on these products, however, these risks are not a material component of the Group's risk profile. Controls include the hedging of these products as and when they arise.

Outlook

The BoE continues to assess the appropriateness of a negative official Bank Rate, alongside other monetary policy tools that are available to support the economy and may consider using negative rates, if it is deemed to be more effective in terms of policy objectives over other tools. To be an effective policy tool, the BoE recognises the need for the financial sector to be operationally ready to implement such a policy step in a way that doesn't adversely affect the safety and soundness of firms and is engaging with firms on this matter, including the Group. This engagement is not indicative that a zero or negative policy rate will be employed, nor is the engagement asking firms to begin taking steps to ensure operational readiness. The BoE has requested information on the impact of a range of outcomes each of which would have different operational considerations and potentially different outcomes in terms of risk, margins and earnings for firms.

Financial risk

Measurement
IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings-based approaches. In accordance with the Group IRRBB policy standard, risk measurement techniques include: basis point sensitivity, NII sensitivity, value at risk (VaR), economic value of equity, interest rate risk stress testing, and scenario analysis.

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

- basis point sensitivity analysis is performed daily and compares the potential impact of a one basis point (0.01%) change on the present value of all future cash flows;
- NII sensitivity assesses changes to earnings over a 12-month time horizon as a result of interest rate movements and changes to customer behaviour;
- VaR is measured on a statistical basis using a 99% confidence level based on daily rate movements over a two year history set with a one day holding period;
- economic value of equity is measured in line with EBA guidance with all eight of the proposed EBA rate shocks assessed on a quarterly basis, including customer optionality stresses. Reporting is performed both including and excluding equity;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- investment term for capital is modelled with a benchmark term agreed by ALCO;
- investment term for core non-interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by ALCO;
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO; and
- credit spread risk in the banking book (CSRBB) is assessed through VaR applied to the Group's liquid asset buffer portfolio. CSRBB is measured at a 99% confidence level based on daily spread movements over a 10-year history set with a three month holding period.

Foreign exchange risk is assessed based on the absolute exposure to each currency.

Mitigation
Market risks are overseen by ALCO with delegation for day-to-day management given to Treasury. Treasury uses a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange. Basis risk may be managed through a combination of wholesale market basis risk management products, pricing strategies and product innovation.

Fair value hedges – the Group hedges part of its existing interest rate risk, resulting from potential movements in the fair value of fixed rate assets and liabilities. The fair value of these swaps is disclosed within note 3.6 to the Group's consolidated financial statements. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges – the Group hedges a portion of the variability in future cash flows attributable to interest rate and foreign currency risk. The interest and foreign currency risks arise from variable interest rate assets and liabilities which are hedged using cross currency and interest rate swaps, and material non-GBP denominated assets which are hedged using foreign exchange forward contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed within note 3.6 to the Group's consolidated financial statements.

Monitoring
Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of ALCO. Oversight of market risk is conducted by the Group's Financial Risk team which is independent of the Treasury function. The Board and Executive Risk Committee, through ALCO's oversight, monitor risk to ensure it remains within approved policy limits and Board requirements.

Value at Risk (audited)

	Duration risk		Credit spread(2)	
12 months to 30 September	2020 £m	2019(1) £m	2020 £m	2019 £m
As at 30 September	**2**	2	**49**	19
Average value during the year	**2**	2	**36**	23
Minimum value during the year	**1**	–	**23**	19
Maximum value during the year	**2**	2	**49**	26

(1) 2019 duration risk VaR restated from a three-month to a one-day holding period to align to 2020 internal risk methodology.

(2) The history set for credit spread VAR was increased from two years to 10 years from 1 March 2020 under internal methodology driving the year on year increase. The average figures for 2020 include 5 months over a two year history and seven months over a 10 year history.

Financial risk

Market risk linkage to the balance sheet (audited)

The following table shows the Group's principal market risks, linked to the balance sheet assets and liabilities.

	2020 £m	2019 £m	Interest rate duration	Optionality	Basis	Credit spread	Foreign exchange
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**72,430**	73,095	•	•	•		•
Cash and balances with central banks	**9,107**	10,296	•		•		
Due from other banks	**927**	1,018	•		•		•
Financial assets at fair value through profit or loss							
Loans and advances to customers	**190**	253	•	•	•		•
Derivative financial instruments	**318**	366	•		•		•
Other financial assets	**13**	14	•				•
Financial instruments at fair value through other comprehensive income	**5,080**	4,328	•		•	•	•
Other assets	**2,194**	1,629	•				•
Total assets	**90,259**	90,999					
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**67,710**	64,000	•	•	•		•
Debt securities in issue	**8,758**	9,591	•		•		•
Due to other banks	**5,469**	8,916	•		•		•
Financial liabilities at fair value through profit or loss							
Customer deposits	**–**	4	•	•	•		•
Derivative financial instruments	**250**	273	•		•		•
Other liabilities	**3,140**	3,194	•				•
Total liabilities	**85,327**	85,978					

Repricing periods of assets and liabilities by asset/liability category
The following table shows the repricing periods of the Group's assets and liabilities as assessed by the Group. This repricing takes account of behavioural assumptions where material and the Group's policy to hedge capital in accordance with a benchmark term agreed by ALCO. During Q3 2020 the Group shortened the tenor applied to equity and to deposits that are subject to behavioural assumptions.

2020 (unaudited)	Overnight £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Non-interest bearing £m	Total £m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	3,130	14,310	15,101	38,802	1,087	–	72,430
Cash and balances with central banks	7,697	–	–	–	–	1,410	9,107
Due from other banks	167	760	–	–	–	–	927
Financial assets at fair value through profit or loss							
Loans and advances to customers	–	119	10	29	32	–	190
Other financial assets	–	–	–	–	–	318	318
Financial assets at fair value through other comprehensive income	1,017	1,506	150	1,131	1,276	–	5,080
Other assets	–	–	–	–	–	2,207	2,207
Total assets	12,011	16,695	15,261	39,962	2,395	3,935	90,259
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	27,503	22,837	10,201	7,167	2	–	67,710
Debt securities in issue	2,245	2,126	30	2,237	2,120	–	8,758
Due to other banks	5,469	–	–	–	–	–	5,469
Financial liabilities at fair value through profit or loss							
Derivative financial instruments	–	–	–	–	–	250	250
Other liabilities	–	950	–	–	–	2,190	3,140
Equity	4,932	–	–	–	–	–	4,932
Total liabilities and equity	40,149	25,913	10,231	9,404	2,122	2,440	90,259
Notional value of derivatives managing interest rate sensitivity	32,965	6,185	(8,416)	(30,392)	(342)	–	–
Total interest rate gap	4,827	(3,033)	(3,386)	166	(69)	1,495	–
Cumulative interest rate gap	4,827	1,794	(1,592)	(1,426)	(1,495)	–	–

2019 (unaudited)	Overnight £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Non-interest bearing £m	Total £m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	7,475	10,245	13,884	40,122	1,241	128	73,095
Cash and balances with central banks	8,254	572	12	62	–	1,396	10,296
Due from other banks	333	685	–	–	–	–	1,018
Financial assets at fair value through profit or loss							
Loans and advances to customers	–	21	87	145	–	–	253
Derivative financial assets	–	–	–	–	–	366	366
Financial assets at fair value through other comprehensive income	684	1,099	410	836	1,299	–	4,328
Other assets	–	107	80	426	–	1,030	1,643
Total assets	16,746	12,729	14,473	41,591	2,540	2,920	90,999
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	10,353	17,720	12,524	23,401	2	–	64,000
Debt securities in issue	301	5,599	300	1,228	2,163	–	9,591
Due to other banks	2,844	5,922	150	–	–	–	8,916
Financial liabilities at fair value through profit or loss							
Customer deposits	4	–	–	–	–	–	4
Derivative financial instruments	–	–	–	–	–	273	273
Other liabilities	–	48	143	760	–	2,243	3,194
Equity	230	240	719	3,832	–	–	5,021
Total liabilities and equity	13,732	29,529	13,836	29,221	2,165	2,516	90,999
Notional value of derivatives managing interest rate sensitivity	(2,253)	16,185	(800)	(13,149)	17	–	–
Total interest rate gap	761	(615)	(163)	(779)	392	404	–
Cumulative interest rate gap	761	146	(17)	(796)	(404)	–	–

LIBOR replacement

The Group has a LIBOR transition programme to manage the impact of the BoE's plan to discontinue the use of LIBOR as a reference rate after 2021. The work to decommission LIBOR is focused on ceasing the issuance of new LIBOR lending in advance of the end of March 2021 industry deadline, developing and delivering alternative reference rate products, and implementing a back-book migration strategy based on consensual customer agreement and transition before the end of 2021. A similar approach is being taken with new and existing derivatives. All market-facing derivative flows are now executed against SONIA and the strategy to proactively manage the back-book of LIBOR derivatives is underway.

The Group has maintained engagement with the BoE's Working Group on Sterling Risk Free Reference Rates and other industry forums. The programme will ensure that the risks of being unable to offer products with suitable reference rates will be mitigated and that full consideration is given to the potential for any conduct issues that may arise through the transition.

Financial risk

Pension risk

The Group operates a defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the Scheme). Clydesdale Bank PLC (the Bank) is the Scheme's principal employer and there are no other participating employers. The Scheme was closed to future accrual on 1 August 2017 for most members. A small number of members remain on a defined benefit accruals basis subject to certain conditions.

Defined benefit pension schemes provide a promise to pay members a pre-determined level of income at retirement which is independent of the contributions, investments and returns (the scheme assets) used to fund these benefit promises (the scheme liabilities). The operation of a pension scheme gives rise to several risks, for example, movements in equity valuations, changes in bond yields, life expectancy of scheme members, movements in interest and inflation rates and changes in legislation. The Group also supports a defined contribution scheme, however the nature of this type of scheme places the investment and liability risk on the member rather than the Group.

Pension risk is the risk that, at any point in time, the value of the scheme assets is not enough to meet the current or expected future value of the scheme liabilities. This risk will continue to exist until the scheme is formally wound up, either if all the liabilities are transferred to a third party (for example an insurer) or once all individual member benefits have been honoured.

Risk appetite

The Group's pension risk appetite is a component of the Group-wide RAS framework for the management of balance sheet risks and is considered in the context of potential capital impacts as a result of volatility in the Scheme's valuations.

Assets

The Trustee governs investments according to a Statement of Investment Principles. This is reviewed and agreed by the Trustee Board on a regular basis, with the Bank consulted on any proposed changes. The Statement of Investment Principles is drafted in accordance with the requirements of Section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004 and regulations made under it). This sets out the Scheme objectives and the journey plan to meet these objectives.

This results in an appropriate mix of return seeking assets as well as liability matching assets to better match future pension obligations. The split of Scheme assets is shown within note 3.10 to the Group's consolidated financial statements. The fair value of the assets was £4.7bn as at 30 September 2020 (2019: £4.7bn).

Liabilities

The retirement benefit obligations are a series of future cash outflows with relatively long duration and are responsive to movements on many of the inputs including interest rates. On an IAS 19 basis these cash flows are primarily sensitive to changes in the expected long-term price inflation rates (RPI/CPI), the life expectancy of members and the discount rate (linked to yields on AA corporate bonds):

- an increase in long-term expected inflation corresponds to an increase in liabilities;
- an increase in life expectancy corresponds to an increase in liabilities; and
- a decrease in the discount rate corresponds to an increase in liabilities.

Exposure

The Group's defined benefit pension scheme affects its regulatory capital in two ways:

- CET1 capital – while an IAS 19 surplus will increase the Group's balance sheet assets and reserves, any such amount is not recognised for the purposes of determining CET1 capital. However, an IAS 19 deficit, which increases balance sheet liabilities and reduces reserves, is recognised for regulatory capital purposes, and so will decrease CET1 capital.
- Pillar 2A capital – the Group is also required to determine the level of capital required to be held under Pillar 2A for pension obligation risk as part of the annual ICAAP process. This requirement forms part of the Group's regulatory Total Capital Requirement.

Within the Scheme itself, risk arises because the assets (e.g. equities, bonds/gilts, property) are exposed to market valuation movements, within and between asset classes, while the liabilities are more sensitive to interest rate and inflation rate changes, and changes in other actuarial assumptions which may not be borne out in experience, for example life expectancy.

Mitigation

The Trustee and Group have a common view of the Scheme's long-term strategic aims, encapsulated by an agreed de-risking journey plan. Within the journey plan, several core principles have been established, including a long-term self-sufficiency funding target (i.e. the point in time when the Scheme would no longer need to call on the Bank for additional funding) with assumptions as to how this target is expected to be managed, monitored and met. Potential actions to address deviations in the actual funding level relative to the journey plan have also been considered.

Several other activities have been implemented by the Group and Trustee with the specific aim of reducing risk in the Scheme, including equity options which reduce the downside risk of a fall in equity values, increasing the levels of inflation, interest rate hedging and several member benefit reforms, culminating in closure to future accrual for most members.

In addition, the Group has signed a contingent security arrangement to give the Trustee a degree of protection against the risk of the Group defaulting on its obligations under the Recovery Plan and to provide an additional amount to partially mitigate adverse changes impacting the Scheme's assets or liabilities. Further information is shown within note 3.10 to the Group's consolidated financial statements.

The Bank and the Trustee continue to explore other cost-effective options to further reduce risk within the Scheme.

Monitoring

Information on the Scheme's current valuations, asset holdings and discount and inflation rate assumptions are presented monthly to ALCO. The impact of the Scheme on the Group is also subject to risk oversight from the Risk function. In addition, semi-annual pension risk updates are provided to the Executive and Board Risk Committees.

Performance of the Scheme's asset portfolio against the various risk metrics is independently monitored by the Scheme investment adviser, Willis Towers Watson, and reported to the Investment Sub Committee (ISC), which includes Group representation, and Trustee Board on a quarterly basis.

Directors' responsibility statement in respect of the Annual Report & Accounts

The responsibility statement below has been prepared in connection with the Company's full Annual Report & Accounts for the year ending 30 September 2020. Certain parts thereof are not included within this announcement.

The Directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group and the undertakings included in the consolidation taken as a whole; and
- the Strategic report includes a fair review of the development and performance of the business and the position of the Company and the Group, together with a description of the principal risks and uncertainties that they face.

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

David Duffy
Chief Executive Officer
24 November 2020

Consolidated income statement

For the year ended 30 September	Note	2020 £m	2019[(1)] £m
Interest income		**2,129**	2,420
Other similar interest		**8**	13
Interest expense and similar charges		**(854)**	(919)
Net interest income	2.2	**1,283**	1,514
Gains less losses on financial instruments at fair value		**(11)**	(17)
Other operating income		**171**	252
Non-interest income	2.3	**160**	235
Total operating income		**1,443**	1,749
Operating and administrative expenses before impairment losses	2.4	**(1,104)**	(1,729)
Operating profit before impairment losses		**339**	20
Impairment losses on credit exposures	3.2	**(507)**	(252)
Loss on ordinary activities before tax		**(168)**	(232)
Tax credit	2.5	**27**	53
Loss for the year		**(141)**	(179)
Attributable to:			
Ordinary shareholders		**(220)**	(253)
Other equity holders		**79**	41
Non-controlling interests		**–**	33
Loss for the year		**(141)**	(179)
Basic loss per share (pence)	2.6	**(15.3)**	(17.9)
Diluted loss per share (pence)	2.6	**(15.3)**	(17.9)

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

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

The notes on pages 76 to 126 form an integral part of these financial statements.

Consolidated statement of comprehensive income

For the year ended 30 September	Note	2020 £m	2019[1] £m
Loss for the year		**(141)**	(179)
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
(Losses)/gains during the year		**(133)**	73
Transfers to the income statement		**60**	(57)
Taxation thereon – deferred tax credit/(charge)		**20**	(9)
Taxation thereon – current tax (charge)/credit		**(1)**	6
		(54)	13
Change in fair value through other comprehensive income reserve			
Gains during the year		**15**	13
Transfers to the income statement		**(16)**	(4)
Taxation thereon – deferred tax credit/(charge)		**1**	(2)
		–	7
Total items that may be reclassified to the income statement		**(54)**	20
Items that will not be reclassified to the income statement			
Change in asset revaluation reserve		**–**	–
Taxation thereon – deferred tax charge		**–**	(1)
Change in defined benefit pension plan	3.10	**292**	110
Taxation thereon – deferred tax charge		**(117)**	(56)
Taxation thereon – current tax credit		**9**	7
		184	61
Total items that will not be reclassified to the income statement		**184**	60
Other comprehensive income, net of tax		**130**	80
Total comprehensive losses for the year, net of tax		**(11)**	(99)
Attributable to:			
Ordinary shareholders		**(90)**	(173)
Other equity holders		**79**	41
Non-controlling interests		**–**	33
Total comprehensive losses for the year, net of tax		**(11)**	(99)

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

The notes on pages 76 to 126 form an integral part of these financial statements.

Consolidated balance sheet

As at 30 September	Note	2020 £m	2019 £m
Assets			
Financial assets at amortised cost			
Loans and advances to customers	3.1	**72,430**	73,095
Cash and balances with central banks	3.4	**9,107**	10,296
Due from other banks		**927**	1,018
Financial assets at fair value through profit or loss			
Loans and advances to customers	3.5	**190**	253
Derivative financial instruments	3.6	**318**	366
Other financial assets	3.5	**13**	14
Financial assets at fair value through other comprehensive income	3.7	**5,080**	4,328
Property, plant and equipment		**288**	145
Intangible assets and goodwill	3.8	**491**	516
Current tax assets		**27**	13
Deferred tax assets	3.9	**326**	322
Defined benefit pension assets	3.10	**723**	396
Other assets		**339**	237
Total assets		**90,259**	90,999
Liabilities			
Financial liabilities at amortised cost			
Customer deposits	3.11	**67,710**	64,000
Debt securities in issue	3.12	**8,758**	9,591
Due to other banks	3.13	**5,469**	8,916
Financial liabilities at fair value through profit or loss			
Customer deposits		**–**	4
Derivative financial instruments	3.6	**250**	273
Deferred tax liabilities	3.9	**274**	201
Provisions for liabilities and charges	3.14	**172**	459
Other liabilities	3.15	**2,694**	2,534
Total liabilities		**85,327**	85,978
Equity			
Share capital and share premium	4.1	**147**	146
Other equity instruments	4.1	**915**	915
Capital reorganisation reserve	4.1	**(839)**	(839)
Merger reserve	4.1	**2,128**	2,128
Other reserves	4.1	**(43)**	10
Retained earnings		**2,624**	2,661
Total equity		**4,932**	5,021
Total liabilities and equity		**90,259**	90,999

The notes on pages 76 to 126 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 24 November 2020 and were signed on its behalf by:

David Bennett
Chairman

David Duffy
Chief Executive Officer

Virgin Money UK PLC, Registered number: 09595911

Consolidated statement of changes in equity

					Other reserves								
	Share capital and share premium £m	Capital reorg' reserve £m	Merger reserve £m	Other equity instru-ments £m	Own shares held £m	Deferred shares reserve £m	Equity based comp' reserve £m	Asset reval' reserve £m	FVOCI reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Non control-ling interest £m	Total equity £m
Note	4.1.1	4.1.3	4.1.4	4.1.2	4.1.5	4.1.5	4.1.5		4.1.5	4.1.5		4.1.6	
As at 1 October 2018	89	(839)	633	450	–	–	10	2	4	(39)	2,855	–	3,165
Loss for the year(1)	–	–	–	–	–	–	–	–	–	–	(179)	–	(179)
Other comprehensive (losses)/income, net of tax	–	–	–	–	–	–	–	(1)	7	13	61	–	80
Total comprehensive (losses)/income for the year	–	–	–	–	–	–	–	(1)	7	13	(118)	–	(99)
Acquisition of Virgin Money Holdings (UK) PLC	54	–	1,495	–	(5)	23	–	–	–	–	–	422	1,989
Dividends paid to ordinary shareholders	–	–	–	–	–	–	–	–	–	–	(45)	–	(45)
AT1 distribution paid(1)	–	–	–	–	–	–	–	–	–	–	(41)	–	(41)
Distributions to non-controlling interests(1)	–	–	–	–	–	–	–	–	–	–	(33)	–	(33)
Transfer from equity based compensation reserve	–	–	–	–	–	–	(8)	–	–	–	8	–	–
Equity based compensation expensed	–	–	–	–	–	–	4	–	–	–	–	–	4
Settlement of Virgin Money Holdings (UK) PLC share awards	3	–	–	–	4	(4)	–	–	–	–	1	–	4
AT1 issuance	–	–	–	465	–	–	–	–	–	–	–	–	465
Capital note redemption	–	–	–	–	–	–	–	–	–	–	34	(422)	(388)
As at 30 September 2019	146	(839)	2,128	915	(1)	19	6	1	11	(26)	2,661	–	5,021
Adjustment on adoption of IFRS 16 (net of tax) – note 5.4	–	–	–	–	–	–	–	–	–	–	1	–	1
As at 1 October 2019	146	(839)	2,128	915	(1)	19	6	1	11	(26)	2,662	–	5,022
Loss for the year	–	–	–	–	–	–	–	–	–	–	(141)	–	(141)
Other comprehensive (losses)/income net of tax	–	–	–	–	–	–	–	–	–	(54)	184	–	130
Total comprehensive(losses)/ income for the year	–	–	–	–	–	–	–	–	–	(54)	43	–	(11)
AT1 distribution paid	–	–	–	–	–	–	–	–	–	–	(79)	–	(79)
Ordinary shares issued	1	–	–	–	–	–	–	–	–	–	–	–	1
Transfer from equity based compensation reserve	–	–	–	–	–	–	(6)	–	–	–	6	–	–
Equity based compensation expensed	–	–	–	–	–	–	10	–	–	–	–	–	10
Release of asset revaluation reserve	–	–	–	–	–	–	–	(1)	–	–	–	–	(1)
Settlement of Virgin Money Holdings (UK) PLC share awards	–	–	–	–	1	(3)	–	–	–	–	1	–	(1)
FSMA Part VII transfer	–	–	–	–	–	–	–	–	–	–	(9)	–	(9)
As at 30 September 2020	**147**	**(839)**	**2,128**	**915**	**–**	**16**	**10**	**–**	**11**	**(80)**	**2,624**	**–**	**4,932**

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

The notes on pages 76 to 126 form an integral part of these financial statements.

Consolidated statement of cash flows

For the year ended 30 September	Note	2020 £m	2019[2] £m
Operating activities			
Loss on ordinary activities before tax		**(168)**	(232)
Adjustments for:			
Non-cash or non-operating items included in loss before tax	5.2	**(606)**	(1,035)
Changes in operating assets	5.2	**(75)**	(2,543)
Changes in operating liabilities	5.2	**1,877**	2,630
Payments for short-term and low value leases		**(2)**	–
Interest received		**2,152**	2,320
Interest paid		**(684)**	(745)
Tax paid		**(12)**	(8)
Net cash provided by operating activities		**2,482**	387
Cash flows from investing activities			
Interest received		**35**	27
Cash acquired on acquisition of Virgin Money Holdings (UK) PLC		–	4,663
Proceeds from maturity of financial assets at fair value through other comprehensive income		**1,568**	659
Proceeds from sale of financial assets at fair value through other comprehensive income		**587**	352
Purchase of financial assets at fair value through other comprehensive income		**(2,838)**	(1,647)
Proceeds from sale of 50% (less one share) consideration in Virgin Money Unit Trust Managers Limited		–	45
Purchase of shares issued by Virgin Money Unit Trust Managers Limited		**(2)**	–
Proceeds from sale of property, plant and equipment		**5**	3
Purchase of property, plant and equipment		**(14)**	(20)
Purchase and development of intangible assets		**(78)**	(130)
Net cash (used in)/provided by investing activities		**(737)**	3,952
Cash flows from financing activities			
Interest paid		**(195)**	(81)
Repayment of principal portions of lease liabilities[1]	3.17	**(30)**	–
Proceeds from issuance of other equity instruments		–	247
Repayment of AT1 classified as non-controlling interest		–	(160)
Redemption and principal repayment on RMBS and covered bonds	3.12	**(1,492)**	(2,003)
Redemption and principal repayment on medium-term notes/subordinated debt	3.12	**(745)**	–
Issuance of RMBS and covered bonds	3.12	**491**	2,227
Issuance of medium-term notes/subordinated debt	3.12	**922**	642
Amounts drawn down under the TFSME		**1,300**	–
Amounts repaid under the TFS		**(3,234)**	(1,295)
Ordinary dividends paid		–	(45)
AT1 distributions	4.1.2	**(79)**	(41)
Distributions to non-controlling interests		–	(33)
Net cash used in financing activities		**(3,062)**	(542)
Net (decrease)/increase in cash and cash equivalents		**(1,317)**	3,797
Cash and cash equivalents at the beginning of the year		**11,131**	7,334
Cash and cash equivalents at the end of the year	5.2	**9,814**	11,131

(1) The Group adopted IFRS 16 ‘Leases’ on 1 October 2019. The payment of principal amounts of lease liabilities is now included as a deduction within financing activities whereas previously under IAS 17 ‘Leases’ operating lease charges were included as a deduction within cash flow from operating activities. Interest on lease liabilities is included within interest paid and depreciation on right-of-use assets is included within depreciation.

(2) Cash and cash equivalents has been restated in the comparative year in line with the current year presentation, as detailed in note 1.11.

Consolidated statement of cash flows

Movements in liabilities arising from financing activities

	Term funding schemes £m	Debt securities in issue £m	Lease liabilities[1] £m	Total £m
At 30 September 2019	7,308	9,591	–	16,899
Adjustment on transition to IFRS 16	–	–	205	205
Revised 1 October 2019	7,308	9,591	205	17,104
Cash flows:				
Issuances	–	1,413	–	1,413
Drawdowns	1,300	–	–	1,300
Redemptions	–	(2,237)	–	(2,237)
Repayment	(3,234)	–	(30)	(3,264)
Non-cash flows:				
Fair value adjustments and associated unwind on acquired TFS and debt securities in issue	36	27	–	63
Additions to right-of-use asset in exchange for increased lease liabilities	–	–	2	2
Remeasurement	–	–	(6)	(6)
Movement in accrued interest	(13)	(7)	4	(16)
Unrealised foreign exchange movements	–	(23)	–	(23)
Unamortised costs	–	(6)	–	(6)
At 30 September 2020	**5,397**	**8,758**	**175**	**14,330**

(1) The Group adopted IFRS 16 'Leases' on 1 October 2019. The payment of principal amounts of lease liabilities is now included as a deduction within financing activities whereas previously under IAS 17 'Leases' operating lease charges were included as a deduction within cash flow from operating activities. Interest on lease liabilities is included within interest paid.

The notes on pages 76 to 126 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 which are relevant to the Group, and whether they are effective in 2020 or later years. We explain how these changes are expected to impact the financial position and performance of the Group.

The Group has adopted the UK Finance Code for Financial Reporting Disclosure and has prepared the 2020 Annual Report & Accounts in compliance with the Code.

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 consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU and in accordance with the provisions of the Companies Act 2006.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value through profit or loss and other comprehensive income. 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 Presentation of risk, offsetting and maturity disclosures

Certain disclosures required under IFRS 7 'Financial instruments: disclosures' and IAS 1 'Presentation of financial statements' have been included within the audited sections of the Risk report. Where information is marked as audited, it is incorporated into these financial statements by this cross reference and it is covered by the Independent auditor's report.

1.4 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 in the Group's Annual Report & Accounts. In addition, the Risk report 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 2020, the Directors have considered a number of factors, including the current balance sheet position, the Group's strategic and financial plan, taking account of possible changes in trading performance and funding retention, and stress testing and scenario analysis. The assessment concluded that, for the foreseeable future, the Group has sufficient capital and liquidity for the next 12 months. The Group's capital ratios and its total capital resources are comfortably in excess of PRA requirements and internal stress testing indicates the Group can withstand severe economic and competitive stresses. The Group's MREL ratio at 30 September 2020 comfortably exceeds its interim MREL requirements and is in line with its expected end-state MREL requirements. This means future MREL issuance is focused on building a prudent management buffer over the expected end-state MREL minimum requirement.

As a result of the assessment, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

1.5 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. 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 Group's interests in JV entities are accounted for using the equity method and then assessed for impairment in the relevant holding companies' financial statements.

The consolidated financial statements have been prepared using uniform accounting policies.

Notes to the consolidated financial statements

Section 1: Basis of preparation

1.6 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.

1.7 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 FVTPL or FVOCI 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.

Classification and measurement
The Group measures a financial asset or liability on initial recognition at its fair value, plus or minus transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability (with the exception of financial assets or liabilities at FVTPL, where transaction costs are recognised directly in the income statement as they are incurred).

Financial assets
Subsequent accounting for a financial asset is determined by the classification of the asset depending on the underlying business model and contractual cash flow characteristics. This results in classification within one of the following categories: i) amortised cost; ii) FVTPL; or iii) FVOCI.

A financial asset is measured at amortised cost when: (1) the asset is held within a business model whose objective is achieved by collecting contractual cash flows; and (2) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding. The amortised cost classification applies to the Group's loans and advances to customers (note 3.1), cash and balances from central banks (note 3.4) and balances due from other banks. Financial assets classified at amortised cost are subject to ECL requirements as detailed in note 3.2.

The accounting policies for financial assets at FVTPL and FVOCI are detailed in notes 3.5 and 3.7 respectively.

Financial liabilities
All financial liabilities are measured at amortised cost, except for financial liabilities at FVTPL. Such liabilities include derivatives (other than derivatives that are financial guarantee contracts or are designated and effective hedging instruments) and liabilities designated at FVTPL on initial recognition.

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 offset the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

1.8 Property, plant and equipment

The Group's property, plant and equipment is 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.

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 operating expenses in the income statement.

The Group previously held freehold and long-term leasehold land and buildings at fair value as highlighted in note 1.11.

Notes to the consolidated financial statements

1.9 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. Actual results may differ from those on which management's estimates are based. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. Estimates which are based on future economic conditions, and sensitive to changes in those conditions, have been impacted by COVID-19. This estimation impact has primarily been in the measurement of ECL, EIR and assessing the recoverability of deferred tax balances. Actual results may differ materially from these estimates.

The Group considers the most significant use of accounting estimates and judgements relate to the following areas:

- impairment provisions on credit exposures (note 3.2);
- EIR (note 2.2);
- deferred tax (note 3.9);
- PPI redress provision and other conduct related matters (note 3.14); and
- retirement benefit obligations (note 3.10).

1.10 New accounting standards and interpretations

The Group has adopted a number of International Accounting Standards Board (IASB) pronouncements in the current financial year.

IFRS 16 'Leases'

IFRS 16 'Leases' is effective for financial periods beginning on or after 1 January 2019 and replaces IAS 17 'Leases', IFRIC 4 'Determining whether an Arrangement contains a Lease,' SIC-15 'Operating Leases - Incentives' and SIC-27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease.'

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. The Group's accounting as a lessor is substantially unchanged from the previous approach under IAS 17; however, IFRS 16 resulted in most leases where the Group is a lessee being brought on to the balance sheet under a single lease model, removing the distinction between finance and operating leases. IFRS 16 requires a lessee to recognise a 'right-of-use' asset and a corresponding lease liability at the date on which the leased asset is available for use. Assets and liabilities arising from a lease are initially measured on a present value basis. The accounting policy for leases (note 3.17) has been revised.

As permitted by the new standard, the Group has implemented IFRS 16 using the 'modified retrospective' approach and recognised the cumulative impact of transition as an adjustment through retained earnings. Therefore, the comparative information has not been restated and is presented, as previously reported, under IAS 17 and related interpretations. Adoption of the new standard has had a material impact on the Group's financial statements, with right-of-use assets of £194m recognised on transition together with lease liabilities of £205m. As at 30 September 2020 the right-of-use assets and lease liabilities were £162m and £175m respectively. The right-of-use assets are presented in property, plant and equipment and the liabilities are presented in other liabilities. Further detail on the transitional impact of IFRS 16 can be found in note 5.4.

Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)

Amendments to IFRS 9, IAS 39 and IFRS 7 were issued in September 2019. The amendments are effective for financial years beginning on or after 1 January 2020 (with early adoption permitted) and were endorsed for use in the EU in January 2020. The amendments provide temporary reliefs which enable hedge accounting to continue during the period of uncertainty before the hedged items or hedging instruments affected by the current interest rate benchmarks are amended as a result of the ongoing interest rate benchmark reforms.

The Group exercised the accounting policy choice to continue hedge accounting under IAS 39 on adoption of IFRS 9 in October 2018. The Group has also early adopted the amendments and related disclosure requirements relating to IAS 39 and IFRS 7 with effect from 1 October 2019. Adopting these amendments allows the Group to continue hedge accounting during the period of uncertainty arising from interest rate benchmark reforms. Further detail is provided in note 3.6.

Notes to the consolidated financial statements

Section 1: Basis of preparation

1.10 New accounting standards and interpretations continued

Other accounting standards and interpretations

Except where otherwise stated, the following IASB pronouncements did not have a material impact on the Group's consolidated financial statements:

- IFRIC interpretation 23: 'Uncertainty over Income Tax Treatments' issued in 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', 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'. The amendment to IAS 12 clarifies that the income tax consequences of distributions on financial instruments classified as equity should be recognised alongside the past transactions or events that generated the distributable profits. This means that the taxation impacts of distributions relating to AT1 securities and non-controlling interests are now recognised within tax expense in the income statement as opposed to being recognised directly in retained earnings within equity. The amendment impacts only the presentation of the related taxation and not the calculation, with no change to the Group's net assets but an increase in profit attributable to equity owners. Comparatives have been restated. The adoption of this amendment has resulted in a reduction in tax expense and an increase in profit for the year of £15m (12 months to 30 September 2019: £15m) for the Group and a reduction in tax expense and an increase in profit for the year of £15m (12 months to 30 September 2019: £8m) for the Company;
- amendment to IAS 19: 'Plan amendment, curtailment or settlement' 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
- amendment to IAS 28: 'Long-term Interests in Associates and Joint Ventures' issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendment clarifies that an entity applies IFRS 9 to long-term interests in an associate or JV to which the equity method is not applied but that, in substance, form part of the net investment in the associate or JV (long-term interests).

New accounting standards and interpretations not yet adopted

Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)

Following completion of the second part of the IASB's two-phased project, amendments were issued in August 2020 and are effective for financial years beginning on or after 1 January 2021. The amendments have not yet been endorsed for use by the EU and therefore have not been adopted by the Group.

The amendments address issues that might affect financial reporting as a result of the reform of an interest rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate. The amendments provide practical relief from certain requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 relating to:

- changes in the basis for determining contractual cash flows of financial assets, financial liabilities and lease liabilities; and
- hedge accounting.

On application of the amendments, the Group does not expect any impact on amounts reported for 2020 or prior years.

The IASB has issued a number of other minor amendments to IFRSs that are not mandatory for 30 September 2020 reporting years and have not been early adopted by the Group. These amendments are not expected to have a material impact for the Group.

1.11 Other changes in the year

Freehold and long-term leasehold land and buildings – change in accounting policy

The Group changed its accounting policy with respect to freehold and long-term leasehold land and buildings. The Group now applies the cost model, where these assets are carried at cost less accumulated depreciation and any accumulated impairment. Prior to this change in policy, freehold and long-term leasehold land and buildings were recorded at their fair values. The Group concluded that the cost model provides a more reliable and more meaningful presentation following the adoption of IFRS 16 which introduced a significant property related right-of-use asset, held at cost, on the balance sheet in the year, and also removed the previous distinction between finance and operating leases. The application of the cost model is also standard market practice across the UK banking sector. For these reasons the Group determined it should harmonise the measurement basis for all property related assets to be at cost. This change in accounting policy has not had a material impact on the Group's balance sheet as there has been no difference of significance between the fair value and cost value on freehold and long-term leasehold land and buildings for a number of years. The £1m asset revaluation reserve that existed at 30 September 2019 has been released. Due to the immaterial effect of this change, comparatives have not been restated.

Cash and cash equivalents – change in definition

During the year, the Group has reassessed the individual elements that comprise 'cash and cash equivalents'. This has resulted in a revision to the definition that more closely aligns the Group's internal use of the cash and cash equivalents definition and cash management practices, with the changes resulting in an increase to the cash and cash equivalents balance primarily as a result of the inclusion of amounts due from other banks. The revised definition can be found in the Glossary. Comparative years have been restated to reflect this change in definition, with the balance for the 12 months to 30 September 2019 increasing by £1,012m from £10,119m to £11,131m.

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.

With effect from 1 October 2019, the business has been aligned operationally into three divisions: Mortgages, Personal and Business. However, the business continues to be reported to the Group's Chief Operating Decision Maker as a single segment and decisions made on the performance of the Group on that basis. Segmental information will therefore continue to be presented on this single segment basis until segment reporting has been fully embedded within the Group.

Summary income statement

	2020 £m	2019 £m
Net interest income	**1,283**	1,514
Non-interest income	**160**	235
Total operating income	**1,443**	1,749
Operating and administrative expenses	**(1,104)**	(1,729)
Impairment losses on credit exposures	**(507)**	(252)
Segment loss before tax	**(168)**	(232)
Average interest earning assets	**86,826**	86,362

The Group has no operations outside the UK and therefore no secondary geographical area information is presented. The Group is not reliant on a single customer. Liabilities are managed on a centralised basis.

2.2 Net interest income

Accounting policy

Interest income is recognised 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 gross carrying amount of the non-credit impaired financial asset. Interest expense is recognised in the income statement using the same effective interest method on the amortised cost of the financial liability.

When calculating the EIR, 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 EIR 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 EIR calculation. Fees in relation to the non-utilisation of a commitment are 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 on financial assets in impairment Stages 1 and 2 is recognised on the unwind of the discount from the initial recognition of the ECL using the original EIR. Once a financial asset or group of similar financial assets has been categorised as credit-impaired (Stage 3), interest income is recognised on the net carrying value (after the ECL allowance) using the asset's original EIR. The interest income for POCI financial assets is calculated using the credit-adjusted EIR applied to the amortised cost of the financial asset from initial recognition. The Group recognises and presents the reversal of ECLs following the curing of a credit impaired financial asset as a reversal of impairment losses.

Interest income and interest expense on hedged assets and liabilities and financial assets and liabilities designated as FVTPL are also recognised as part of NII.

Interest income and expense on derivatives economically hedging interest bearing financial assets or liabilities (but not designated as hedging instruments) and other financial assets and liabilities held at FVTPL (either mandatory or by election) are presented within 'Other similar interest'.

Included in interest income is finance lease income which is recognised at a constant periodic rate of return on the net investment.

Notes to the consolidated financial statements

Section 2: Results for the year

2.2 Net interest income continued

Critical accounting estimates and judgements

EIR

The EIR is determined at initial recognition based upon the Group's best estimate of the future cash flows of the financial instrument. In the event these estimates are revised at a later date, a present value adjustment to the carrying value of the EIR asset may be recognised in profit or loss. Such adjustments can introduce income statement volatility and consequently the EIR method introduces a source of estimation uncertainty. The Group considers that material risk of adjustments exists in relation to the application of EIR to the Group's mortgage and credit card portfolios.

Mortgages

The main accounting judgement when assessing the cash flows within the Group's secured lending EIR model is the product life (including assumptions based on observed historic customer behaviour when in a standard variable rate (SVR) period) and the early repayment charge income receivable. The Group currently assumes that 84% of customers will have fully repaid or remortgaged within two months of reverting to SVR. If this were to increase to 89%, the loans and advances to customers balance would reduce by £9m with the adjustment recognised in NII.

Credit cards

The Group measures credit card EIR by modelling expected cash flows based on assumptions of future customer behaviour, which is supported by observed experience. Key behavioural assumptions include an estimation of utilisation of available credit, future retail and cash transactions, repayment activity and the retention of the customer balance after the end of a promotional period.

The EIR of new business written in the current year is 5.60% (2019: 5.26%).

The Group specifically considered the impact of COVID-19 on the expected cash flows, and adjustments were made to assumptions of future customer behaviour, in particular utilisation of available credit, future retail transactions and repayment activity. In the weeks that followed the initial UK lockdown retail spend fell by almost 60% before beginning to recover as lockdown restrictions began to ease. Retail and cash transactions remain below the level of pre-COVID-19 volumes, at around 75% of pre-COVID-19 volumes. The Group currently assumes that retail and cash transaction activity will recover during 2021, however if current customer behaviour was to continue and retail transaction activity remained at 75% of pre-COVID-19 volumes for the next 12 months to 30 September 2021, with an associated adjustment to expected repayment activity of 0.6% to account for the lower retail and cash transactions, the Group estimates this would result in a negative present value adjustment of approximately £20m as at 30 September 2020.

The Group holds an appropriate level of model risk reserve across both asset classes to mitigate the risk of estimation uncertainty.

The Group will continue to monitor the impact of COVID-19 and update key assumptions and judgements as required.

	2020 £m	2019 £m
Interest income		
Loans and advances to customers	**2,062**	2,320
Loans and advances to other banks	**35**	72
Financial assets at fair value through other comprehensive income	**32**	27
Other interest income	**–**	1
Total interest income	**2,129**	2,420
Other similar interest		
Financial assets at fair value through profit or loss	**15**	21
Derivatives economically hedging interest bearing assets	**(7)**	(8)
Total other similar interest	**8**	13
Less: interest expense and similar charges		
Customer deposits	**(588)**	(580)
Debt securities in issue	**(193)**	(185)
Due to other banks	**(68)**	(144)
Other interest expense	**(5)**	(10)
Total interest expense and similar charges	**(854)**	(919)
Net interest income	**1,283**	1,514

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 FVTPL – these relate principally to the Group's fixed interest rate loan portfolio and related term deposits (note 3.5), 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 3.6).

Fees and commissions

Fees and commissions receivable which are not an integral part of the EIR are recognised as income as the Group fulfils its performance obligations. The Group's principal performance obligations arising from contracts with customers are in respect of current accounts, debit cards and credit cards. The Group provides the service and consequently generates the fees monthly; the fees are recognised in income on this basis. Costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

Income from insurance, protection and investments

This includes management fees in the previous year generated from the sale of and management of funds, Stocks and Shares ISAs and pensions to retail investors.

	2020 £m	2019 £m
Gains less losses on financial instruments at fair value		
Held for trading derivatives	**15**	16
Financial assets and liabilities at fair value(1)	**2**	3
Ineffectiveness arising from fair value hedges (note 3.6)	**(17)**	(22)
Amounts recycled to profit and loss from cash flow hedges(2) (note 3.6)	**(5)**	–
Ineffectiveness arising from cash flow hedges (note 3.6)	**(6)**	(14)
	(11)	(17)
Other operating income		
Net fee and commission income	**142**	195
Margin on foreign exchange derivative brokerage	**17**	19
Gain on sale of financial assets at fair value through other comprehensive income	**16**	3
Gain on sale of Virgin Money Unit Trust Managers Limited	**–**	35
Share of joint venture loss after tax(3)	**(7)**	(1)
Other income	**3**	1
	171	252
Total non-interest income	**160**	235

(1) A credit risk gain on loans and advances at fair value of £1m and a fair value loss of £5m have been recognised in the current year (2019: £2m gain and £2m fair value loss).
(2) In respect of terminated hedges.
(3) The share of joint venture loss after tax is included within continuing activities.

2.3 Non-interest income continued

Non-interest income includes the following fee and commission income disaggregated by income type:

	2020 £m	2019 £m
Current account and debit card fees	**94**	117
Credit cards	**41**	42
Insurance, protection and investments	**16**	37
Other fees[1]	**31**	31
Total fee and commission income	**182**	227
Total fee and commission expense	**(40)**	(32)
Net fee and commission income	**142**	195

(1) Other fees include mortgages, invoice and asset finance and ATM fees.

2.4 Operating and administrative expenses before impairment losses

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 3.10 and 4.2 respectively.

	2020 £m	2019 £m
Personnel expenses	**396**	421
Depreciation and amortisation expense[1]	**149**	108
Other operating and administrative expenses	**559**	1,200
Total operating and administrative expenses	**1,104**	1,729

(1) Following the adoption of IFRS 16 from 1 October 2019, the depreciation charge arising on the right-of-use assets is reported within depreciation and amortisation expense. Prior to adoption of IFRS 16, the equivalent operating lease charges were reported within other operating and administrative expenses.

Personnel expenses comprise the following items:

	2020 £m	2019 £m
Salaries, wages and non-cash benefits and social security costs	**252**	256
Defined contribution pension expense	**49**	47
Defined benefit pension expense (note 3.10)	**–**	9
Equity based compensation (note 4.2)	**10**	4
Other personnel expenses	**85**	105
Personnel expenses	**396**	421

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

	2020 Number	2019 Number
Managers	**2,911**	2,989
Clerical staff	**5,345**	5,714
	8,256	8,703

The average monthly number of employees was 9,275 (2019: 9,787).

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

2.4 Operating and administrative expenses before impairment losses continued

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

	2020 £'000	2019 £'000
Fees payable to the Company's auditor for the audit of the Company's financial statements	**20**	21
Fees payable to the Company's auditor for the audit of the Company's subsidiaries[1]	**3,218**	2,967
Total audit fees	**3,238**	2,988
Audit related assurance services	**322**	436
Other assurance services	**329**	289
Total non-audit fees	**651**	725
Fees payable to the Company's auditor in respect of associated pension schemes	**91**	88
Total fees payable to the Company's auditor	**3,980**	3,801

(1) Includes the audit of the Group's structured entities.

Non-audit services of £0.7m (2019: £0.7m) performed by the auditor during the year included the review of the Interim Financial Report, comfort letters for the global medium-term note programme and AT1 issuance, and client money reviews. In addition to the above, out of pocket expenses of £0.1m (2019: £0.2m) 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 (excluding AT1 distributions where the tax impact is recognised in the income statement). 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.

	2020 £m	2019 £m
Current tax		
Current year	**10**	5
Adjustment in respect of prior years	**(6)**	(5)
	4	–
Deferred tax (note 3.9)		
Current year	**(38)**	(56)
Adjustment in respect of prior years	**7**	3
	(31)	(53)
Tax credit for the year	**(27)**	(53)

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 credit implied by the standard rate to the actual tax credit is as follows:

	2020 £m	2019 £m
Loss on ordinary activities before tax	**(168)**	(232)
Tax credit based on the standard rate of corporation tax in the UK of 19% (2019: 19%)	**(32)**	(44)
Effects of:		
Disallowable expenses	**5**	50
Conduct indemnity adjustment	**(39)**	10
Deferred tax assets derecognised/(recognised)	**90**	(49)
Non-taxable gain on partial disposal of Virgin Money Unit Trust Managers Limited (note 2.3)	**–**	(7)
Bank levy	**–**	1
Impact of rate changes	**(37)**	3
AT1 distribution	**(15)**	(15)
Adjustments in respect of prior years	**1**	(2)
Tax credit for the year	**(27)**	(53)

The conduct indemnity adjustment represents a reduction in the amount payable to the Group's former parent, NAB, under the term of the Deed of Indemnity entered into at demerger in 2016. The reduction reflects the forecast decrease in utilisation of tax losses that are the subject of the indemnity, with a consequent reduction in the amount to be returned to NAB. The current anticipated cumulative liability, measured in accordance with the Group's established methodology, is £64m (2019: £104m), shown within 'Due to other banks' on the Company balance sheet. The liability will crystallise when certain tax losses are used within the Virgin Money UK PLC group to reduce the Group's corporation tax liability.

Deferred tax assets derecognised represent historic losses that have been derecognised in accordance with the Group's established deferred tax recognition methodology, reflecting their expected utilisation against future taxable profits. More information on deferred tax is given in note 3.9.

The rate change credit arises on the revaluation of the Group's net deferred tax assets. The valuation at 30 September 2019 reflected the enacted reduction to a 17% rate, but this reduction was cancelled in the Budget of 11 March 2020 with reversion to 19%.

As outlined in note 1.10, and in accordance with IASB improvements for periods commencing on or after 1 January 2019, the tax credit associated with the distribution on AT1 instruments has been presented in the income statement, rather than in equity. This change is presentational only; it has no effect on total shareholder assets. Prior year comparatives have been restated.

2.6 Earnings per share (EPS)

Accounting policy

Basic EPS

Basic EPS is calculated by taking the profit attributable to ordinary shareholders of the parent company and then dividing this by the weighted-average number of ordinary shares outstanding during the year after deducting the weighted-average of the Group's holdings of its own shares.

Diluted EPS

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 per share data in relation to the ordinary shares of Virgin Money UK PLC.

	2020 £m	2019 £m
Loss attributable to ordinary equity holders for the purposes of basic and diluted EPS	**(220)**	(253)

	2020	2019
Weighted-average number of ordinary shares in issue (millions)		
– Basic	**1,440**	1,414
– Diluted	**1,440**	1,414
Basic loss per share (pence)	**(15.3)**	(17.9)
Diluted loss per share (pence)	**(15.3)**	(17.9)

Basic loss per share has been calculated after deducting 0.3m (2019: 1m) ordinary shares representing the weighted-average of the Group's holdings of its own shares. The calculation of the diluted earnings per share in the current and prior year excluded conditional awards of 1m ordinary shares made under equity based compensation schemes. These have been considered anti-dilutive due to the Group making a loss in the current and prior year.

Notes to the consolidated financial statements

Section 3: Assets and liabilities

3.1 Loans and advances to customers

Accounting policy

Loans and advances to customers arise when the Group provides money directly to a customer and includes mortgages, term lending, overdrafts, credit card lending, lease finance and invoice financing. They are recognised initially at fair value and are subsequently measured at amortised cost, using the effective interest method, adjusted for ECLs (note 3.2). 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 years to reflect a constant periodic rate of return.

	2020 £m	2019 £m
Gross loans and advances to customers	**72,925**	73,246
Impairment provisions on credit exposures (note 3.2)	**(735)**	(362)
Fair value hedge adjustment	**240**	211
	72,430	73,095

The Group has a portfolio of fair valued business loans of £190m (2019: £253m) which are classified separately as financial assets at FVTPL on the balance sheet (note 3.5). Combined with the above, this is equivalent to total loans and advances of £72,620m (2019: £73,348m).

The fair value hedge adjustment represents an offset to the fair value movement on derivatives designated in hedge relationships to manage the interest rate risk inherent in the Group's fixed rate mortgage portfolio.

The Group has transferred a proportion of mortgages to the securitisation and covered bond programmes (note 3.3).

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 £61m (2019: £38m) and £346m (2019: £408m) respectively.

Finance lease receivables are presented in the statement of financial position within 'Loans and advances to customers'. The maturity analysis of lease receivables, including the undiscounted lease payments to be received are as follows:

Gross investment in finance lease and hire purchase receivables

	2020 £m	2019 £m
Less than 1 year	**265**	276
1-2 years	**186**	180
2-3 years	**125**	112
3-4 years	**65**	63
4-5 years	**32**	31
More than 5 years	**33**	23
	706	685
Unearned finance income	**(36)**	(36)
Net investment in finance lease and hire purchase receivables	**670**	649

Finance income recognised on the net investment in the lease was £22m (2019: £22m) and is included in 'Interest income' in the income statement (note 2.2).

3.2 Impairment provisions on credit exposures

Accounting policy
At each reporting date, the Group assesses financial assets measured at amortised cost, as well as loan commitments and financial guarantees not measured at FVTPL, for impairment. The impairment loss allowance is calculated using an ECL methodology and reflects: (i) an unbiased and probability weighted amount; (ii) the time value of money which discounts the impairment loss; and (iii) 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.

ECL methodology is based upon the combination of PD, LGD and EAD estimates that consider a range of factors that impact on credit risk and consequently the level of impairment loss provisioning. The Group uses reasonable and supportable forecasts of future economic conditions in estimating the ECL allowance. The methodology and assumptions used in the ECL calculation are reviewed regularly and updated as necessary.

The ECL assessment is performed on either a collective or individual basis:

Collectively assessed: these assets are assessed and provided for on a group or a pooled basis due to the existence of shared risk characteristics for as long as they retain those similar characteristics. Financial assets are considered to have shared risk characteristics when, at a given point in time, they will tend to display a similar PD and credit risk profile.

Individually assessed: these assets are assessed and provided for at the financial instrument level, with the assessment (which is governed by the Group's Credit Policy) taking into consideration a range of likely potential outcomes relating to each customer and their associated financial assets.

Regardless of the calculation basis, the Group generates an allowance at the individual financial instrument level.

SICR assessment and staging
The ECL is calculated as either a 12-month (Stage 1) or lifetime ECL depending on whether the financial asset has suffered a SICR since origination (Stage 2) or has otherwise become credit impaired (Stage 3) as at the reporting date. The Group uses a PD threshold curve (distinct for each portfolio) to assess for a SICR and also utilises the 30 days past due and 90 days past due backstops for recognising Stage 2 and Stage 3 provisions respectively.

In addition to the above stages, POCI financial assets are those which are assessed as being credit impaired upon initial recognition. Once a financial asset is classified as POCI, it remains there until derecognition irrespective of its credit quality. POCI financial assets are disclosed separately from those financial assets in Stage 3. The Group regards the date of acquisition as the origination date for purchased portfolios.

Financial assets can move between stages when the relevant staging criteria are no longer satisfied. If the level of impairment loss reduces in a subsequent year, the previously recognised impairment loss allowance is reversed and recognised in the income statement.

The Group has not made use of the low credit risk option under IFRS 9 for loans and advances at amortised cost.

Write-offs and recoveries
When there is no reasonable expectation of recovery for a loan, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the impairment charge in the income statement.

The Group's impairment policy for debt instruments at FVOCI is included in note 3.7. The impact of the ECL methodology on the Group's cash and balances with central banks and due from other banks balances is immaterial.

Critical accounting estimates and judgements
The use of an ECL methodology under IFRS 9 requires the Group to apply estimates and exercise judgement when calculating an impairment allowance for credit exposures.

Further detail on the scenarios, macroeconomic assumptions and weightings used in the ECL calculation together with sensitivity analysis is detailed in the Risk report on pages 42 to 45.

3.2 Impairment provisions on credit exposures continued

Movement in impairment provisions on credit exposures	2020 £m	2019 £m
Opening balance	**362**	224
Charge for the year	**507**	252
Amounts written off	**(159)**	(142)
Recoveries of amounts written off in previous years	**25**	28
Closing balance	**735**	362
Individually assessed	**53**	47
Collectively modelled	**682**	315
	735	362

The Group impairment provision is classified by stage allocation as follows:

	2020 £m	2019 £m
Stage 1	**136**	79
Stage 2	**465**	168
Stage 3[(1)]	**134**	115
	735	362

(1) Stage 3 includes £2m (2019: £3m) of POCI gross loans and advances.

3.3 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, the full details of which can be found in note 6.2 to the Company financial statements. The Group has no shareholding in these entities, but is exposed, or has rights, to variable returns and has the ability to affect those returns. The entities are consolidated in the Group's financial statements in accordance with note 1.5.

Securitisation
The Group has securitised a portion of its retail mortgage loan portfolio under both master trust (Lanark and Lannraig) and standalone (Gosforth) securitisation programmes. The securitised mortgage loans have been assigned at principal value to bankruptcy remote structured entities. 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 externally held securitised notes in issue are included within debt securities in issue (note 3.12). There are a number of notes held internally by the Group 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 bankruptcy remote limited liability partnerships, Clydesdale Covered Bond No 2 LLP and Eagle Place LLP, to provide a guarantee for the obligations payable on the covered bonds issued by the Group.

The covered bond partnerships are consolidated with the mortgage loans retained on the consolidated balance sheet and the covered bonds issued included within debt securities in issue (note 3.12). The covered bond holders have dual recourse: firstly, to the bond issuer on an unsecured basis; and secondly, to the appropriate LLP under the Covered Bond Guarantee secured against the mortgage loans.

Under both the securitisation and covered bond programmes, the mortgage loans do not qualify for balance sheet 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 Group continues to service the mortgage loans in return for an administration fee and is also entitled to any residual income after all payment obligations due under the terms of the programmes and senior programme expenses have been met. In the mortgage originator a deemed loan liability is recognised for the proceeds of the funding transaction.

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

3.3 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:

	2020		2019	
	Loans and advances securitised £m	Notes in issue £m	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes				
Lanark Master Issuer	**5,686**	**4,757**	5,009	4,597
Lannraig Master Issuer	**860**	**765**	1,032	838
Gosforth 2014-1	**–**	**–**	372	385
Gosforth 2015-1	**–**	**–**	707	630
Gosforth 2016-1	**1,141**	**947**	1,142	1,048
Gosforth 2016-2	**–**	**–**	701	579
Gosforth 2017-1	**910**	**709**	934	852
Gosforth 2018-1	**1,227**	**1,060**	1,353	1,267
	9,824	**8,238**	11,250	10,196
Less held by the Group		**(4,236)**		(5,154)
		4,002		5,042
Covered bond programmes				
Clydesdale Bank PLC	**905**	**781**	1,253	776
Clydesdale Bank PLC (formerly Virgin Money PLC)	**3,446**	**1,137**	2,622	1,126
	4,351	**1,918**	3,875	1,902

The fair values of financial assets and associated liabilities relating to the securitisation programmes where the counterparty to the liabilities has recourse only to the financial assets were £9,807m and £3,988m respectively (2019: £11,329m and £5,085m).

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 are shown in the table below:

	2020 £m	2019 £m
Beneficial interest held	**1,795**	1,467
Subordinated loans	**46**	100
Junior notes held	**1,299**	1,722
	3,140	3,289

Looking forward through future reporting years 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 programmes

The nominal level of over-collateralisation was £520m (2019: £699m) in the Clydesdale Bank PLC programme and £2,314m (2019: £1,490m) in the Clydesdale Bank PLC (formerly Virgin Money PLC) programme. From time to time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

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

3.4 Cash and balances with central banks

Accounting policy

Cash and balances with central banks are measured at amortised cost, using the effective interest method, adjusted for ECLs, and are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. These balances are generally of a short-term nature and repayable on demand or within a short timescale, generally three months.

	2020 £m	2019 £m
Cash assets	**1,560**	1,574
Balances with central banks (including EU payment systems)	**7,547**	8,722
	9,107	10,296
Less mandatory deposits with central banks(1)	**(220)**	(183)
Included in cash and cash equivalents (note 5.2)	**8,887**	10,113

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

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

Accounting policy

A financial asset is measured at FVTPL if it (i) does not fall into one of the business models for amortised cost (note 1.7) or FVOCI (note 3.7); (ii) is specifically designated as FVTPL on initial recognition in order to eliminate or significantly reduce a measurement mismatch; or (iii) is classified as held for trading.

Financial liabilities are measured at FVTPL where they are trading liabilities or where they are designated at FVTPL (e.g. an accounting mismatch) or where the performance is evaluated on a fair value basis in accordance with risk management and investment strategies.

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

Associated gains and losses are recognised in the income statement as they arise (note 2.3).

	2020 £m	2019 £m
Financial assets at fair value through profit or loss		
Loans and advances	**190**	253
Other financial assets	**13**	14
	203	267

Loans and advances

Included in financial assets at FVTPL 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 £190m (2019: £253m) including accrued interest receivable of £1m (2019: £1m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £3m (2019: £4m) and the change for the current year is a decrease of £1m (2019: decrease of £4m), of which £1m (2019: £2m) has been recognised in the income statement.

Other financial assets

Included in other financial assets are £12m (2019: £8m) of unlisted securities and £1m (2019: £6m) of debt instruments.

Refer to note 3.16 for further information on the valuation methodology applied to financial assets held at FVTPL and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk report.

3.6 Derivative financial instruments

Accounting policy
The Group uses derivative financial instruments to manage exposure to interest rate and foreign currency risk. Interest rate risk arises when there is a mismatch between fixed interest rate and floating interest rates, and different repricing characteristics between assets and liabilities. Currency risk arises when assets and liabilities are not denominated in the functional currency of the entity. Derivatives are recognised on the balance sheet at fair value on trade date and are 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.

Netting
Derivative assets and liabilities are offset against collateral received and paid respectively, and the net amount reported in 'due to and from other banks' in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis. Amounts offset on the balance sheet represent the Group's centrally cleared derivative financial instruments and collateral paid to/from central clearing houses, which meet the criteria for offsetting under IAS 32.

Hedge accounting
The Group elects to apply hedge accounting for the majority of its risk management activity that uses derivatives. This results in greater alignment in the timing of recognition of gains and losses on hedged items and hedging instruments and therefore reduces income statement volatility. The Group does not have a trading book, however derivatives that do not meet the hedging criteria, or for which hedge accounting is not applied, are classified as held for trading.

The Group has elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39. 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).

As highlighted in note 1.10, the Group has early adopted the 'Amendments to IAS 39 and IFRS 7 Interest Rate Benchmark Reform' issued in September 2019. In accordance with the transition provisions, the amendments have been adopted retrospectively in respect of hedging relationships that existed at the start of the reporting year or were designated thereafter, and to the amount accumulated in the cash flow hedge reserve at that date.

The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR (Interbank Offered Rates) reform. The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness continues to be recorded in the income statement. Furthermore, the amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present.

In summary, the reliefs provided by the amendments that apply to the Group are:

- When considering the 'highly probable' requirement, the Group has assumed that the IBOR interest rates upon which the hedged items are based do not change as a result of IBOR reform;
- In assessing whether the hedge is expected to be highly effective on a prospective basis the Group has assumed that the IBOR interest rates upon which the cash flows of the hedged items and the hedging instruments that hedge them are based are not altered by IBOR reform;
- The Group will not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80-125 per cent range and the hedging relationship be subject to interest rate benchmark reforms. For those hedging relationships that are not subject to the interest rate benchmark reforms the Group will continue to cease hedge accounting if retrospective effectiveness is outside the 80-125 per cent range;
- The Group has retained the cumulative gain or loss in the cash flow hedge reserve for designated cash flow hedges that are subject to interest rate benchmark reforms even though there is uncertainty arising from the interest rate benchmark reform with respect to the timing and amount of the cash flows of the hedged items. Should the Group consider the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reform, the cumulative gain or loss will be immediately reclassified to profit or loss; and
- The Group has assessed whether the hedged IBOR risk component is a separately identifiable risk only when it first designates a hedged item in a fair value hedge and not on an ongoing basis.

3.6 Derivative financial instruments continued

Accounting policy continued
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 year 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. This movement in the fair value of the hedged item 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 over the remaining life of the asset or liability.

Derivatives held for trading
Changes in value of held for trading derivatives are immediately recognised in the income statement (note 2.3).

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

	2020 £m	2019 £m
Fair value of derivative financial assets		
Designated as hedging instruments	**198**	315
Designated as held for trading	**120**	51
	318	366
Fair value of derivative financial liabilities		
Designated as hedging instruments	**158**	191
Designated as held for trading	**92**	82
	250	273

In respect of derivatives with other banks, cash collateral totalling £53m (2019: £55m) has been pledged and £93m has been received (2019: £149m). These amounts are included within due from and due to other banks respectively. Collateral placed with clearing houses, which did not meet offsetting criteria, totalled £202m (2019: £55m) and is included within other assets.

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.

3.6 Derivative financial instruments continued

Total derivative contracts

	2020			2019		
	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**29,645**	**74**	**215**	25,023	105	121
Less: net settled interest rate swaps(1)	**(19,187)**	**(13)**	**(171)**	(14,513)	(47)	(75)
Interest rate swaps (net)(2)	**10,458**	**61**	**44**	10,510	58	46
Cross currency swaps(2)	**420**	**28**	**–**	1,446	162	–
	10,878	**89**	**44**	11,956	220	46
Fair value hedges						
Interest rate swaps (gross)	**37,803**	**182**	**751**	25,492	146	526
Less: net settled interest rate swaps(1)	**(30,603)**	**(92)**	**(642)**	(23,872)	(60)	(389)
Interest rate swaps (net)(2)	**7,200**	**90**	**109**	1,620	86	137
Cross currency swaps(2)	**1,448**	**19**	**5**	808	9	8
	8,648	**109**	**114**	2,428	95	145
Total derivatives designated as hedging instruments	**19,526**	**198**	**158**	14,384	315	191
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange(2)	**1,003**	**15**	**15**	728	16	15
Cross currency swaps(2)	**1,263**	**56**	**7**	1,123	11	9
Options(2)	**1**	**–**	**–**	2	–	–
	2,267	**71**	**22**	1,853	27	24
Interest rate related contracts						
Interest rate swaps (gross)	**704**	**28**	**47**	1,159	24	53
Less: net settled interest rate swaps(1)	**–**	**–**	**–**	(363)	(5)	(2)
Interest rate swaps (net)(2)	**704**	**28**	**47**	796	19	51
Swaptions(2)	**10**	**–**	**2**	11	–	2
Options(2)	**426**	**2**	**3**	465	2	3
	1,140	**30**	**52**	1,272	21	56
Commodity related contracts	**131**	**19**	**18**	55	2	2
Equity related contracts	**–**	**–**	**–**	3	1	–
Total derivatives designated as held for trading	**3,538**	**120**	**92**	3,183	51	82

(1) Presented within other assets.
(2) Presented within derivative financial instruments.

3.6 Derivative financial instruments continued

Hedge accounting
The hedging strategy of the Group is divided into micro hedges, where the hedged item is a distinctly identifiable asset or liability, and portfolio hedges, where the hedged item is a homogenous portfolio of assets and liabilities.

In some hedge accounting relationships, the Group designates risk components of hedged items as follows:

- benchmark interest rate risk as a component of interest rate risk, such as the SONIA component;
- exchange rate risk for foreign currency financial assets and financial liabilities; and
- components of cash flows of hedged items, for example certain interest payments for part of the life of an instrument.

Other risks such as credit risk and liquidity risk are managed by the Group but are not included in the hedge accounting relationship. Changes in the designated risk component usually account for the largest portion of the overall change in fair value or cash flows of the hedged item.

Portfolio cash flow hedges
The Group applies macro cash flow hedge accounting to a portion of its floating rate financial assets and liabilities. The hedged cash flows are a group of forecast transactions that result in cash flow variability from resetting of interest rates, reinvestment of financial assets, or refinancing and rollovers of financial liabilities. This cash flow variability can arise on recognised assets or liabilities or highly probable forecast transactions. The hedged items are designated as the gross asset or liability positions allocated to time buckets based on projected repricing and interest profiles. The Group aims to maintain a position where the principal amount of the hedged items is greater than or equal to the notional amount of the corresponding interest rate swaps used as the hedging instruments. The hedge accounting relationship is reassessed on a monthly basis with the composition of hedging instruments and hedged items changing frequently in line with the underlying risk exposures. If necessary, the hedge relationships are de-designated and redesignated based on the effectiveness test results.

Micro cash flow hedges
Floating rate issuances that are denominated in currencies other than the functional currency of the Group are designated in cash flow hedges with cross currency swaps.

Portfolio fair value hedges
The Group applies macro fair value hedging to its fixed rate mortgages. During the year fair value hedging of fixed rate deposits was discontinued. The Group determines hedged items by identifying portfolios of homogeneous loans or deposits based on their contractual maturity and other risk characteristics. Loans or deposits within the identified portfolios are allocated to repricing time buckets based on expected, rather than contractual, repricing dates. The hedging instruments are designated to those repricing time buckets. Hedge effectiveness is measured on a monthly basis, by comparing fair value movements of the designated proportion of the bucketed loans due to the hedged risk against the fair value movements of the derivatives.

The aggregated fair value changes in the hedged loans and deposits are recognised on the Group's balance sheet as an asset and liability respectively. At the end of every month, in order to minimise the ineffectiveness from early repayments and accommodate new exposures, the Group voluntarily de-designates the hedge relationships and redesignates them as new hedges.

Micro fair value hedges
The Group uses this hedging strategy on GBP and foreign currency denominated fixed rate assets held at FVOCI and GBP and foreign currency denominated fixed rate debt issuances by the Group.

Hedge ineffectiveness
Hedge ineffectiveness can arise from:

- mismatches between the contractual terms of the hedged item and hedging instrument, including basis differences;
- differences in timing of cash flows of hedged items and hedging instruments;
- changes in expected timings and amounts of forecast future cash flows; and
- derivatives used as hedging instruments having a non-zero fair value at the time of designation.

Additionally, for portfolio fair value hedges of the Group's fixed rate mortgage portfolio, ineffectiveness also arises from the difference between forecast and actual repayments (e.g. prepayment risk and impact of short-term payment holidays granted to customers in response to COVID-19).

Interest Rate Benchmark Reform
The Group has cash flow and fair value hedge accounting relationships that are exposed to different IBORs, predominantly GBP LIBOR but also Euro Interbank Offer Rate (EURIBOR), which are subject to IBOR reform.

As at 30 September 2020, the principal of the hedged items designated into cash flow hedge relationships that is directly affected by the interest rate benchmark reform is £611m. The principal of the hedged items designated in fair value hedge relationships that is directly affected by the interest rate benchmark reform is £780m, of which £78m relates to EURIBOR. These fair value hedges principally relate to GBP and foreign currency denominated fixed rate assets, and GBP fixed rate debt.

At 30 September 2020, the principal amount of the hedging instruments in hedge relationships to which these amendments apply was £908m, of which £778m relates to fair value hedges and £130m relates to cash flow hedges.

Page 67 of the Risk report describes how the Group is managing the transition to new benchmark interest rates.

3.6 Derivative financial instruments continued

The Group will continue to apply the amendments to IAS 39 until the uncertainty arising from IBOR reform, with respect to the timing and the amount of the underlying cash flows that the Group is exposed to, ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date on which the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and the relevant spread adjustment.

The table below discloses the impact derivatives held in micro hedging relationships are expected to have on the timing and uncertainty of future cash flows. All notional principal amounts and carrying values are presented gross, prior to any netting permitted for balance sheet presentation as this reflects the derivative position used for risk management and the impact on future cash flows.

	3 months or less	3 to 12 months	1 to 5 years	Total
2020				
Cash flow hedges				
Foreign exchange risk				
Cross currency swap				
Notional principal (£m)	**185**	**235**	**–**	**420**
Average GBP/EUR rate	**1.4149**	**1.4149**	**–**	**n/a**
Average GBP/USD rate	**1.3023**	**1.2984**	**–**	**n/a**
2019				
Cash flow hedges				
Foreign exchange risk				
Cross currency swap				
Notional principal (£m)	107	445	894	1,446
Average GBP/EUR rate	1.3459	1.3423	1.3680	n/a
Average GBP/USD rate	1.3263	1.3228	1.3089	n/a

3.6 Derivative financial instruments continued

Summary of hedging instruments in designated hedge relationships

In the table below, the Group sets out the accumulated adjustments arising from the corresponding continuing hedge relationships, irrespective of whether or not there has been a change in hedge designation during the year.

	2020				2019			
		Carrying amount				Carrying amount		
	Notional contract amount £m	Assets £m	Liabilities £m	Change in fair value of hedging instrument in the year used for ineffectiveness measurement[(2)] £m	Notional contract amount £m	Assets £m	Liabilities £m	Change in fair value of hedging instrument in the year used for ineffectiveness measurement[(2)] £m
Cash flow hedges								
Interest rate risk								
Interest rate swaps[(1)]	**29,645**	**74**	**(215)**	**(80)**	25,023	105	(121)	–
Foreign exchange risk								
Cross currency swaps	**420**	**28**	**–**	**(59)**	1,446	162	–	59
Total derivatives designated as cash flow hedges	**30,065**	**102**	**(215)**	**(139)**	26,469	267	(121)	59
Fair value hedges								
Interest rate risk								
Interest rate swaps[(1)]	**37,803**	**182**	**(751)**	**(40)**	25,492	146	(526)	(264)
Foreign exchange and interest rate risk								
Cross currency swaps	**1,448**	**19**	**(5)**	**–**	808	9	(8)	1
Total derivatives designated as fair value hedges	**39,251**	**201**	**(756)**	**(40)**	26,300	155	(534)	(263)

(1) As shown in the total derivatives contracts table on page 94, for centrally cleared derivatives, where the IAS 32 'Financial Instruments: Presentation' netting criteria is met, the derivative balances are offset within other assets. For all other derivatives, the derivative balances are presented within derivative financial instruments.

(2) Changes in fair value of cash flow hedging instruments are recognised in other comprehensive income. Changes in fair value of fair value hedging instruments are recognised in the income statement in non-interest income.

Summary of hedged items in designated hedge relationships

In the table below, the Group sets out the accumulated adjustments arising from the corresponding continuing hedge relationships, irrespective of whether or not there has been a change in hedge designation during the year.

	2020			2019		
		Cash flow hedge reserve			Cash flow hedge reserve (excluding deferred tax)	
	Change in fair value of hedged item in the year used for ineffectiveness measurement £m	Continuing hedges £m	Discontinued hedges £m	Change in fair value of hedged item in the year used for ineffectiveness measurement £m	Continuing hedges £m	Discontinued hedges £m
Cash flow hedges						
Interest rate risk						
Gross floating rate assets and gross floating rate liabilities[(1)]	**74**	**(123)**	**17**	(14)	(15)	(20)
Foreign exchange risk						
Floating rate currency issuances[(2)]	**59**	**(1)**	**–**	(59)	–	–
Total	**133**	**(124)**	**17**	(73)	(15)	(20)

(1) Highly probable future cash flows arising from loans and advances to customers, due to customers and debt securities in issue.

(2) Hedged item is recorded in debt securities in issue.

3.6 Derivative financial instruments continued

	2020				2019			
	Carrying amount of hedged items		Accumulated amount of fair value adjustments on the hedged item	Change in fair value of hedged items in the year used for ineffectiveness measurement	Carrying amount of hedged items		Accumulated amount of fair value adjustments on the hedged item	Change in fair value of hedged items in the year used for ineffectiveness measurement
	Assets £m	Liabilities £m	£m	£m	Assets £m	Liabilities £m	£m	£m
Fair value hedges								
Interest rate risk								
Fixed rate mortgages[3]	**31,110**	**–**	**240**	**29**	16,436	–	211	209
Fixed rate customer deposits[4]	**–**	**–**	**(11)**	**1**	–	(4,769)	(10)	(9)
Fixed rate FVOCI debt instruments[5]	**3,001**	**–**	**74**	**16**	2,940	–	166	133
Fixed rate issuances[2]	**–**	**(2,576)**	**146**	**(23)**	–	(2,368)	122	(92)
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments[5]	**83**	**–**	**5**	**3**	82	–	3	4
Fixed rate currency issuances[2]	**–**	**(1,389)**	**4**	**(3)**	–	(530)	1	(4)
Total	**34,194**	**(3,965)**	**458**	**23**	19,458	(7,667)	493	241

(1) Highly probable future cash flows arising from loans and advances to customers, due to customers and debt securities in issue.
(2) Hedged item is recorded in debt securities in issue.
(3) Hedged item and the cumulative fair value changes, are recorded in loans and advances to customers.
(4) Hedge relationship was discontinued during the year. The fair value adjustment taken will be amortised over the remaining life of the hedged items, and is recorded in due to customers.
(5) Hedged item is recorded in financial assets at FVOCI.

	2020				2019			
	Hedge ineffectiveness recognised in income statement[1]	Effective portion recognised in other comprehensive income	Reclassified into income statement as		Hedge ineffectiveness recognised in income statement[1]	Effective portion recognised in other comprehensive income	Reclassified into income statement as	
	£m	£m	Net interest income £m	Non-interest income £m	£m	£m	Net interest income £m	Non-interest income £m
Cash flow hedges								
Interest rate risk								
Gross floating rate assets and gross floating rate liabilities	**(6)**	**(74)**	**4**	**(5)**	(14)	14	–	–
Foreign exchange risk								
Floating rate currency issuances	**–**	**(59)**	**–**	**(59)**	–	59	–	57
Total losses on cash flow hedges	**(6)**	**(133)**	**4**	**(64)**	(14)	73	–	57

3.6 Derivative financial instruments continued

	Hedge ineffectiveness recognised in income 2020 £m	2019 £m
Fair value hedges		
Interest rate risk		
Fixed rate mortgages	**(22)**	(24)
Fixed rate customer deposits	**3**	4
Fixed rate FVOCI debt instruments	**–**	(2)
Fixed rate issuances	**2**	(1)
Foreign exchange and interest rate risk		
Fixed rate currency FVOCI debt instruments	**–**	–
Fixed rate currency issuances	**–**	1
Total losses on fair value hedges[1]	**(17)**	(22)

(1) Recognised in gains less losses on financial assets at fair value.

3.7 Financial assets at fair value through other comprehensive income

Accounting policy

A financial asset is measured at FVOCI when (i) the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and (ii) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding unless the financial asset is designated at FVTPL on initial recognition. An option for equity investments that are not held for trading can be taken to classify them at FVOCI where an irrevocable election is made at initial recognition. This option is available for each separate investment. The Group has not exercised this option for any equity investments.

Interest income and impairment gains and losses on FVOCI assets are measured in the same manner as for assets measured at amortised cost and are recognised in the income statement, with all other gains or losses recognised in other comprehensive income as a separate component of equity in the year in which they arise. Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement. For all FVOCI assets, the gain or loss is calculated with reference to the gross carrying amount.

Debt instruments at FVOCI are subject to the same impairment criteria as amortised cost financial assets (note 3.2), with the ECL element recognised directly in the income statement. As the financial asset is fair valued through other comprehensive income, the change in its value includes the ECL element, with the remaining fair value change recognised in other comprehensive income. Any reversal of the ECL is recorded in the income statement up to the value recognised previously.

The Group exercises the low credit risk option for debt instruments classified as FVOCI, recognising the high credit quality of the instruments, accordingly a 12-month ECL is calculated on the assets.

	2020 £m	2019 £m
Listed securities	**5,080**	4,328
Total financial assets at fair value through other comprehensive income	**5,080**	4,328

Refer to note 3.16 for further information on the valuation methodology applied to financial assets at FVOCI at 30 September 2020 and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk report.

3.8 Intangible assets and goodwill

Accounting policy
Capitalised software is 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 software costs are amortised on a straight line basis over their expected useful lives, usually between three and ten years. Impairment losses are recognised in the income statement as incurred.

Goodwill arises on the acquisition of an entity and represents the excess of the fair value of the purchase consideration and direct costs of making the acquisition over the fair value of the Group's share of the net assets at the date of the acquisition. Goodwill is not subject to amortisation and is tested for impairment on an annual basis.

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 £m	Goodwill £m	Core deposit intangible £m	Total £m
Cost				
At 1 October 2018	733	–	–	733
Acquisition of Virgin Money Holdings (UK) PLC	172	11	6	189
Additions	130	–	–	130
Write-off	(85)	–	–	(85)
At 30 September 2019	950	11	6	967
Additions	78	–	–	78
At 30 September 2020	**1,028**	**11**	**6**	**1,045**
Accumulated amortisation				
At 1 October 2018	321	–	–	321
Charge for the year	82	–	1	83
Impairment	115	–	–	115
Write-off	(68)	–	–	(68)
At 30 September 2019	450	–	1	451
Charge for the year	102	–	1	103
At 30 September 2020	**552**	**–**	**2**	**554**
Net book value				
At 30 September 2020	**476**	**11**	**4**	**491**
At 30 September 2019	500	11	5	516

£4m (2019: £31m) of the £78m (2019: £130m) software additions do not form part of internally generated software projects.

Notes to the consolidated financial statements

Section 3: Assets and liabilities

3.9 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 £326m (2019: £322m), the principal components of which are tax losses and capital allowances.

The Group has assessed the recoverability of these deferred tax assets at 30 September 2020 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. This assessment is based on the latest strategic plan which has taken account of the volatile and uncertain macroeconomic conditions in the UK due to the COVID-19 pandemic and the uncertainty around Brexit. Deferred tax assets are recognised to the extent that they are expected to be utilised over six years from the balance sheet date. If instead of six years the period was five years or seven years the recognised deferred tax asset would be £309m or £345m respectively. All tax assets arising will be used within the UK.

Movement in net deferred tax asset

	2020 £m	2019 £m
At 1 October	**121**	136
Recognised in the income statement (note 2.5)	**31**	53
Recognised directly in equity	**(100)**	(68)
At 30 September	**52**	121

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

	2020 £m	2019 £m
Deferred tax assets		
Tax losses carried forward	**151**	146
Capital allowances	**113**	91
Cash flow hedge reserve	**23**	3
Acquisition accounting adjustments(1)	**1**	44
Transitional adjustment – IFRS 9	**15**	16
Transitional adjustment – available for sale reserve	**-**	1
Employee equity based compensation	**5**	5
Unamortised issue costs	**4**	4
Pension spreading	**9**	11
Other	**5**	1
	326	322
Deferred tax liabilities		
Defined benefit pension scheme surplus	**(253)**	(139)
Acquisition accounting adjustments(1)	**(11)**	(51)
Gains on financial instruments at fair value through other comprehensive income	**(6)**	(6)
Intangible assets	**(3)**	(4)
Other	**(1)**	(1)
	(274)	(201)
Net deferred tax asset	**52**	121

(1) Following the execution of FSMA part VII, the deferred tax assets and liabilities in respect of acquisition accounting adjustments have been offset to provide a single number that will unwind in the same entity over coming years.

The deferred tax assets and liabilities detailed above arise primarily in Clydesdale Bank PLC.

The value of tax losses carried forward of £151m (2019: £146m) has increased due to the recognition of current year losses and the rate change arising from the increase in the corporation tax rate. The de-recognition of historic losses has largely been offset by a reduction in the conduct indemnity adjustment (note 2.5). At 30 September 2020, the Group had an unrecognised deferred tax asset of £217m (2019: £114m) representing trading losses with a gross value of £1,142m valued at 19% (2019: £668m valued at 17%).

Notes to the consolidated financial statements

Section 3: Assets and liabilities

3.10 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 its obligation to make 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 future payments is available.

Defined benefit pension scheme

A liability or asset is recognised on the balance sheet in respect of the defined benefit scheme and is measured as the difference between 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 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 ultimately be recovered.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, past service cost resulting from a scheme amendment or curtailment, net interest on the net defined benefit obligation/asset, 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 year 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 following table summarises the present value of the defined benefit obligation and fair value of plan assets for the Scheme as at 30 September:

	2020 £m	2019 £m
Active members' defined benefit obligation	**(23)**	(30)
Deferred members' defined benefit obligation	**(2,064)**	(2,537)
Pensioner and dependant members' defined benefit obligations	**(1,871)**	(1,744)
Total defined benefit obligation	**(3,958)**	(4,311)
Fair value of Scheme assets	**4,681**	4,707
Net defined benefit pension asset	**723**	396

The Group's pension arrangements

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 current version of the Scheme was established under trust on 30 September 2009 with the assets held in a trustee administered fund. The Trustee is responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

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

The Group has implemented a number of reforms to the Scheme to manage the obligation. 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 Group's existing defined contribution scheme, 'Total Pension'. The income statement charge for this is separately disclosed in note 2.4.

The Group also provides post-retirement healthcare under a defined benefit scheme for pensioners and their dependant 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 obligation in respect of this scheme was £2m at 30 September 2020 (2019: £3m) and is included within other liabilities in note 3.15.

3.10 Retirement benefit obligations continued

Scheme valuations

There are a number of means of measuring liabilities in the defined benefit schemes, with the ultimate aim of the Trustee being that the Scheme is 100% funded on an agreed self-sufficiency basis (which is where the Scheme is essentially self-funded and does not need to call on the Group for any additional funding). The two bases used by the Group to value its obligations are: (i) an IAS 19 accounting basis; and (ii) a Trustee's Technical Provision basis.

(i) IAS 19 accounting basis

The valuations of the Scheme assets and obligations are calculated on an accounting basis in accordance with the applicable accounting standard IAS 19 which provides the basis for the accounting framework and methodology for entries in the income statement, balance sheet and capital reporting. The principal purpose of this valuation is to allow comparison of pension obligations between companies. The obligation under an accounting valuation can be higher or lower than those under a Trustee's Technical Provision valuation.

The rate used to discount the obligation on an IAS 19 basis is a key driver of any potential volatility and is based on yields on AA rated high-quality corporate bonds, regardless of how the Trustee of the Scheme invests the assets. The accounting valuation under IAS 19 can therefore move adversely because of low rates and narrowing credit spreads which are not fully matched by the Scheme assets. Inflation is another key source of volatility and arises as a result of member benefits having an element of index linking, which causes the obligation to increase in line with rises in long-term inflation assumptions. In practice however, over the long term, the relationship between interest and inflation rates tends to be negatively correlated resulting in a degree of risk offset.

(ii) Trustee's Technical Provision basis

This valuation basis reflects how much money the Trustee considers is required now in order to provide for the promised benefits as they come up for payment in the future. The Trustee is responsible for ensuring that the calculation is conducted prudently on an actuarial basis, taking into account factors including the Scheme's investment strategy and the relative financial strength of the sponsoring employer.

A key aspect of this valuation is the investment strategy the Trustee proposes to follow as part of the policy for meeting the Scheme's obligations. Because there are no guarantees about investment returns over long periods, legislation requires the Trustee to consider carefully how much of their expected future investment returns it would be prudent for them to account for in advance.

During the current year the Trustee concluded the latest triennial valuation for the Scheme, which was conducted in accordance with Scheme data and market conditions as at 30 September 2019. The valuation resulted in an improvement in the Scheme's funding position, with a reported surplus of £144m (previously a deficit of £290m) and a Technical provisions funding level of 103% (previously 94%). As the 2019 valuation outcome was a funding surplus, future payments to the Scheme are limited solely to those relating to a payment holiday agreed between the Group and Scheme Trustee in respect of contributions due under the prior 2016 valuation. These total £52m and will be paid at the rate of £2m per month over the period January 2021 to April 2023.

Scheme assets are not subject to the same valuation differences as Scheme obligations and are consistently valued at current market value.

3.10 Retirement benefit obligations continued

IAS 19 position

The Scheme movements in the year are as follows:

	2020				2019			
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Cumulative loss in OCI £m	Present value of obligation £m	Fair value of plan assets £m	Total £m	Cumulative loss in OCI £m
Balance sheet surplus at 1 October	**(4,311)**	**4,707**	**396**		(3,746)	3,958	212	
				(594)				(704)
Total expense								
Current service cost	**–**	**–**	**–**		–	–	–	
Past service cost	**(1)**	**–**	**(1)**		(11)	–	(11)	
Interest (expense)/income	**(75)**	**82**	**7**		(100)	107	7	
Administrative costs	**–**	**(6)**	**(6)**		–	(5)	(5)	
Total (expense)/income recognised in the consolidated income statement	**(76)**	**76**	**–**		(111)	102	(9)	
Remeasurements								
Return on Scheme assets greater than discount rate	**–**	**61**	**61**	**61**	–	772	772	772
Actuarial:								
Gain/(loss) – experience adjustments	**140**	**–**	**140**	**140**	(9)	–	(9)	(9)
Gain – demographic assumptions	**116**	**–**	**116**	**116**	30	–	30	30
Loss – financial assumptions	**(25)**	**–**	**(25)**	**(25)**	(683)	–	(683)	(683)
Remeasurement gains/(losses) recognised in other comprehensive income	**231**	**61**	**292**	**292**	(662)	772	110	110
Contributions and payments								
Employer contributions	**–**	**35**	**35**		–	83	83	
Benefit payments	**105**	**(105)**	**–**		96	(96)	–	
Transfer payments	**93**	**(93)**	**–**		112	(112)	–	
	198	**(163)**	**35**		208	(125)	83	
Balance sheet surplus at 30 September	**(3,958)**	**4,681**	**723**		(4,311)	4,707	396	
				(302)				(594)

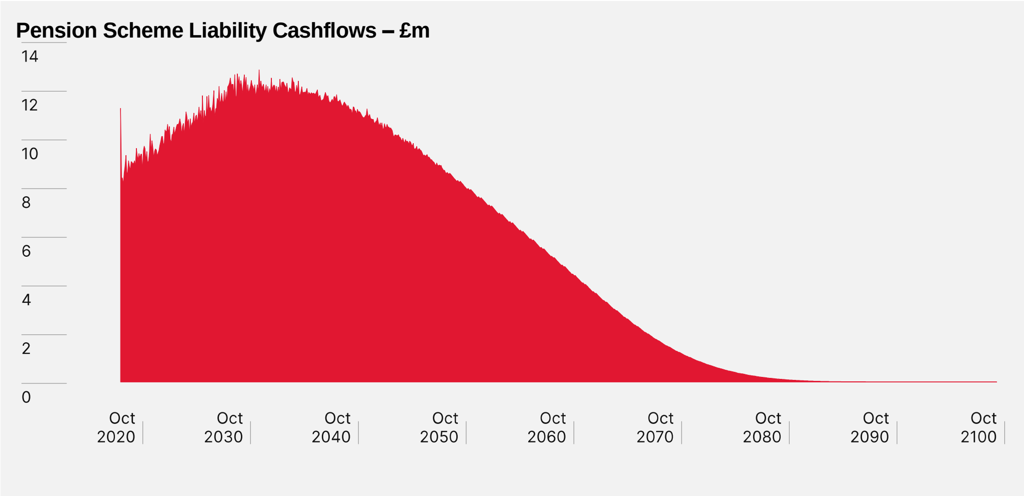
3.10 Retirement benefit obligations continued

The expected contributions and expected benefit payments for the year ending 30 September 2021 are £39m (2020: £56m) and £108m (2020: £108m) respectively.

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

Maturity of Scheme liabilities

The estimated maturity period of Scheme obligations on an IAS 19 accounting basis is as follows:



The discounted mean term of the defined benefit obligation at 30 September 2020 is 19 years (2019: 20 years).

Scheme assets

In order to meet the obligations of the Scheme, the Trustee invests in a diverse portfolio of assets, with the level and volatility of asset returns being a key factor in the overall investment strategy. The investment portfolio is subject also to a range of risks typical of the types of assets held, such as: equity risk; credit risk on bonds; currency risk; interest rate and inflation risk; and exposure to the property market. The Trustee's investment strategy (including physical assets and derivatives) seeks to reduce the Scheme's exposure to these risks. In managing interest rate and inflation risks, the investment strategy seeks to hold portfolios of matching assets (including derivatives) that enable the Scheme's assets to better match movements in the value of liabilities due to changes in interest rates and inflation.

As at 30 September 2020, the interest rate and inflation rate hedge ratios were around 97% and 84% respectively (2019: 85% and 75%) of the obligation when measured on a self-sufficiency basis. This strategy reflects the Scheme's obligation 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.

The Trustee's investment strategy involves two main categories of investments:

- matching assets – a range of investments that provide a match to changes in obligation values; and
- return seeking assets – a range of investments designed to provide specific, planned and consistent returns.

3.10 Retirement benefit obligations continued

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

	2020				2019			
	Quoted £m	Unquoted £m	Total £m	%	Quoted £m	Unquoted £m	Total £m	%
Bonds								
Fixed government	**930**	**–**	**930**		569	–	569	
Index linked government	**2,001**	**–**	**2,001**		1,757	–	1,757	
Global sovereign	**115**	**1**	**116**		20	1	21	
Corporate and other	**879**	**48**	**927**		531	305	836	
	3,925	**49**	**3,974**	**85%**	2,877	306	3,183	68%
Equities(1)								
Global equities	**–**	**368**	**368**		–	503	503	
Emerging market equities	**–**	**43**	**43**		–	50	50	
UK equities	**–**	**114**	**114**		–	32	32	
	–	**525**	**525**	**11%**	–	585	585	12%
Other								
Secured income alternatives	**–**	**165**	**165**		–	358	358	
Derivatives(2)	**–**	**78**	**78**		–	219	219	
Repurchase agreements	**–**	**(1,025)**	**(1,025)**		–	(534)	(534)	
Property	**–**	**122**	**122**		–	129	129	
Alternative credit	**–**	**563**	**563**		–	409	409	
Infrastructure	**–**	**127**	**127**		–	352	352	
Cash	**–**	**146**	**146**		–	1	1	
Equity options	**6**	**–**	**6**		5	–	5	
	6	**176**	**182**	**4%**	5	934	939	20%
Total Scheme assets	**3,931**	**750**	**4,681**	**100%**	2,882	1,825	4,707	100%

(1) Equity investments are classified as unquoted reflecting the nature of the funds in which the Scheme invests directly. The underlying investments within those funds are, however, mostly quoted.

(2) Derivative financial instruments are used to modify the profile of the assets of the Scheme to better match the Scheme liabilities. Derivative holdings may lead to increased or decreased exposures to the physical asset categories disclosed above. At 30 September 2020, the Scheme had employer-related investments within the meaning of Section 40 (2) of the Pensions Act 1995 totalling £2m (2019: £2m).

Actuarial assumptions

The following assumptions were used in arriving at the IAS 19 defined benefit obligation:

	2020 % p.a.	2019 % p.a.
Financial assumptions		
Discount rate	**1.58**	1.77
Inflation (RPI)	**2.93**	3.20
Inflation (CPI)	**2.03**	2.20
Career average revalued earnings (CARE) revaluations:		
Pre 31 March 2012 benefits (RPI)	**2.93**	3.20
Post 31 March 2012 benefits (CPI capped at 5% per annum)	**2.03**	2.20
Pension increases (capped at 2.5% per annum)	**2.01**	2.10
Pension increases (capped at 5% per annum)	**2.85**	3.07
Rate of increase for pensions in deferment	**2.03**	2.20

3.10 Retirement benefit obligations continued

Demographic assumptions

	2020 Years	2019 Years
Post-retirement mortality:		
Current pensioners at 60 – male	**27.2**	28.0
Current pensioners at 60 – female	**29.3**	29.6
Future pensioners at 60 – male	**28.2**	29.1
Future pensioners at 60 – female	**30.4**	30.8

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:

- *discount rate applied:* this is set with reference to market yields at the end of the reporting year 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 20 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:* this 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; and
- *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 (as adjusted to reflect the characteristics of Scheme members) which allow for future improvements in life expectancies.

The table below sets out the sensitivity and impact on the balance sheet surplus position of the Scheme, the defined benefit obligation and pension cost to changes in the key actuarial assumptions:

Assumption change		Balance sheet surplus £m	Obligation £m	Pension cost £m
Discount rate	+ 0.25%	(29)	(180)	(5)
	– 0.25%	33	192	4
Inflation	+ 0.25%	(23)	128	2
	– 0.25%	26	(124)	(2)
Life expectancy	+1 year	(161)	161	3
	–1 year	156	(156)	(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.

3.11 Customer deposits

	2020 £m	2019 £m
Interest bearing demand deposits	**41,866**	38,551
Term deposits	**21,107**	22,239
Non-interest bearing demand deposits	**4,549**	3,002
Other wholesale deposits	**–**	1
	67,522	63,793
Accrued interest payable	**188**	207
	67,710	64,000

3.12 Debt securities in issue

Accounting policy

Debt securities comprise short and long-term debt issued by the Group including commercial paper, medium-term notes, 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:

	Medium-term notes £m	Subordinated debt £m	Securitisation £m	Covered bonds £m	Total £m
2020					
Amortised cost	**1,991**	**750**	**3,992**	**1,842**	**8,575**
Fair value hedge adjustments	**64**	**–**	**10**	**76**	**150**
Total debt securities	**2,055**	**750**	**4,002**	**1,918**	**8,725**
Accrued interest payable	**13**	**7**	**3**	**10**	**33**
	2,068	**757**	**4,005**	**1,928**	**8,758**
2019					
Amortised cost	1,838	722	5,040	1,828	9,428
Fair value hedge adjustments	47	–	2	74	123
Total debt securities	1,885	722	5,042	1,902	9,551
Accrued interest payable	12	9	9	10	40
	1,897	731	5,051	1,912	9,591

Key movements in the year are shown in the table below[(1)]. Full details of all notes in issue can be found at https://www.virginmoneyukplc.com/investor-relations/debt-investors/. There were no issuances or redemptions of covered bonds during the year.

	Issuances		Redemptions	
	Denomination	£m	Denomination	£m
Medium-term note	EUR	448	GBP	(300)
Subordinated debt	GBP	474	GBP	(445)
Securitisation	USD, GBP	491	USD, EUR, GBP	(1,492)
		1,413		(2,237)

(1) Other movements relate to foreign exchange, amortisation of issuance costs and the unwinding of acquisition accounting adjustments.

3.12 Debt securities in issue continued

The following tables provide a breakdown of the medium-term notes and subordinated debt by instrument as at 30 September:

Medium-term notes (excluding accrued interest)

	2020 £m	2019 £m
VM UK 3.125% fixed-to-floating rate callable senior notes due 2025	**298**	298
VM UK 4% fixed rate reset callable senior notes due 2026	**529**	523
VM UK 3.375% fixed rate reset callable senior notes due 2025	**369**	366
VM UK 4% fixed rate reset callable senior notes due 2027	**406**	397
VM UK 2.875% fixed rate reset callable senior notes due 2025	**453**	–
CB PLC 2.25% fixed rate senior notes due 2020	**–**	301
	2,055	1,885

Subordinated debt (excluding accrued interest)

	2020 £m	2019 £m
VM UK 5% fixed rate reset callable subordinated notes due 2026(1)	**31**	476
VM UK 7.875% fixed rate reset callable subordinated notes due 2028	**247**	246
VM UK 5.175% fixed rate reset callable subordinated notes due 2030	**472**	–
	750	722

(1) Following a successful tender process, 93.6% of this note was repurchased at par on 11 September 2020.

Details of securitisation and covered bond issuances are included in note 3.3.

3.13 Due to other banks

Accounting policy

Repurchase agreements

Securities sold subject to sale and repurchase agreements (‘repo’) 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.

	2020 £m	2019 £m
Secured loans	**5,397**	7,308
Securities sold under agreements to repurchase(1)	**–**	1,554
Transaction balances with other banks	**15**	12
Deposits from other banks	**57**	42
	5,469	8,916

(1) The underlying securities sold under agreements to repurchase have a carrying value of £Nil (2019: £2,324m).

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

3.14 Provisions 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
With the FCA's timebar deadline on PPI complaints having now passed and significant progress having been made into the large stock of complaints and IRs received in the weeks preceding the time bar, the level of uncertainty in determining the quantum of PPI related liability has reduced. The provision, however, continues to be subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2020, consequently the provision calculated may be subject to change in the future 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.

	2020 £m	2019 £m
PPI redress provision		
Opening balance	**379**	275
Charge to the income statement	**–**	415
Utilised	**(272)**	(311)
Closing balance	**107**	379
Customer redress and other provisions		
Opening balance	**25**	41
Adoption of IFRS 16 (note 5.4)	**8**	–
Opening balance (restated)	**33**	41
Virgin Money provision on acquisition	**–**	11
Charge to the income statement	**28**	18
Utilised	**(30)**	(45)
Closing balance	**31**	25
Property closure and redundancy provision		
Opening balance	**55**	15
Adoption of IFRS 16 (note 5.4)	**(11)**	–
Opening balance (restated)	**44**	15
Virgin Money provision on acquisition	**–**	2
Charge to the income statement	**19**	64
Utilised	**(29)**	(26)
Closing balance	**34**	55
Total provisions for liabilities and charges	**172**	459

3.14 Provisions for liabilities and charges continued

PPI redress

In common with the wider UK retail banking sector, the Group continues to deal with complaints received in the period up to the time bar in August 2019. The Group has made good progress in reviewing and closing the remaining IRs and related complaints and considers the remaining provision to be enough to meet current and future expectations in relation to the mis-selling of PPI policies and therefore no additional charge was required in the year. The total provision raised to date in respect of PPI is £3,055m (2019: £3,055m), with £107m of this remaining (2019: £379m).

At 30 September 2020 the Group had received 730,000 complaints with c.30,000 of those left to review.

The overall provision continues to be based on several assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. Our experience since the time bar has been within expectations, particularly around the validity of complaints requiring redress (uphold rate). The PPI operation is now moving into the final months and the main area of variability is the uphold rate on the remaining complaints. Until this process is fully complete there remains a residual risk that existing provisions for PPI customer redress may not cover all potential costs.

Customer redress and other provisions

Other provisions include amounts in respect of a number of non-PPI customer redress matters, legal proceedings, claims arising in the ordinary course of the Group's business and other matters. The Group has raised £26m of further provisions in relation to non-PPI customer redress matters in the year. The ultimate cost to the Group of these 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.

3.15 Other liabilities

Accounting policy

Deferred grants

Deferred grants are recognised when there is reasonable assurance that the grant will be received and that any conditions attached to the grant will be complied with. Where the grant relates to costs, it is released to the income statement on a systematic basis in line with the incurring of the related costs. Where the grant relates to the cost of an asset, it is released and recognised directly against the cost of the asset when incurred.

	2020 £m	2019 £m
Notes in circulation	**2,319**	2,277
Accruals and deferred income	**94**	130
Deferred grant	**35**	–
Other	**246**	127
	2,694	2,534

During the year, the Group applied for and was successful in receiving £35m from the CIF (as part of the RBS alternative remedies package). This will be utilised under the terms of the grant application in future financial years.

3.16 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 a financial 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 FVTPL 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 ELs 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 year in which they occur.

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

The tables show a comparison of the carrying amounts of financial assets and liabilities measured at amortised cost, 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 2020		30 September 2019	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Loans and advances to customers(1)	**72,430**	**71,788**	73,095	73,119
Financial liabilities				
Due to other banks(2)	**5,469**	**5,469**	8,916	8,874
Customer deposits(2)	**67,710**	**67,809**	64,000	64,166
Debt securities in issue(3)	**8,758**	**8,836**	9,591	9,667

(1) Loans and advances to customers are categorised as Level 3 in the fair value hierarchy with the exception of £1,060m (2019: £1,513m) of overdrafts which are categorised as Level 2.
(2) Categorised as Level 2 in the fair value hierarchy.
(3) Categorised as Level 2 in the fair value hierarchy with the exception of £2,846m of listed debt (2019: £2,606m) which is categorised as Level 1.

3.16 Fair value of financial instruments continued

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 which have similar characteristics. Contractual cash flows are then adjusted for ECLs 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.

(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) *Customer deposits* – The fair value of deposits is determined using a replacement cost method which assumes alternative funding is raised in the most advantageous market. The contractual cash flows have been discounted using a funding curve with credit spreads reflecting the tenor of each deposit.

(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 2020				Fair value measurement as at 30 September 2019			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets at fair value through other comprehensive income	**5,080**	**–**	**–**	**5,080**	4,328	–	–	4,328
Loans and advances at fair value through profit or loss	**–**	**190**	**–**	**190**	–	253	–	253
Other financial assets at fair value through profit or loss	**–**	**8**	**5**	**13**	–	–	14	14
Derivative financial assets	**–**	**318**	**–**	**318**	–	366	–	366
Total financial assets at fair value	**5,080**	**516**	**5**	**5,601**	4,328	619	14	4,961
Financial liabilities								
Financial liabilities at fair value	**–**	**–**	**–**	**–**	–	4	–	4
Derivative financial liabilities	**–**	**250**	**–**	**250**	–	273	–	273
Total financial liabilities at fair value	**–**	**250**	**–**	**250**	–	277	–	277

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

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) *Fair value through other comprehensive income* – The fair values of listed investments are based on quoted closing market prices.

(b) *Financial assets and liabilities at fair value through profit or loss:*

Loans and advances to customers and term deposits (Level 2) – The 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.

Financial assets at fair value through profit or loss (Level 2) – Comprises £8m of Visa Inc. Series A preferred stock which converted from Series B in September 2020. The fair value is derived from the closing bid price of Common A shares and the conversion factor.

Financial assets at fair value through profit or loss (Level 3) – Primarily represents £3m of Visa Inc. Series B preferred stock received as partial consideration for the sale of the Group's share in Visa Europe. 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 year end New York Stock Exchange share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity investments, the Group's share of the net asset value or the transaction price respectively is considered the best representation of the exit price and is the Group's best estimate of fair value.

(c) *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.

3.16 Fair value of financial instruments continued

Level 3 movement analysis:

	2020 Financial assets at fair value through profit or loss £m	2019 Financial assets at fair value through profit or loss £m
Balance at the beginning of the year	**14**	11
Fair value gains recognised[1]		
In profit or loss – unrealised	**1**	1
In profit or loss – realised	**5**	3
Purchases	**–**	3
Sales	**(10)**	–
Settlements	**(5)**	(4)
Balance at the end of the year	**5**	14

(1) Net gains or losses were recorded in non-interest income or FVOCI reserve as appropriate.

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 2020.

	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Other financial assets at FVTPL					
Equity investments	4	Discounted cash flow	Contingent litigation risk	0%	100%
Debt investments	1	Discounted cash flow	Recoverable amount	0%	100%

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 into the FVTPL equity investment is the contingent litigation risk.

Were this to crystallise in its entirety, the carrying value of the equity investments would reduce by £3m.

Other than this significant Level 3 measurement, 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.

Notes to the consolidated financial statements

Section 3: Assets and liabilities

3.17 Lessee accounting

Accounting policy

The Group as lessee

The Group leases offices, stores and other premises, and sub-leases certain premises which are no longer occupied by the Group. The Group applies a single lessee accounting model to all lease arrangements it enters into from the date on which the leased asset is available for use, with the exception of low value leases and short-term leases (less than 12 months) in respect of which the associated lease payments are expensed in the income statement on a straight line basis over the lease term.

Under the single lessee accounting model, the Group recognises a right-of-use asset and a lease liability at the commencement date of the lease. The right-of-use asset is initially measured at cost, comprising the initial amount of the lease liability plus any initial direct costs incurred and any lease payments made at or before the lease commencement date, less any lease incentives received. The right-of-use asset is subsequently depreciated using the straight line method from the commencement date to the earlier of the end of the useful life of the asset or the end of the lease term, subject to review for impairment. The lease liability is initially measured at the present value of the lease payments, discounted using the interest rate implicit in the lease, or if that rate cannot readily be determined (as is the case in the majority of the leasing activities of the Group), the incremental borrowing rate. The liability is remeasured when there is a change in future lease payments arising from a change in an index or a rate or a change in the Group's assessment of whether it will exercise an extension or termination option. When the lease liability is remeasured, a corresponding adjustment is made to the right-of-use asset or is recorded in the income statement if the carrying amount of the right-of-use asset has been reduced to zero.

Termination options are included in a number of leases across the Group with a small number of leases having extension options. These terms are used to maximise operational flexibility in terms of managing contracts. In determining judgements on the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Periods covered by termination options are only included in the lease term if it is reasonably certain that the lease will not be terminated. The assessment of the lease term is reviewed if a significant event or a significant change in circumstances occurs that is within the control of the Group.

The Group as sub-lessor

Sub-leases are classified as finance leases if substantially all the risks and rewards incidental to ownership of the underlying asset are transferred, otherwise they are classified as operating leases. Finance sub-leases are recognised in other assets 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 reflecting a constant periodic rate of return. Operating sub-lease income is recognised in the income statement on a straight line basis over the lease term.

a) Amounts recognised in the income statement

The income statement includes the following amounts related to leases:

	2020 £m
Interest expense and similar charges	
Interest expense	**(3)**
Other operating income	
Amounts receivable under leases where the Group is a lessor	**1**
Operating and administrative expenses	
Depreciation and impairment of right-of-use assets	**(30)**
Expense relating to short-term leases	**(3)**
Expense relating to leases of low-value assets that are not short-term leases	**(2)**
Amounts recognised in the income statement	**(37)**

Total leasing cash outflow in the year was £30m.

3.17 Lessee accounting continued

b) Amounts recognised on the balance sheet

Right-of-use assets

	2020 £m
As at 30 September 2019	–
Adjustment on transition to IFRS 16	194
As at 1 October 2019	**194**
Additions	3
Remeasurements	(6)
Depreciation and impairment	(30)
As at 30 September 2020	**161**

All right-of-use assets relate to leases of land and buildings.

On 31 July 2020 the Group announced plans for the closure of 35 properties leased by the Group. The value of the right-of-use asset associated with these properties at that time was £10m. Following the announcement, the recoverable amount of the right-of-use assets was assessed. Where it is expected the Group can sub-lease the property, the value-in-use was determined on expected sub-lease income. Where the Group does not expect to be able to generate any cash inflows beyond the closure date the value-in-use was determined to be £Nil. The discount rates used in the value-in-use calculations ranged from 0.8%-1.6%. The total value-in-use was £4m resulting in an impairment charge of £6m, which has been recognised in other operating and administration expenses. In addition to the impairment charge relating to the right-of-use assets, a provision has been recognised for other costs associated with the closures (note 3.14).

On 30 September 2020 the Group also reviewed its existing surplus estate population for impairment. It was concluded that 27 properties should be impaired following this assessment. The discount rates used in the value-in-use calculations ranged from 0.7%-1.7%. The total value-in-use was £4m resulting in an impairment charge of £0.5m, which has been recognised in other operating and administrative expenses.

Sub-leases

Future undiscounted minimum payments receivable in respect of sub-leased assets at 30 September were as follows:

	2020 £m
Operating leases	4
Finance leases	5
	9

Lease liabilities

	2020 £m
Lease liabilities[1]	175

(1) Lease liabilities are presented within other liabilities on the balance sheet.

Future undiscounted minimum payments under lease liabilities at 30 September 2020 were as follows:

Amounts falling due	2020 £m
Within 1 year	27
Between 1 and 5 years	84
Over 5 years	88
	199

3.17 Lessee accounting continued

c) Lease commitments not recognised on the balance sheet

In addition to the lease liabilities recognised on the balance sheet, the Group also has lease commitments relating to leases which have not yet commenced at the balance sheet date. Future undiscounted minimum payments on leases which are yet to commence were as follows:

Amounts falling due	2020 £m	2019(1) £m
Within 1 year	**–**	35
Between 1 and 5 years	**18**	135
Over 5 years	**112**	244
	130	414

(1) The 2019 disclosure includes all lease commitments and is presented on an IAS 17 basis, prior to the adoption of IFRS 16 on 1 October 2019. As such, the prior year is not directly comparable with the undiscounted lease liability payments in the current year due to differences between the cash flows included in the measurement of the lease liability compared to the basis of calculation for the 2019 commitment disclosure. Refer to note 5.4 for a reconciliation of the prior year commitment to the opening lease liability balance.

Notes to the consolidated financial statements

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 impose 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.

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.

Dividends

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 and share premium

	2020 £m	2019 £m
Share capital	**144**	143
Share premium	**3**	3
Share capital and share premium	**147**	146

	2020 Number of shares	2019 Number of shares	2020 £m	2019 £m
Ordinary shares of £0.10 each – allotted, called up and fully paid				
Opening ordinary share capital	**1,434,485,689**	886,079,959	**143**	89
Share for share exchange	**–**	540,856,644	**–**	54
Issued under employee share schemes	**4,088,998**	7,549,086	**1**	–
Closing ordinary share capital	**1,438,574,687**	1,434,485,689	**144**	143

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 2020 rank equally with regard to the Company's residual assets.

During the year, 4,088,998 (2019: 7,549,086) ordinary shares were issued under employee share schemes with a nominal value of £0.4m (2019: £0.7m).

A final dividend in respect of the year ended 30 September 2018 of 3.1p per ordinary share amounting to £45m was paid in February 2019. This dividend was deducted from retained profits in the prior year. No dividend was declared or paid in respect of the year ended 30 September 2019. In light of the current uncertainty as to the economic impact of the COVID-19 pandemic, the Directors do not recommend payment of a dividend in respect of the year ended 30 September 2020.

Share premium represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued ordinary shares.

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 Equity continued

4.1.2 Other equity instruments

Other equity instruments consist of the following Perpetual Contingent Convertible Notes:

- Perpetual securities (fixed 8% up to the first reset date) issued on 8 February 2016 with a nominal value of £450m and optional redemption on 8 December 2022;
- Perpetual securities (fixed 8.75% up to the first reset date) issued on 10 November 2016 with a nominal value of £230m and optional redemption on 10 November 2021. This was held by Virgin Money Holdings (UK) PLC on the date of acquisition and was originally recognised as a non-controlling interest (note 4.1.6). Following a change in obligor from Virgin Money Holdings (UK) PLC to CYBG PLC on 20 August 2019, this has been recognised within other equity; and
- Perpetual securities (fixed 9.25% up to the first reset date) issued on 13 March 2019 with a nominal value of £250m and optional redemption on 8 June 2024.

The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £15m (2019: £15m). AT1 distributions of £79m were paid in the year (2019: £41m). Following revisions to the tax rules on hybrid capital which took effect from 1 January 2019, Hybrid Capital Instruments elections covering the Group's AT1s that existed at 1 January 2019 were made to HMRC on 27 September 2019. Accordingly, in line with the revised standard, the tax credits for these payments have been recognised in the income statement.

4.1.3 Capital reorganisation reserve

The capital reorganisation reserve of £839m was recognised on the issuance of the Company's ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of the Group's previous parent company, CYB Investments Limited (CYBI). The reserve reflects the difference between the consideration for the issuance of the Company's 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 the Company's ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of CYBI. An additional £1,495m was recognised on the issuance of the Company's ordinary shares in October 2018 in exchange for the acquisition of the entire share capital of Virgin Money Holdings (UK) PLC. The merger reserve reflects the difference between the consideration for the issuance of the Company's shares and the nominal value of the shares issued.

4.1.5 Other reserves

Own shares held

Virgin Money Holdings (UK) PLC established an EBT in 2011 in connection with the operation of its share plans. On the date of acquisition by the Company, the shares held in the EBT were converted to the Company's shares at a ratio of 1.2125 Company shares for each Virgin Money Holdings (UK) PLC share. The investment in own shares as at 30 September 2020 is £0.5m (2019: £1m). The market value of the shares held in the EBT at 30 September 2020 was £0.1m (2019: £1m).

Deferred shares reserve

The deferred shares reserve comprises shares to be issued in the future relating to employee share plans in regard to the settlement of outstanding Virgin Money Holdings (UK) PLC share awards, which will be settled through the issuance of the Company's shares at a future date in line with the vesting profile of the underlying plans.

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.

FVOCI reserve

The FVOCI reserve records the unrealised gains and losses arising from changes in the fair value of financial assets at FVOCI. The movements in this reserve are detailed in the consolidated statement of comprehensive income.

Cash flow hedge reserve

The cash flow hedge reserve represents the effective portion of 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.

	2020 £m	2019 £m
At 1 October	**(26)**	(39)
Amounts recognised in other comprehensive income:		
Cash flow hedge – interest rate risk		
Effective portion of changes in fair value of interest rate swaps	**(74)**	14
Amounts transferred to the income statement	**1**	–
Taxation	**19**	(3)
Cash flow hedge – foreign exchange risk		
Effective portion of changes in fair value of cross currency swaps	**(59)**	59
Amounts transferred to the income statement	**59**	(57)
At 30 September	**(80)**	(26)

4.1 Equity continued

4.1.6 Non-controlling interests

On 15 October 2018, the date on which it was acquired by the Company, Virgin Money Holdings (UK) PLC (now an intermediate holding company within the Group) had in issue Fixed Rate Resettable AT1 securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these were classified as equity instruments. The Group did not acquire the AT1 securities at that time, consequently these represented a non-controlling interest. As the AT1 instruments were actively traded, the fair value on acquisition of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018. Subsequently on 20 August 2019, there was a change in obligor from Virgin Money Holdings (UK) PLC to the Company, following which these instruments have been recognised within other equity (note 4.1.2).

There were no distributions to non-controlling interests in the current year (2019: £33m paid, £26m net of 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 year, 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 £10m (2019: £4m).

Virgin Money UK PLC awards

The Group issues awards to employees under the following share plans:

Plan	Eligible employees	Nature of award	Vesting conditions(1)	Grant dates(2)
DEP(3)	Selected employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances	2016, 2017, 2018 and 2019
LTIP	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, 2018 and 2019
SIP	All employees	Non-conditional share award	Continuing employment	2016, 2017 and 2018

(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 DEP are made the year following the financial year to which they relate.

Further detail on each plan is provided below:

DEP

Under the plan, employees are awarded conditional rights to Virgin Money UK 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; and
- buyout of equity from previous employment.

LTIP

Under the plan, employees are awarded conditional rights to Virgin Money UK 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 Group's strategic goals. Measures, relative weightings and the quantum for assessing performance are outlined in the Directors' remuneration report contained in the Group's Annual Report & Accounts.

Notes to the consolidated financial statements

4.2 Equity based compensation continued

SIP

At the date of the awards, eligible employees are awarded Group shares which are held in the 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 and 2017 awards, leavers (with the exception of gross misconduct) retain their awards but they must withdraw their shares from the SIP Trust.

Awards/rights made during the year

Plan	Number outstanding at 1 October 2019	Number awarded	Number forfeited	Number released	Number outstanding at 30 September 2020	Average fair value of awards at grant pence
DEP						
2015 Demerger	28,224	–	–	(28,224)	–	196.96
2016 Bonus	10,703	–	–	(10,703)	–	266.03
2016 Commencement	20,404	–	–	(14,694)	5,710	266.03
2017 Bonus	231,070	–	–	(7,706)	223,364	313.20
2017 Commencement	5,109	–	–	(5,109)	–	313.20
2018 Bonus	171,805	–	–	(1,156)	170,649	192.35
2019 Bonus	–	1,710,334	(7,969)	(1,610,437)	91,928	174.50
2019 Commencement	–	67,528	–	(35,890)	31,638	174.50
LTIP						
2016 LTIP	2,028,468	–	(803,312)	(1,225,156)	–	266.03
2017 LTIP	2,106,953	–	(63,551)	–	2,043,402	313.20
2018 LTIP	5,795,804	–	(149,594)	–	5,646,210	190.47
2019 LTIP	–	8,976,526	(39,509)	–	8,937,017	174.50
SIP						
2015 Demerger	1,026,492	–	(2,560)	(95,903)	928,029	194.67
2017 Free Share	836,976	–	(4,611)	(62,328)	770,037	313.20
2019 Free Share	2,210,802	–	(110,208)	(119,802)	1,980,792	202.53

Determination of grant date fair values

The grant date fair value of the awards 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 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.

The ECL requirements as described in note 3.2 apply to loan commitments and financial guarantee contracts.

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 customers default. 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

	2020 £m	2019 £m
Guarantees and assets pledged as collateral security:		
Due in less than 3 months	**18**	24
Due between 3 months and 1 year	**15**	24
Due between 1 year and 3 years	**14**	6
Due between 3 years and 5 years	**2**	11
Due after 5 years	**46**	48
	95	113
Other credit commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**16,775**	15,158

Of the Group's total loan commitments and financial guarantee contracts of £16,870m, £15,155m (89.8%) are held under Stage 1 for IFRS 9 purposes, with £1,666m in Stage 2 and £49m in Stage 3. ECLs of £7m (2019: £5m) are held for undrawn exposures, of which £1m was held under Stage 1 and £6m under Stage 2. In terms of credit quality, over 95% of the loan commitments and financial guarantee contracts were classed as either 'Good' or 'Strong' under the Group's internal PD rating scale.

Capital commitments

The Group had future capital expenditure which had been contracted for, but not provided for, at 30 September 2020 of £0.4m (2019: £0.2m).

The Group has committed to providing additional funding of up to £10.9m over the next 12 months to support the strategic and customer proposition development of UTM. AAM, the other shareholder in UTM, has also committed to providing additional funding of up to £10.9m over the same timeframe.

Other contingent liabilities

Conduct risk related matters

There continues to be 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. Following the August 2019 time bar for PPI complaints the Group has made good progress in reviewing and closing the IRs and related complaints. Until all matters are closed the final amount required to settle the Group's potential liabilities for these, and other conduct related matters, remains 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.

5.2 Notes to the statement of cash flows

	2020 £m	2019 £m
Adjustments included in the loss before tax		
Interest receivable	**(2,137)**	(2,432)
Interest payable	**854**	918
Depreciation and amortisation (note 2.4)	**149**	108
Derivative financial instruments fair value movements	**11**	17
Impairment losses on credit exposures (note 3.2)	**507**	252
Software impairments and write-offs	**–**	132
IFRS 16 impairment losses on PPE	**6**	–
Gain on sale of 50% (less one share) consideration in Virgin Money Unit Trust Managers Limited	**–**	(35)
Equity based compensation (note 4.2)	**10**	4
Gain on disposal of fair value through other comprehensive income assets (note 2.3)	**(16)**	–
Other non-cash movements	**10**	1
	(606)	(1,035)
Changes in operating assets		
Net increase in:		
Balances with supervisory central banks	**(38)**	(20)
Due from other banks	**–**	(143)
Derivative financial instruments	**(96)**	64
Financial instruments at fair value through other comprehensive income	**–**	16
Financial assets at fair value through profit or loss	**65**	103
Loans and advances to customers	**134**	(2,663)
Defined benefit pension assets	**(35)**	(74)
Other assets	**(105)**	174
	(75)	(2,543)
Changes in operating liabilities		
Net increase in:		
Due to other banks	**(1,531)**	(12)
Derivative financial instruments	**(23)**	(128)
Financial liabilities at fair value through profit or loss	**(4)**	(11)
Customer deposits	**3,728**	2,837
Provisions for liabilities and charges	**(294)**	128
Other liabilities	**1**	(184)
	1,877	2,630

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).

	2020 £m	2019 £m
Cash and balances with central banks (less mandatory deposits)	**8,887**	10,113
Due from other banks (less than three months)	**927**	1,018
	9,814	11,131

5.3 Related party transactions

	2020 £m	2019 £m
Investments in joint ventures and associates		
Virgin Money Unit Trust Managers Limited(1)	**3**	8
Salary Finance Loans Limited(2)	**–**	–
Loans and advances		
Salary Finance Loans Limited(2)	**119**	53
Other assets		
Amounts due from Virgin Money Unit Trust Managers Limited(1)	**3**	2
Total assets with related entities	**125**	63
Customer deposits		
The Virgin Money Foundation	**–**	1
Other liabilities		
Group pension deposits(3)	**17**	17
Commissions and charges due to Virgin Atlantic Airways Limited(4)	**1**	6
Trademark licence fees due to Virgin Enterprises Limited(5)	**4**	4
Total liabilities with related entities	**22**	28
Non-interest income		
Net fees and commissions to Virgin Atlantic Airways Limited(4)	**(12)**	(15)
Share of post-tax result of Virgin Money Unit Trust Managers Limited(1)	**(6)**	(1)
Gain on sale of 50% (less one share) consideration in Virgin Money Unit Trust Managers Limited to Aberdeen Asset Management(1)	**–**	35
Operating and administrative expenses		
Trademark licence fees to Virgin Enterprises Limited(5)	**(13)**	(11)
Costs recharged to Virgin Money Unit Trust Managers Limited(1)	**7**	2
Donations to the Virgin Money Foundation(6)	**(1)**	(2)
Total income statement	**(25)**	8

(1) The Group has a JV with AAM, named UTM. During the year, the Group purchased additional shares in the JV totalling £1.6m as part of a commitment to provide £12.5m of additional funding over the 12 month period to April 2021. Amounts due from UTM and costs recharged to UTM relate to the recharge of relevant Group costs such as systems support, staff costs, and marketing.

(2) The Group has a JV with Salary Finance Limited, where both shareholders own a 50% equity share in Salary Finance Loans Limited. The JV connects to the payroll of participating employers to offer salary-deducted loans. The Group provides a revolving credit facility funding line, of which the current gross lending balance is £119m (2019: £53m). The facility is held under Stage 1 for credit risk purposes with a minimal amount of ECLs held. The undrawn facility is £81m (2019: £47m). The share of loss is £0.2m (2019: £0.3m).

(3) 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 £0.1m (2019: £0.1m), were charged to the Group sponsored scheme. Information on the pension schemes operated by the Group is provided in note 3.10. Pension contributions of £35m (2019: £83m) were made to the Scheme (note 3.10).

(4) The Group incurs credit card commissions and air mile charges from Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. £1m (2019: £4m) of cash costs payable to VAA have been deferred on the balance sheet.

(5) Licence fees of £13m (2019: £11m) were payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark.

(6) The Group has made donations to the Virgin Money Foundation to enable it to pursue its charitable objectives. The Group has also provided a number of support services to the Virgin Money Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.4m (2019: £0.6m) and is included in the total value disclosed above.

The Group paid £Nil (2019: £0.2m) ordinary dividends to Virgin Group Holdings Limited during the year.

5.3 Related party transactions continued

Compensation of key management personnel (KMP)
KMP comprises Directors of the Company and members of the Executive Leadership Team.

	2020 £m	2019 £m
Salaries and short-term benefits	**10**	14
Termination benefits	**1**	5
Equity based compensation(1)	**4**	2
	15	21

(1) The expense recognised in the year is in accordance with IFRS 2 'Equity based compensations', including associated employers' NIC.

The following information regarding Directors' remuneration is presented in accordance with the Companies Act 2006.

	2020 £m	2019 £m
Aggregate remuneration(1)	**4**	5

(1) Aggregate emoluments include amounts paid for the 2020 year and amounts paid under LTIPs in 2020 relating to 2016 LTIP awards released in 2020 (£0.3m).

None of the Directors were members of the Group's defined contribution pension scheme during 2020 (2019: none).

None of the Directors were members of the Group's defined benefit pension scheme during 2020 (2019: none). None of the Directors hold share options and none were exercised during the year (2019: none).

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

	2020 £m	2019 £m
Loans and advances	**4**	4
Deposits	**2**	3

No provisions have been recognised in respect of loans provided to the KMP (2019: £Nil). There were no debts written off or forgiven during the year to 30 September 2020 (2019: £Nil). Included in the above are eight (2019: four) loans totalling £1m (2019: £1m) made to Directors. In addition to the above, there are guarantees of £Nil (2019: £Nil) made to Directors and their related parties.

5.4 Transition to IFRS 16 'Leases'

The Group has adopted IFRS 16 Leases from 1 October 2019 and elected to apply the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings as at 1 October 2019 and comparatives are not restated. Under the modified retrospective approach, at transition, lease liabilities have been measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as at 1 October 2019. The weighted-average borrowing rate applied to these lease liabilities on transition was 1.7%. For the purposes of applying the modified retrospective approach, the Group has elected to:

- measure the right-of-use asset at an amount equal to the lease liability at the date of initial application adjusted by the amount of any prepaid or accrued lease payments;
- apply the exemption not to recognise right-of-use assets and liabilities for leases with less than 12 months of lease term;
- apply the practical expedient to rely on its assessment as to whether the lease was onerous under IAS 37 and therefore adjust the right-of-use asset at the date of initial application by the onerous lease provision rather than conduct an impairment test; and
- apply the practical expedient to grandfather the assessment of which transactions are leases. It will apply IFRS 16 only to contracts that were previously identified as leases by IAS 17. Contracts that were not identified as leases under IAS 17 and IFRIC 4 will not be reassessed. Therefore, the definition of a lease under IFRS 16 will only be applied to contracts entered into or changed on or after 1 October 2019.

5.4 Transition to IFRS 16 'Leases' continued

The impact of the adoption of IFRS 16 on the opening balance sheet as at 1 October 2019 is shown in the table below:

	As at 30 September 2019 £m	Impact of IFRS 16 £m	Restated as at 1 October 2019 £m
Property, plant and equipment	145	194	339
Other assets	237	–	237
Provisions	459	(3)	456
Other liabilities	2,534	196	2,730
Equity	5,021	1	5,022

The adoption of IFRS 16 has absorbed 10bps of the Group's CET1 capital, principally through the risk weighting of assets now recognised on balance sheet.

Lease liabilities amounting to £205m in respect of leased properties previously accounted for as operating leases were recognised at 1 October 2019. Offsetting this in the £196m movement in other liabilities on adoption is a £9m transfer of rent-free period accruals out of other liabilities on transition.

The following is a reconciliation of operating lease commitments disclosed at 30 September 2019 to the lease liability recognised at 1 October 2019:

	£m
Undiscounted future minimum lease payments under operating leases at 30 September 2019	414
Leases not yet commenced at 1 October 2019	(129)
Irrecoverable VAT included in future minimum lease payments	(49)
Short-term leases recognised on a straight line basis as an expense	(2)
Lease prepayments	(6)
Discounted at the incremental borrowing rate	(24)
Other	1
Total lease liability recognised as at 1 October 2019	205

IFRS 16 amends the criteria applied to assess whether a sub-lease is an operating lease or a finance lease. Changes to the classification of sub-leases where the Group is lessor under IFRS 16 has resulted in certain sub-leases of surplus estate previously classified as operating leases being reclassified as finance leases. In those cases, any difference between the value of the impaired right-of-use asset on transition and the sub-lease receivable recognised on transition is recognised as a gain or loss directly within equity.

Under IFRS 16, the operating lease expense previously recorded in operating and administrative costs has been replaced by a depreciation charge (also included within operating and administrative costs), which is lower than the operating lease expense recognised under IAS 17, and a separate interest expense, recorded in 'interest expense'. While the decision to transition using the modified retrospective approach impacts comparability with prior years within the Group's consolidated income statement, the line item impact is not material.

There is no net cash flow impact arising from the adoption of the new standard.

The Group's revised accounting policy is disclosed in note 3.17.

5.5 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 2020 financial year, will be issued concurrently with the Annual Report & Accounts and can be found at www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/.

5.6 Post balance sheet events

Appointment of Group Chief Financial Officer

On 17 November 2020, we announced that Clifford Abrahams had been appointed Executive Director and Group Chief Financial Officer and that it was expected that he would join the Group in March 2021, subject to regulatory approval.

Additional information

Financial performance measures

As highlighted in the Business and financial review and the Risk report, 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 statutory cost to income ratio and the statutory RoTE.

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 129, directly following this section. These adjustments to the Group's statutory results made by management are designed 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**	Underlying NII as a percentage of average interest earning assets for a given year. Underlying NII of £1,351m (2019: £1,433m) is divided by average interest earning assets for a given year of £86,826m (2019: £86,362m) (which has been adjusted to exclude short-term repos used for liquidity management purposes). As a result of the exclusions noted above, average interest earning assets used as the denominator have been reduced by £16m (2019: £Nil).
Statutory return on tangible equity **(RoTE)**	**A**	Statutory loss after tax attributable to ordinary equity holders of £220m (2019: loss of £253m) as a percentage of average tangible equity of £3,554m (2019: £3,727m) (average total equity less intangible assets, AT1 and non-controlling interests) for a given year.
Statutory return on assets	**A**	Statutory loss after tax as a percentage of average total assets for a given year.
Statutory basic earnings per share **(EPS)**	**S**	Statutory loss after tax attributable to ordinary equity shareholders of £220m (2019: loss of £253m), divided by the weighted average number of ordinary shares in issue for a given year of 1,440m shares (2019: 1,414m) (which includes deferred shares and excludes own shares held or contingently returnable shares).
Underlying RoTE	**A**	Underlying profit after tax attributable to ordinary equity holders of £20m, (2019: £403m), as a percentage of average tangible equity of £3,554m (2019: £3,727m) (average total equity less intangible assets, AT1 and non-controlling interests) for a given year.
Underlying CIR	**A**	Underlying operating and administrative expenses as a percentage of underlying total operating income for a given year.
Underlying return on assets	**A**	Underlying profit after tax as a percentage of average total assets for a given year.
Underlying basic EPS	**A**	Underlying profit after tax attributable to ordinary equity holders of £20m, (2019: £403m), divided by the weighted average number of ordinary shares in issue for a given year of 1,440m shares (2019: 1,434m) (which includes deferred shares and excludes own shares held or contingently returnable shares).
Underlying profit after tax attributable to ordinary equity holders	**A**	Underlying profit before tax of £124m (2019: £539m) less underlying tax charge of £25m (2019: £62m), less AT1 distributions of £79m (2019: £41m), less distributions to non-controlling interests of £Nil (2019: £33m) and was equal to £20m (2019: £403m). The underlying tax charge (or credit) is the difference between the statutory tax charge (or credit) and the tax attributable to exceptional items.

(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 such as highlights, key metrics, KPIs and key credit metrics.

Financial performance measures

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).
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 for the Clydesdale Bank PLC portfolio while the Virgin Money Holdings (UK) PLC portfolio is indexed using the Markit indices.

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 RWAs.
Total capital ratio	**R**	Total capital resources divided by RWAs at a given date.
CRD IV leverage ratio	**R**	This is a regulatory standard ratio proposed by 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.
UK 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 (total equity less intangible assets, AT1 and non-controlling interests) as at the year end of £3,526m (2019: £3,590m) divided by the number of ordinary shares in issue at the year end of 1,444m (2019: 1,441m) (which includes deferred shares of 6m (2019: 7m) and excludes own shares held of 0.2m (2019: 0.5m)).
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.
Minimum requirement for own funds and eligible liabilities **(MREL)** ratio	**R**	Total capital resources less ineligible AT1 and Tier 2 instruments at the year end of £4,935m (2019: £4,840m) plus senior unsecured securities issued by Virgin Money UK PLC with greater than one year to maturity at the year end of £2,002m (2019: £1,550m) divided by RWAs at the period end of £24,399m (2019: £24,046m).
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.

Underlying adjustments to the statutory view of performance

On 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, as management consider that this presents more comparable results year-on-year. These items are all significant and are typically one-off in nature. Additional detail is provided below where considered necessary to further explain the rationale for their exclusion from underlying performance, in particular for new items in the current year or recurring non-underlying items:

Item	2020 £m	2019 £m	Reason for exclusion from the Group's current underlying performance
Integration and transformation costs	**(139)**	(156)	These are part of the Group's publicised three-year integration plan following the acquisition of Virgin Money Holdings (UK) PLC and comprise a number of one-off expenses that are required to realise the anticipated cost synergies. Also included are one-off costs to support transformation. This programme will improve our digital capability and consequently enable super straightforward efficiency.
Acquisition accounting unwinds	**(113)**	(87)	This consists principally of the unwind of the IFRS 3 fair value adjustments created on the acquisition of Virgin Money Holdings (UK) PLC in October 2018 (£96m charge) and the IFRS 9 impairment impact in 2020 on acquired assets (£6m charge) with other smaller items amounting to £11m. These represent either one-off adjustments or are the scheduled reversals of the accounting adjustments that arose following the fair value exercise required by IFRS 3. These will continue to be treated as non-underlying adjustments over the expected three to five-year period until they have been fully reversed.
Legacy conduct	**(26)**	(433)	These costs are historical in nature and are not indicative of the Group's current practices.
Other:			
SME transformation	**(11)**	(30)	These costs are significant and relate to the Group's transformation of its Business banking propositions and encompass process re-engineering and customer journey improvements required to support customers migrating under the RBS incentivised switching proposition, and certain costs in respect of government backed schemes.
UTM transition costs	**(8)**	(1)	These costs relate to UTM's transformation costs principally for the build of a new platform for administration and servicing. The costs are one-off in nature as part of the transition to the new JV proposition.
VISA Shares	**5**	–	A one-off gain on conversion of Visa B Preference shares to Series A preference shares.
Intangible asset write-off	**–**	(127)	The charge for the software write-off in the prior year was significant and arose in respect of software assets which are no longer considered to be of value relative to the Group's strategy following the acquisition of Virgin Money Holdings (UK) PLC.
Mortgage EIR adjustments	**–**	80	The alignment of accounting practices was a one-off exercise arising from the acquisition.
Virgin Money Holdings (UK) PLC transaction costs	**–**	(55)	These costs related directly to the transaction and comprised legal, advisory and other associated costs required to complete the transaction.
Consent solicitation	**–**	(18)	One-off costs relating to the change in obligor of senior debt from Virgin Money Holdings (UK) PLC to CYBG on 20 August 2019.
Gain on sale of UTM	**–**	35	A one-off gain recognised on the disposal of 50% (less one share) of UTM.
GMP equalisation cost	**–**	(11)	A one-off charge for GMP equalisation in the Group's defined benefit scheme.
Legacy restructuring and separation	**–**	(5)	These legacy costs were significant in prior years and related to the Sustain programme, and demerger from NAB, both of which are now complete.
Gain on disposal of VocaLink	**–**	4	
Total other	**(14)**	(128)	

Glossary

Term	Definition
Additional Tier 1 **(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.
Bank	Clydesdale Bank PLC.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision (BCBS) in June 2004.
Basel III	Reforms issued by the BCBS in December 2017 with subsequent revisions.
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 Virgin Money UK PLC Board or the Clydesdale Bank PLC Board as appropriate.
Bounce back loan scheme **(BBLS)**	A scheme implemented by the UK Government to provide financial support to businesses across the UK that are losing revenue, and seeing their cashflow disrupted as a result of COVID-19, and that can benefit from £50,000 or less in finance.
Business lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.
carbon related assets	Assets tied to the energy and utilities sectors under the Global Industry Classification Standard (mapped to internal industry classifications), excluding water utilities and independent power and renewable electricity producer industries.
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.
cash and cash equivalents	For the purposes of the statement of cash flows, cash and cash equivalents comprise cash and non-mandatory deposits with central banks and amounts due from other banks with a maturity of less than three months.
Code	The 2018 UK Corporate Governance Code.
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	Virgin Money UK PLC, and its controlled entities following the acquisition of Virgin Money Holdings (UK) PLC.
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	Virgin Money UK 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.
Coronavirus business interruption loan scheme **(CBILS)**	A scheme implemented by the UK Government to provide financial support to smaller businesses across the UK that are losing revenue, and seeing their cashflow disrupted, as a result of COVID-19.
Coronavirus large business interruption loan scheme **(CLBILS)**	A scheme implemented by the UK Government to provide financial support to mid-sized and larger businesses across the UK that are suffering disruption to their cashflow due to lost or deferred revenues as a result of COVID-19.
counterparty	The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete.
Coverage ratio	Impairment allowance as at the year end shown as a percentage of gross loans and advances as at the year end.
covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
CRD IV	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 conversion factor **(CCF)**	Credit conversion factors are used in determining the exposure at default in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn and off-balance sheet commitments expected to be drawn down at the point of default.
Credit impaired financial asset	A financial asset that is in default or has an individually assessed provision. This is also referred to as a 'Stage 3' impairment loss and subject to a lifetime ECL calculation. The Group considers 90 DPD as a backstop in determining whether a financial asset is credit impaired.

Glossary

Term	Definition
Credit risk mitigation **(CRM)**	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set-off or netting.
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 or corporate entities that are not credit institutions, and can be either interest bearing, non-interest bearing or term deposits.
days past due **(DPD)**	The number of days a facility has borrowing in excess of an agreed or expired limit or, where facilities are subject to a regular repayment schedule, contractual payments are not fully up to date.
default	A customer is in default when either they are more than 90 DPD 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.
effective interest rate **(EIR)**	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.
Exposure at default **(EAD)**	The estimate of the amount that the customer will owe at the time of default.
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 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, 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	Virgin Money UK PLC 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.
IFRS 9	The financial instrument accounting standard which was adopted by the Group with effect from 1 October 2018.
impairment allowances	An ECL provision held on the balance sheet for financial assets calculated in accordance with IFRS 9. The impairment allowance is calculated as either a 12-month or a lifetime ECL.
impairment losses	The ECL calculated in accordance with IFRS 9 and recognised in the income statement with the carrying value of the financial asset reduced by creating an impairment allowance. Impairment losses are calculated as either a 12-month or lifetime ECL.
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.
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.

Glossary

Term	Definition
lifetime expected credit loss	The expected credit loss calculation performed on financial assets where a SICR since origination has been identified.This can be either a 'Stage 2' or 'Stage 3' impairment loss depending on whether the financial asset is credit impaired.
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 given default **(LGD)**	The estimate of the loss that the Group will suffer if the customer defaults (incorporating the effect of any collateral held).
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.
net interest income **(NII)**	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.
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.
Personal lending	Lending to individuals rather than institutions and excludes mortgage lending which is reported separately.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.
probability of default **(PD)**	The probability that a customer will default over either the next 12 months or lifetime of the account.
regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA.
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).
ring-fencing	A 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.
Significant increase in credit risk **(SICR)**	The assessment performed on financial assets at the reporting date to determine whether a 12-month or lifetime ECL calculation is required. Qualitative and quantitative triggers are assessed in determining whether there has been a significant increase in credit risk since origination. The Group considers 30 DPD as a backstop in determining whether a significant increase in credit risk since origination has occurred.
standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions 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.

Glossary

Term	Definition
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 CET1 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.
unaudited	Financial information that has not been subject to validation by the Group's external auditor.
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 UK PLC. 'Virgin Money' is also used throughout this report when referring to the acquired business of Virgin Money Holdings (UK) PLC or subsequent integration of the acquired business within the newly combined Group.
Virgin Money Holdings	Virgin Money Holdings (UK) PLC.

Abbreviations

AAM	Aberdeen Asset Managers PLC
ACS	Annual cyclical scenario
AFD	Approaching financial difficulty
AIRB	Advanced internal ratings-based
ALCO	Asset and Liability Committee
API	Application programming interface
ASX	Australian Securities Exchange
AT1	Additional Tier 1
ATM	Automated teller machine
BAME	Black, Asian and ethnic minority
BAU	Business-as-usual
BBL	Bounce back loan
BBLS	Bounce back loan scheme
BCA	Business current account
BCBS	Basel Committee on Banking Supervision
BCR	Banking Competition Remedies
BoE	Bank of England
bps	Basis points
BTL	Buy-to-let
CAGR	Compound Annual Growth Rate
CARE	Career average revalued earnings
CBIL	Coronavirus business interruption loan
CBILS	Coronavirus business interruption loan scheme
CCB	Capital Conservation Buffer
CCF	Credit conversion factor
CCyB	Countercyclical Capital Buffer
CDI	CHESS Depositary Interest
CDP	Carbon Disclosure Project
CET1	Common Equity Tier 1 Capital
CIF	Capability and Innovation Fund
CIR	Cost to income ratio
CISRO	Chief Information Security and Resilience Officer
CLBILS	Coronavirus large business interruption loan scheme
CMA	Competition and Markets Authority
COVID-19	Corona Virus Disease 2019
CPI	Consumer Price Index
CRD IV	Capital Requirements Directive IV
CRE	Commercial real estate
CRH	Capital Repayment Holidays
CRM	Credit risk mitigation
CRR	Capital Requirements Regulation
CSR	Corporate social responsibility
CSRBB	Credit spread risk in the banking book
DEP	Deferred Equity Plan
DPD	Days past due
DTR	Disclosure and Transparency Rules
EAD	Exposure at default
EaR	Earnings at risk
EBA	European Banking Authority
EBT	Employee benefit trust
EEL	Excess expected loss
ECL	Expected credit loss
EIR	Effective interest rate
EL	Expected loss
EPC	Energy performance certificate
EPS	Earnings per share
ESG	Environmental, social and governance
FCA	Financial Conduct Authority
FIRB	Foundation internal ratings-based
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
FTE	Full time equivalent
FV	Fair value
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GDIA	Group Director Internal Audit
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GHG	Greenhouse Gases
GMP	Guaranteed Minimum Pension
G-SII	Global Systemically Important Institution
HMRC	Her Majesty's Revenue and Customs
HPI	House Price Index
HQLA	High Quality Liquid Assets
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
ILAAP	Internal Liquidity Adequacy Assessment Process
IPO	Initial Public Offering
IR	Information request
IRB	Internal ratings-based

Abbreviations

IRHP	Interest rate hedging products
IRRBB	Interest rate risk in the banking book
ISA	Individual Savings Account
ISDA	International Swaps and Derivatives Association
JV	Joint venture
KMP	Key management personnel
KPI	Key Performance Indicator
LCR	Liquidity coverage ratio
LDR	Loan to deposit ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
LSE	London Stock Exchange
LTI	Loan to income
LTIP	Long-term incentive plan
LTV	Loan to value
MDA	Maximum Distributable Amount
MGC	Model Governance Committee
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
MRT	Material Risk Takers
NAB	National Australia Bank Limited
NII	Net interest income
NIM	Net interest margin
NIST	National Institute of Standards and Technology
NPS	Net promoter score
NSFR	Net stable funding ratio
PBT	Profit before tax
PCA	Personal current accounts
PD	Probability of Default
PMA	Post model adjustment
POCI	Purchased or originated credit impaired
PPI	Payment protection insurance

PRA	Prudential Regulation Authority
PSD2	Payment Services Directive 2
RAF	Risk Appetite Framework
RAS	Risk Appetite Statement
RMBS	Residential mortgage-backed securities
RMF	Risk Management Framework
RoTE	Return on Tangible Equity
RPI	Retail Price Index
RTS	Regulatory Technical Standards
RWA	Risk-weighted asset
SAYE	Save As You Earn
SDG	Sustainable Development Goal
SICR	Significant increase in credit risk
SIP	Share Incentive Plan
SME	Small or medium-sized enterprise
SMF	Sterling Monetary Framework
SONIA	Sterling Overnight Index Average
SRB	Systemic Risk Buffer
SVR	Standard variable rate
TCC	Transactional Credit Committee
TCFD	Task Force on Climate-related Financial Disclosures
TFS	Term Funding Scheme
TFSME	Term funding scheme with additional incentives for SMEs
TNAV	Tangible net asset value
TSR	Total Shareholder Return
UN PRB	United Nations' Principles for Responsible Banking
UTM	Virgin Money Unit Trust Managers
VAA	Virgin Atlantic Airways
VaR	Value at risk
VIU	Value in use
YoY	Year-on-year

Country by country reporting

The Capital Requirements (Country by Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's CRD IV. The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations.

The vast majority of entities that are consolidated within the Group's financial statements are UK registered entities. The activities of the Group are described in the Strategic report contained in the Group's Annual Report & Accounts.

	2020 UK
Average FTE employees (number)	**8,256**
Total operating income (£m)	**1,443**
Loss before tax (£m)	**168**
Corporation tax paid (£m)	**12**
Public subsidies received (£m)	**–**

The only other non-UK registered entity of the Group is a Trustee company that is part of the Group's securitisation vehicles (Lanark and Lannraig). Lannraig Trustees Limited is registered in Jersey. This entity plays a part in the overall securitisation process by having the beneficial interest in certain mortgage assets assigned to it. This entity has no assets or liabilities recognised in its financial statements with the securitisation activity taking place in other UK registered entities of the structures. This entity does not undertake any external economic activity and has no employees. The results of this entity as well as those of the entire Lanark and Lannraig securitisation structures are consolidated in the financial statements of the Group.

Other information

The financial information included in this results announcement does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 30 September 2020 were approved by the directors on 24 November 2020 and will be delivered to the Registrar of Companies following publication in December 2020. The auditor's report on those accounts was unqualified and did not include a statement under sections 498(2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 498(3) (failure to obtain necessary information and explanations) of the Companies Act 2006.