Virgin Money Holdings (UK) plc
Pillar 3 Disclosures
31 December 2016

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1. Introduction

This document presents the consolidated Pillar 3 disclosures of Virgin Money Holdings (UK) plc (the Group, or Virgin Money) as at 31 December 2016.

Pillar 3 requirements are set out under the Capital Requirements Directive and Regulation (CRD IV) and are designed to promote market discipline through the disclosure of key information around capital, risk exposures and risk management. The Group's year end disclosures comply with the requirements of CRD IV and associated European Banking Authority (EBA) guidelines in force at 31 December 2016.

The disclosures also take into account the recommendations of the Enhanced Disclosure Task Force (EDTF) by including a reconciliation of the Group's accounting balance sheet to its regulatory balance sheet and analyses of movements in risk-weighted assets (RWAs) and own funds.

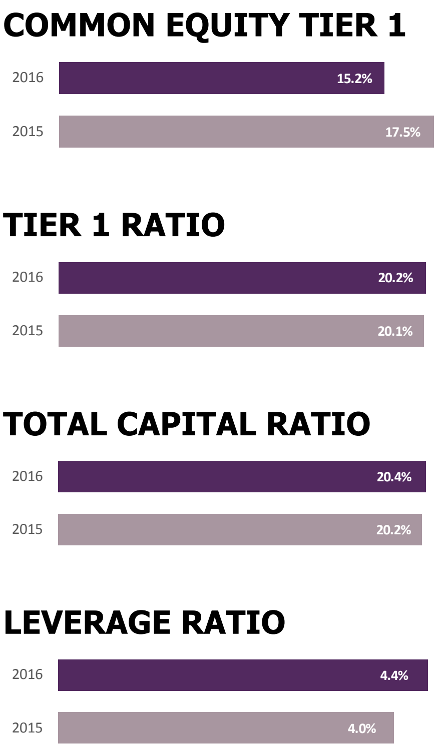
Where appropriate cross references have been made to supporting disclosures that are included within the 2016 Virgin Money Group Annual Report and Accounts. As such, these disclosures should be read in conjunction with that document.

2. Summary Analysis

This section provides a summary analysis of the consolidated capital position, capital requirements and credit risk exposures of the Group as at 31 December 2016.

Capital and leverage ratios

Table 1: Capital ratios year-on-year comparison



The Group's capital position remained strong during 2016 with the key capital ratios reflecting the Group's strategy of ensuring strong capital adequacy as the business grows. The Group's objective continues to be the enhancement of shareholder returns while maintaining an overall quality and quantity of capital in line with the Group's low risk profile.

The Common Equity Tier 1 (CET1) ratio reduced to 15.2% at the end of 2016 (2015: 17.5%). This reduction was a result of a 25.9% increase in risk-weighted assets following strong growth in mortgage and credit card lending during 2016. This was partly offset by capital generation through strong profitability in the year. The CET1 ratio remains well in excess of the Group's target minimum ratio of 12%.

In November 2016, the Group issued a further £230 million (£227.6 million after issue costs) of Additional Tier 1 capital to support continued asset growth. As a consequence, Tier 1 and total capital ratios both increased compared to 2015, despite the growth in lending in the year. The total capital ratio ended 2016 at 20.4% (2015: 20.2%).

The leverage ratio increased to 4.4% at the end of 2016 (2015: 4.0%). Growth in total assets, arising from the increased mortgage and credit card lending, was offset by the increase in total capital from retained profits and the AT1 capital raise. The leverage ratio is in excess of the regulatory minimum of 3%, under CRD IV which is effective from 1 January 2018.

Capital resources

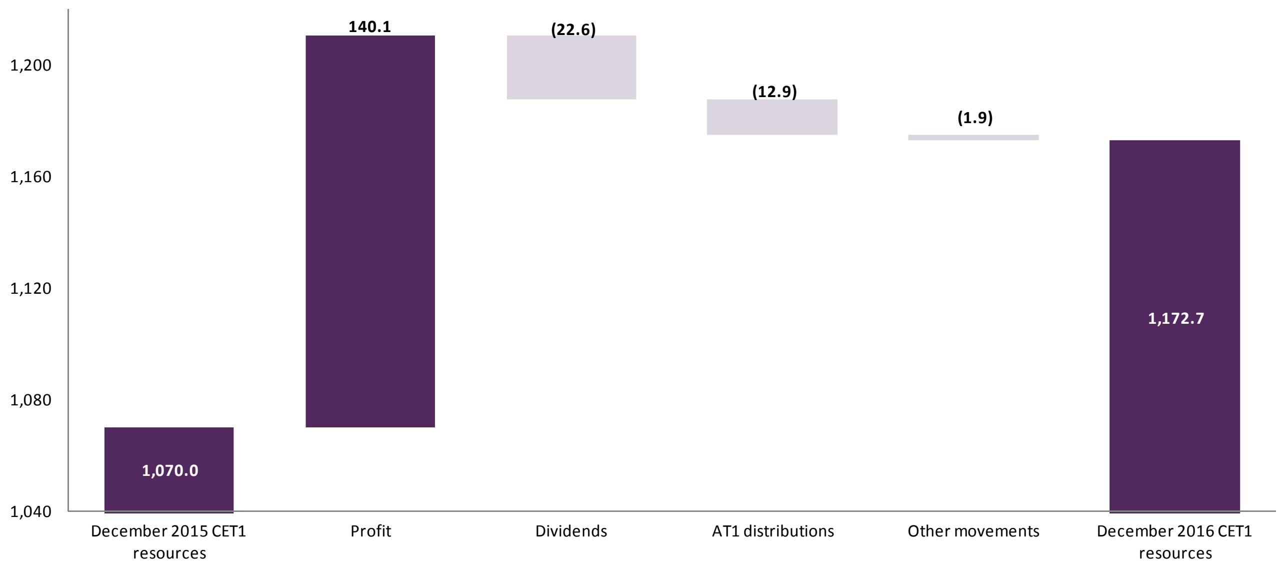
The capital resources of the Group as at 31 December 2016 are presented in the table below:

Table 2: Capital resources

	2016	2015
	£m	£m
Common Equity Tier 1		
Share capital and share premium	**654.6**	654.6
Other equity instruments	**384.1**	156.5
Other reserves	**(27.4)**	(15.6)
Retained earnings	**659.2**	544.8
Total equity per balance sheet	**1,670.5**	1,340.3
Regulatory capital adjustments	**(497.8)**	(270.3)
Common Equity Tier 1 capital	**1,172.7**	1,070.0
Additional Tier 1 securities	**384.1**	156.5
Total Tier 1 capital	**1,556.8**	1,226.5
Tier 2 capital		
General credit risk adjustments	**11.9**	7.6
Total Tier 2 capital	**11.9**	7.6
Total own funds	**1,568.7**	1,234.1

For breakdown of regulatory capital adjustments see table 14 on page 23.

Table 3: Movement in CET1 resources



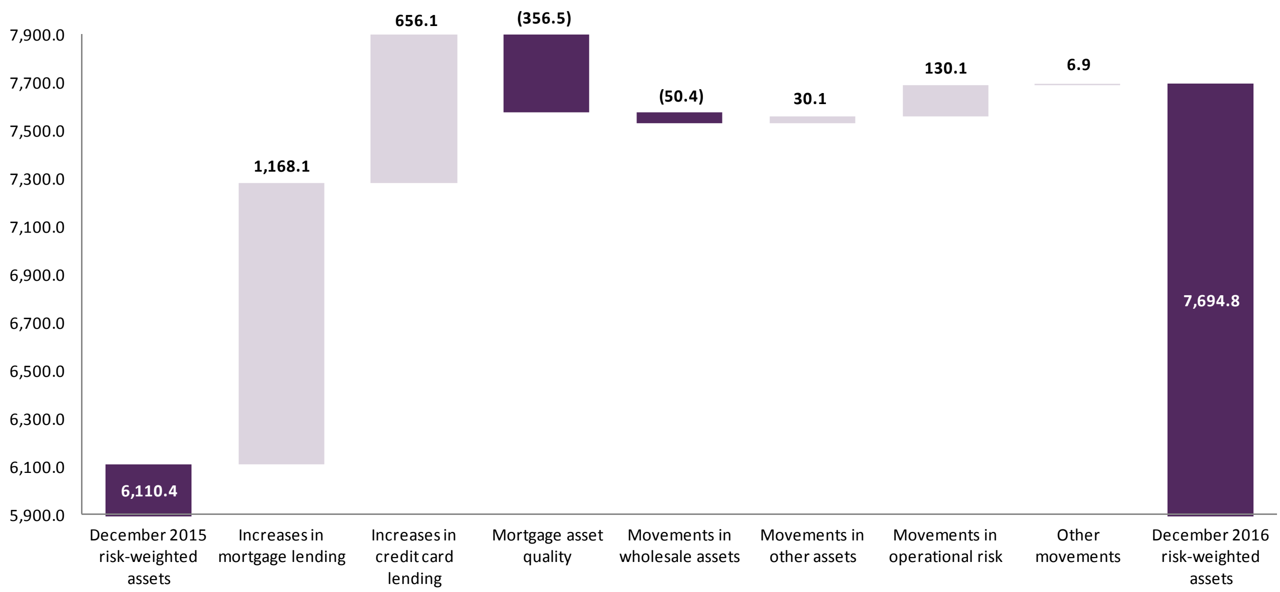
The dividends and AT1 distributions movements above include dividends and AT1 distributions paid during the year and the net movement in foreseeable dividend and AT1 distributions.

Risk-weighted assets and Pillar 1 capital requirements

Table 4: Risk-weighted assets

	2016	2015
Risk-weighted assets	**£m**	£m
Credit risk (Advanced Individual Ratings Based approach)	**4,764.5**	3,952.9
Credit risk (Standardised approach)	**2,182.3**	1,584.2
Total credit risk	**6,946.8**	**5,537.1**
Counterparty credit risk	**59.5**	21.7
Credit valuation adjustment	**22.6**	14.3
Securitisation exposures in the banking book	**10.6**	12.1
Operational risk	**655.3**	525.2
Total	**7,694.8**	**6,110.4**

Table 5: Movement in risk-weighted assets



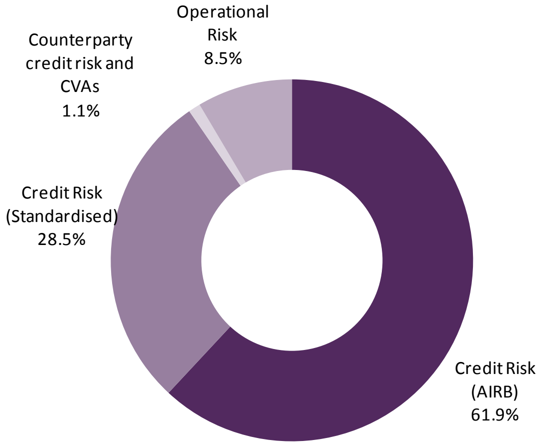
Risk-weighted assets have increased primarily as a result of the growth in mortgage and credit card lending. Mortgage and credit card exposures grew by 16% and 55% respectively in 2016. The resultant increase in risk-weighted assets was partly offset by positive changes in mortgage asset quality, arising from lower mortgage arrears emergence and house price increases. Operational risk increased in 2016 in line with growth in total income over the previous three years.

Table 6: Risk-weighted assets – segmental analysis

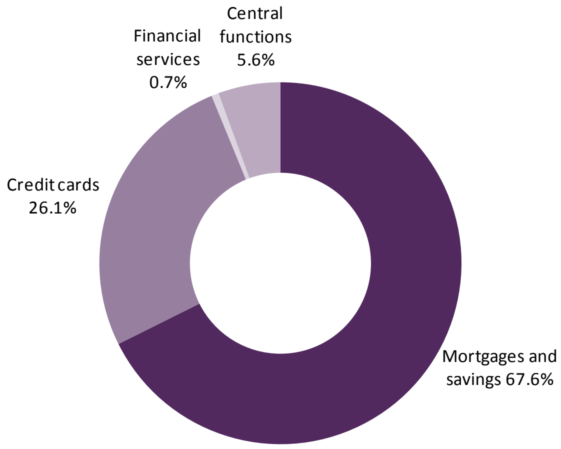
Risk-weighted assets – segmental analysis	**2016** **£m**	2015 £m
Mortgages and savings	**5,204.5**	4,284.5
Credit cards	**2,012.3**	1,334.7
Financial services	**50.4**	51.6
Central functions	**427.6**	439.6
Total	**7,694.8**	6,110.4

Table 7: Risk-weighted assets by risk type and by business segment

2016

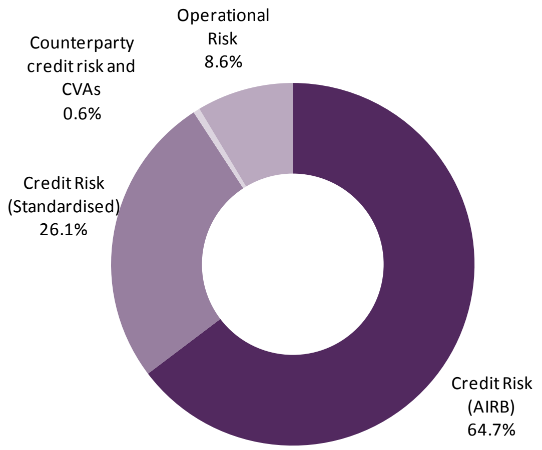


Make up of risk-weighted assets by risk type

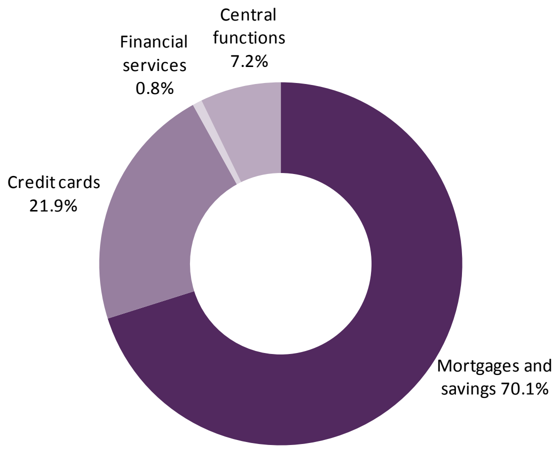


Make up of risk-weighted assets by business line

2015



Make up of risk-weighted assets by risk type



Make up of risk-weighted assets by business line

Credit risk exposures

Table 8: Credit risk exposures

	2016		2015	
	Exposure	**Risk-weighted assets**	Exposure	Risk-weighted assets
	£m	**£m**	£m	£m
AIRB				
Retail exposures secured by real estate collateral	**32,389.6**	**4,764.5**	27,997.5	3,952.9
Standardised				
Credit cards and other retail exposures	**2,446.8**	**1,835.1**	1,574.6	1,180.9
Items in default	**12.3**	**12.3**	11.8	11.8
Central governments and central banks	**1,098.5**	**-**	1,286.9	-
Multilateral development banks	**129.3**	**-**	203.7	-
Institutions	**492.5**	**100.5**	626.1	141.7
Covered bonds	**327.1**	**32.7**	535.3	53.5
Equity exposures	**7.9**	**7.9**	4.6	4.6
Other	**175.5**	**193.8**	173.0	191.7
Total standardised	**4,689.9**	**2,182.3**	4,416.0	1,584.2
Total	**37,079.5**	**6,946.8**	32, 413.5	5,537.1

Advanced Internal Ratings Based (AIRB) exposures are made up solely of residential mortgages. The increase in 2016 reflects the Group's organic growth in mortgage lending.

Standardised exposures include credit card lending and wholesale investments. Credit card exposures increased following organic growth in the credit card book during 2016. During the year, the Group made further use of the Funding for Lending Scheme (FLS) facility to support liquidity management. As a result holdings of other categories of high quality liquid assets reduced in the year.

A detailed analysis of the movements in exposures is provided in table 18 on page 27.

3. Disclosure policy

This section provides a summary of the Group's Pillar 3 disclosure policy, including the basis of preparation of the disclosures within this document.

Basis of preparation

This document contains the consolidated Pillar 3 disclosures of the Group as at 31 December 2016, prepared in accordance with the requirements of Part VIII of the Capital Requirements Regulation (EU Regulation 575/2013, the CRR).

There are a number of differences between the financial reporting disclosures published within the 2016 Virgin Money Group Annual Report and Accounts and these Pillar 3 disclosures. In particular, there are differences in the make-up of the consolidated group for statutory financial reporting and regulatory reporting, and differences in the definition of credit risk exposure. Details on the scope of consolidation are provided within section 4.

Throughout this document, unless otherwise specified, credit risk exposures for mortgages are disclosed using the exposure at default (EAD) measure. This is a parameter used in AIRB approaches to estimate the amount outstanding at the time of default. The EAD calculation is defined as the aggregate of on-balance sheet exposures, off-balance sheet commitments (including amounts where customers have contractual rights to draw down further balances and estimates of interest accruals to the point of default) after application of credit conversion factors, and other relevant regulatory adjustments.

All other credit risk exposures, including credit cards and wholesale assets, are measured using the standardised approach. The exposure value is stated net of individual (specific) impairment provisions. General impairment provisions are not deducted from the exposure value, but instead form part of Tier 2 capital.

Article 432 of the CRR on non-material, proprietary confidential information permits institutions to omit one or more disclosures if the information provided by such a disclosure is not regarded as material. The Group has not omitted any disclosures on this basis.

The implementation of CRD IV is subject to transitional arrangements, with full implementation in the UK required by 1 January 2022 as per Prudential Risk Authority (PRA) policy statement PS7/13. There are no longer any transitional rules that impact the Group, and so the capital positions shown for 2016 and 2015 are on a fully loaded basis. The minimum Pillar 1 capital requirements referred to in this document are calculated as 8 per cent of aggregated risk-weighted assets.

Frequency, media and location

The Group's policy is to publish the required disclosures on an annual basis in conjunction with the Virgin Money Group Annual Report and Accounts. The Pillar 3 disclosures are published within the Investor Relations section of the corporate website www.virginmoney.com.

The frequency of disclosure will be reviewed should there be a material change in any approach used for the calculation of capital, the business structure or regulatory requirements.

Verification

The Group's Pillar 3 disclosures have been reviewed by the Audit Committee and approved by the Board. In addition, the Group remuneration disclosures in Appendix 7 have been reviewed by the Remuneration Committee. The Pillar 3 disclosures are not subject to audit except where they are equivalent to those prepared under financial reporting requirements and disclosed in the 2016 Virgin Money Group Annual Report and Accounts.

Risk profile disclosure

In accordance with Part VIII of the CRR, the Group is required to assess whether its external disclosures portray its risk profile comprehensively. The disclosures of risk management objectives and procedures within this Pillar 3 document are reproduced within the Risk Management Report of the 2016 Virgin Money Group Annual Report and Accounts.

2016 developments

The disclosures follow largely the same format as 2015. In June 2016 the European Banking Authority (EBA) published draft Guidelines on Pillar 3 disclosures following the 2015 recommendations of the Basel Committee, with final revised guidelines issued in December 2016. These will not come into force until the end of 2017, but the EBA have requested that global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) introduce a limited set of the new templates this year. While the Group does not fall into this category, new templates have been disclosed in this document where deemed appropriate, to aid comparison with other institutions. The following templates have been adopted by the Group:

- table 17 provides an overview of total risk-weighted assets;
- table 25 provides a breakdown of credit risk exposures under the standardised approach by asset class and risk weight;
- table 37 provides a breakdown of counterparty credit risk exposures by portfolio (type of counterparties) and by risk weight; and
- table 43 provides a breakdown of the major movements in risk-weighted assets measured under the AIRB approach.

Securitisation exposures and risk-weighted assets have been treated separately from other credit risk exposures in line with the treatment in the new EBA Guidelines. The 2015 comparative tables have been restated to remove securitisation exposures (investments in secured notes).

4. Scope of consolidation

This section describes the scope of consolidation applied to the disclosures presented within this document.

Regulatory consolidation

The scope of consolidation for regulatory reporting purposes, including these Pillar 3 disclosures, differs from the scope of consolidation for statutory financial reporting. Virgin Money Giving Limited is excluded from the regulatory consolidation. Subsidiary undertakings included within the regulatory consolidation are fully consolidated. Equity investments that do not meet the accounting definition of subsidiary are treated as investments and reflected in risk-weighted assets accordingly.

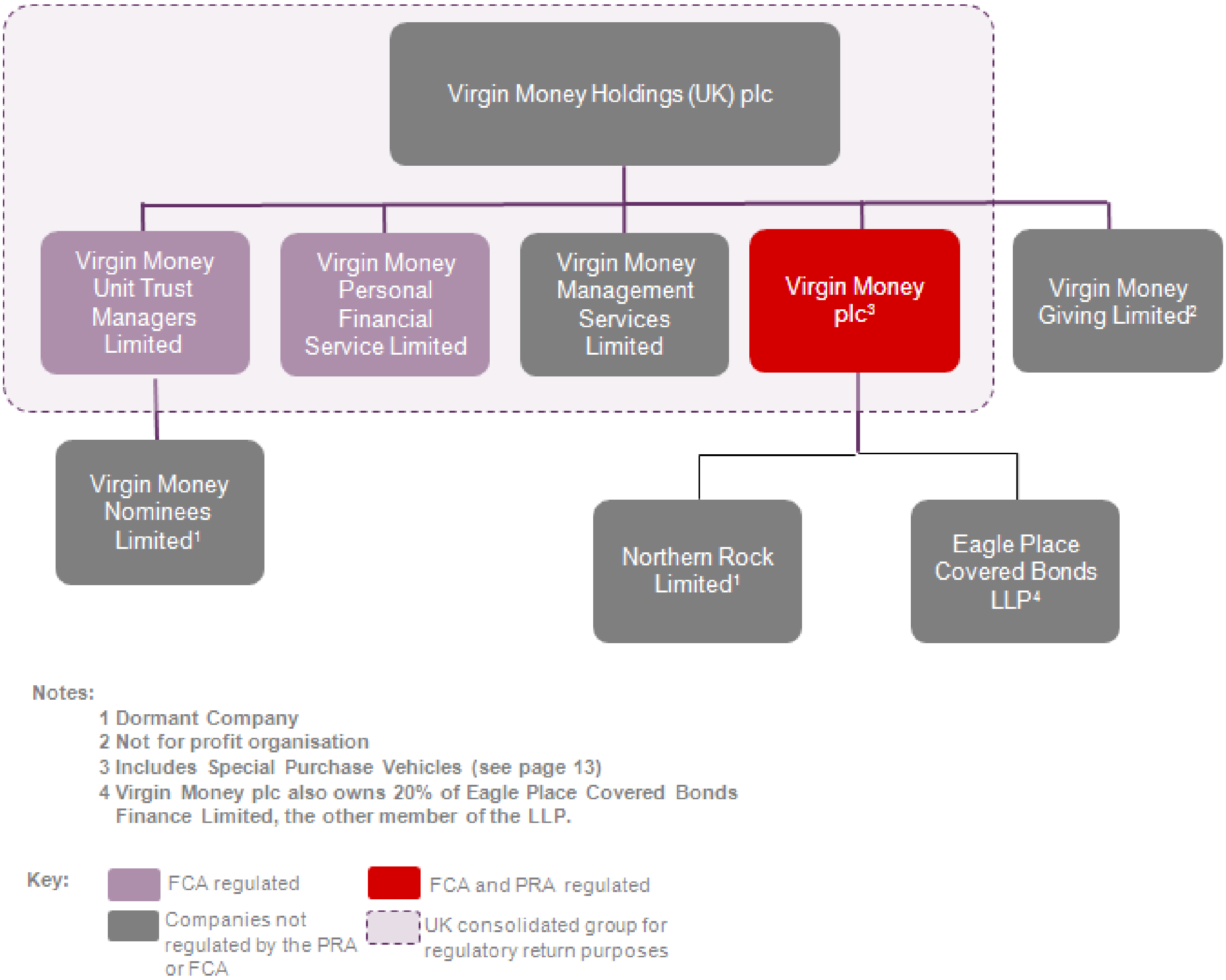
Management practice and policy ensures that capital adequacy is maintained at a solo and consolidated basis within the Group in accordance with the appropriate regulatory requirements.

The legal and regulatory structure of the Group provides the capability for the prompt transfer of surplus capital resources over and above regulatory requirements or repayment of liabilities when due throughout the Group. There are no current or foreseen material practical impediments to the prompt transfer of own funds or repayment of liabilities among the Group companies.

The Group has complied with the Prudential Sourcebooks throughout the year. This disclosure is presented in respect of the year ended 31 December 2016

The Group structure at 31 December 2016 is set out in the table below.

Table 9: Regulatory Group structure



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At 31 December 2016, the Virgin Money Regulated Group was made up of the following companies:

- Virgin Money Holdings (UK) plc;
- Virgin Money plc;
- Virgin Money Unit Trust Managers Limited;
- Virgin Money Personal Financial Service Limited; and
- Virgin Money Management Services Limited.

The regulatory consolidation disclosed within this document therefore differs from the statutory consolidation disclosed within the 2016 Virgin Money Group Annual Report and Accounts, by excluding the following companies.

- Virgin Money Giving Limited;
- Virgin Money Nominees Limited (dormant);
- Northern Rock Limited (dormant); and
- Eagle Place Covered Bonds LLP (dormant).

Subsidiary disclosures

Additional disclosures surrounding the capital resources, leverage exposures and capital requirements of Virgin Money plc (VM plc) have been provided within Appendices 2, 3, 4, 5 and 8 of this document together with analysis of its credit risk exposures, credit risk mitigation and impairments. These disclosures are provided to satisfy the significant subsidiary disclosure requirements under CRR Article 13 (Application of disclosure requirements on a consolidated basis).

There are a number of special purpose vehicles (SPVs) established in connection with the Group's securitisation programme. Although VM plc has no direct or indirect ownership interest in these companies, they are accounted for as subsidiaries of VM plc. This is because they are principally engaged in providing a source of long term funding to the Group, which in substance means the Group is exposed to rights of variable returns from its involvement in the SPVs and has the ability to affect those returns through its power over the entities.

There is no significant risk transfer associated with the securitisations and therefore for the purposes of regulatory capital and Pillar 3 disclosures, the SPVs are consolidated within the VM plc disclosures.

Table 10: Special purpose vehicles

As at 31 December 2016:	**Nature of business**
Gosforth Funding 2011-1 plc	Issue of securitised notes
Gosforth Funding 2012-1 plc	Issue of securitised notes
Gosforth Funding 2012-2 plc	Issue of securitised notes
Gosforth Funding 2014-1 plc	Issue of securitised notes
Gosforth Funding 2015-1 plc	Issue of securitised notes
Gosforth Funding 2016-1 plc	Issue of securitised notes
Gosforth Funding 2016-2 plc	Issue of securitised notes
Gosforth Mortgages Trustee 2011-1 Limited	Trust
Gosforth Mortgages Trustee 2012-1 Limited	Trust
Gosforth Mortgages Trustee 2012-2 Limited	Trust
Gosforth Mortgages Trustee 2014-1 Limited	Trust
Gosforth Mortgages Trustee 2015-1 Limited	Trust
Gosforth Mortgages Trustee 2016-1 Limited	Trust
Gosforth Mortgages Trustee 2016-2 Limited	Trust
Gosforth Holdings 2011-1 Limited	Holding company
Gosforth Holdings 2012-1 Limited	Holding company
Gosforth Holdings 2012-2 Limited	Holding company
Gosforth Holdings 2014-1 Limited	Holding company
Gosforth Holdings 2015-1 Limited	Holding company
Gosforth Holdings 2016-1 Limited	Holding company
Gosforth Holdings 2016-2 Limited	Holding company

Consolidated balance sheet under regulatory consolidation

The table below provides a reconciliation of the Group's consolidated balance sheet on an accounting consolidation basis (which includes all Group companies) to the Group's consolidated balance sheet under the regulatory consolidation basis as at 31 December 2016.

Table 11: Reconciliation of statutory balance sheet to regulatory balance sheet

As at 31 December 2016	Accounting balance sheet as in published financial statements £m	Deconsolidation of entities outside the regulatory group £m	Regulatory balance sheet £m
Assets			
Cash and balances at central banks	**786.3**	**-**	**786.3**
Derivative financial instruments	**104.2**	**-**	**104.2**
Loans and receivables:			
- Loans and advances to banks	**635.6**	**(0.1)**	**635.5**
- Loans and advances to customers	**32,367.1**	**-**	**32,367.1**
- Debt securities	**0.7**	**-**	**0.7**
Available-for-sale financial assets	**858.8**	**-**	**858.8**
Intangible assets	**80.6**	**-**	**80.6**
Tangible fixed assets	**77.4**	**-**	**77.4**
Deferred tax assets	**23.0**	**-**	**23.0**
Other assets	**121.9**	**(0.3)**	**121.6**
Intercompany assets	**-**	**5.7**	**5.7**
Total assets	**35,055.6**	**5.3**	**35,060.9**
Liabilities			
Deposits from banks	**2,132.5**	**-**	**2,132.5**
Customer deposits	**28,106.3**	**-**	**28,106.3**
Derivative financial instruments	**229.7**	**-**	**229.7**
Debt securities in issue	**2,600.0**	**-**	**2,600.0**
Provisions	**8.5**	**(0.1)**	**8.4**
Other liabilities	**308.1**	**-**	**308.1**
Total liabilities	**33,385.1**	**(0.1)**	**33,385.0**
Equity			
Share capital and share premium	**654.6**	**-**	**654.6**
Other equity instruments	**384.1**	**-**	**384.1**
Other reserves	**(27.4)**	**-**	**(27.4)**
Retained earnings	**659.2**	**5.4**	**664.6**
Total equity	**1,670.5**	**5.4**	**1,675.9**
Total liabilities and equity	**35,055.6**	**5.3**	**35,060.9**

Reconciliation of regulatory balance sheet assets to credit risk exposure

A reconciliation of the consolidated regulatory balance sheet to credit risk exposures is presented below.

Table 12: Reconciliation of regulatory balance sheet to credit risk exposure

As at 31 December 2016	Regulatory balance sheet	Assets deducted from own funds	Derivative, central counterparty and repo adjustments	Provisions	Counterparty credit risk exposures	Securitisations	Total credit risk exposures £m
	£m	£m	£m	£m	£m	£m	
Assets							
Cash and balances at central banks	**786.3**	**-**	**-**	**-**	**-**	**-**	**786.3**
Derivative financial instruments	**104.2**	**-**	**(25.0)**	**-**	**(79.2)**	**-**	**-**
Loans and receivables:							
- Loans and advances to banks	**635.5**	**-**	**(168.2)**	**-**	**-**	**-**	**467.3**
- Loans and advances to customers	**32,367.1**	**-**	**(179.2)**	**22.7**	**-**	**-**	**32,210.6**
- Debt securities	**0.7**	**-**	**-**	**-**	**-**	**-**	**0.7**
Available-for-sale financial assets	**858.8**	**-**	**75.7**	**-**	**(75.7)**	**(52.9)**	**805.9**
Intangible assets	**80.6**	**(80.6)**	**-**	**-**	**-**	**-**	**-**
Tangible fixed assets	**77.4**		**-**	**-**	**-**	**-**	**77.4**
Deferred tax assets	**23.0**	**(7.3)**	**-**	**-**	**-**	**-**	**15.7**
Other assets	**121.6**	**-**	**222.4**	**-**	**(273.2)**	**-**	**70.8**
Intercompany assets	**5.7**	**-**	**-**	**-**	**-**	**-**	**5.7**
Total assets	**35,060.9**	**(87.9)**	**(74.3)**	**22.7**	**(428.1)**	**(52.9)**	**34,440.4**
AIRB off Balance Sheet exposures							**2,184.8**
Interest accrued to default							**454.3**
Total regulatory capital exposures							**37,079.5**

Exposures relating to derivatives, central counterparties and repurchase transactions (repos or securities financing transactions) are disclosed within the counterparty credit risk section on pages 43 to 44. All other exposures fall into the credit risk category and are analysed in more detail on pages 30 to 33.

5. Risk management

This section describes the overall risk management policy of the Group. More detailed analyses of individual risks (Credit Risk, Market Risk and Operational Risk) are set out in later sections. Further detail including a statement on the Group's overall risk profile can be found in the Risk Management Report in the 2016 Annual Report and Accounts

The Group's approach to risk management

Risk management is at the heart of the Group's strategy to deliver sustainable growth, quality and returns. This is achieved through a prudent risk appetite and informed risk decision-making, supported by a consistent risk-focused culture across the Group.

Risk culture

The Group has a customer-focused business model built on a prudent risk culture. The risk culture is aligned to the Group's philosophy and reinforces accountability. The Group's risk values, outlined below, describe how it expects all colleagues, suppliers and partners to operate.

Risk appetite

Risk appetite is the amount and type of risk that the Group is prepared to seek, accept or tolerate. It is reflected in frameworks and policies that either limit or, where appropriate, prohibit activities that could be detrimental to the Group. The Group's strategy is developed in conjunction with risk appetite. A Risk Appetite Statement is approved by the Board with each strategic planning cycle.

Governance and control

Delegation of authority from the Board to Executive Committees and senior management establishes governance and control. Issues are escalated promptly and remediation plans are initiated where required.

The key responsibilities of the Board and senior management include setting risk appetite, agreeing the risk management framework, and approving policies and practices.

Accountability

The Group uses a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities ensuring effective independent assurance activities over key business activities.

- line management (first line) have primary responsibility for risk decisions; measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective controls in line with policy, to maintain appropriate risk management skills, practices and tools, and to act within Board-approved risk appetite parameters. All Executives certify to a monthly control effectiveness review and a quarterly risk and control attestation;
- the Risk function (second line) provides proactive advice and constructive challenge on the effectiveness of risk decisions taken by management. It is responsible for the design and development of the risk management framework and for promoting the implementation of a strategic approach to risk management. It provides a view of the Group's risk profile while proposing and reporting against risk appetite to the Board. It also oversees the Group's internal stress testing framework and maintains a good working relationship with regulators; and
- Internal Audit (third line) provides independent, objective assurance to improve operations. It helps the Group achieve its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Risk decision-making and reporting

A current and forecast view of the Group's overall risk profile, key exposures, management actions, and performance is reported to the Risk Management Committee, the Board Risk Committee and the Board. Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios and enable the Group to make appropriate contingency plans. The Chief Risk Officer has direct access to the Chairman of the Board Risk Committee. The Board Risk Committee met 7 times during 2016.

Stress testing

Stress testing is an essential risk management tool which examines the sensitivities of the strategic plan and business model and supports the development of management actions and contingency plans. It is overseen by the Board Risk Committee.

Sensitivity analysis and scenario stress testing is used to:

- ensure the Group operates within a prudent risk appetite and can meet any unexpected demands on financial resources without threatening the viability of the business;
- inform decision-making, ranging from underwriting decisions to ensuring the sufficiency of capital and liquidity over the planning horizon. This involves the use of a variety of macro-economic, operational, liquidity and financial market disruption scenarios;
- support the Internal Capital Adequacy Assessment Process (ICAAP), the Individual Liquidity Adequacy Assessment Process (ILAAP) and inform the setting of regulatory guidance; and
- develop the Recovery Plan for the business including the identification of material recovery options.

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans to extreme adverse events with the aim to improve contingency planning.

The Senior Managers and Certification Regime outlines stress testing as a prescribed responsibility, with clear accountabilities and responsibilities assigned to senior management and the Risk and Finance functions. The Chief Risk Officer is the Accountable Executive for stress testing with collective engagement from the wider Executive and Board.

Risk disclosure statement

The Directors believe that the risk management framework in place is adequate for the Group's profile and strategy.

The Board focuses on ensuring alignment of business development and planning with risk appetite. A clearly defined risk appetite aids the Group in maintaining a high-quality capital base, targeting capital ratios which support business development and are in excess of regulatory minima. Capital is actively managed with regulatory ratios being a key factor in the Group's planning processes and stress analysis. The Group reviews the capital structure on an on-going basis to ensure it is well placed to react to prevailing economic and regulatory conditions. The CET1 ratio for the Group was 15.2% as at 31 December 2016, significantly above regulatory minimum requirements.

6. Regulatory capital framework

This section contains an outline of the capital regulations (as implemented in the UK by the PRA policy statement PS7/13) which define a framework of regulatory capital resources and requirements applicable to the Group. CRD IV came into force in the European Union on 1 January 2014.

Regulatory capital

The capital resources of the Group shown in table 14 are classified depending on the level of permanency and loss absorbancy exhibited:

Common Equity Tier 1 capital

This represents the strongest form of capital consisting of ordinary share capital, share premium and allowable reserves. CET1 capital is stated after deducting regulatory adjustments such as intangible assets, expected losses in excess of provisions in respect of the AIRB mortgage portfolio and deferred taxation arising from tax losses carried forward. CET1 capital can be supplemented by certain subordinated debt liabilities and other capital securities classified as AT1 or Tier 2 capital.

Additional Tier 1 capital

AT1 capital instruments are non-cumulative perpetual securities that contain a specific provision to write down the security or convert it to equity should the CET1 ratio fall below a specified trigger limit. The Group's current AT1 securities contain a conversion trigger of 7 per cent.

Tier 2 capital

Tier 2 capital typically comprises certain other subordinated debt securities that do not qualify as AT1. While the Group has not issued any such instruments, it holds Tier 2 capital comprised of general provisions (under the CRD IV definition) on credit cards.

Capital requirements

The capital and prudential requirements included within the Capital Regulations are categorised under three pillars:

Pillar 1 Capital Requirements

Pillar 1 of the regulatory framework focuses on the determination of risk-weighted assets and expected losses in respect of the firm's exposure to credit, counterparty credit, operational and market risks.

The regulatory minimum amount of total capital is determined as 8 per cent of the aggregate risk-weighted assets and the Pillar 1 capital requirements referenced in this document are calculated using this regulatory minimum value. At least 4.5 per cent of risk-weighted assets must be covered by CET1 capital.

A range of approaches, varying in sophistication, are available under the CRD IV framework to use in measuring risk-weighted assets to determine the minimum level of capital required. Within the Group, mortgage risk-weighted assets are calculated using the AIRB approach which is subject to a number of internal controls and external approval by the PRA. Other risk-weighted assets are calculated using a simpler standardised approach.

Credit risk

The Group is exposed to credit risk through its retail lending and wholesale investment activity.

The AIRB approach is applied to the Group's residential mortgage portfolio. Risk-weighted assets are calculated using a formula incorporating internal assessments of PD, LGD and EAD (subject to certain floors).

The Group uses the standardised approach for all credit risk exposures apart from mortgages. The standardised approach is the most basic approach which applies a specified set of risk weights to exposures. Under this approach banks can utilise external ratings to determine risk weights for rated counterparties.

Further details on the Group's application of the AIRB approach (for mortgages) are provided in Appendix 1.

Counterparty credit risk

The Group is exposed to counterparty credit risk through its use of derivatives for risk management purposes and for asset repurchase agreements (repos) used as a funding tool.

Under the mark-to-market method an add-on for potential future exposure is applied to the balance sheet value of derivatives to give an overall derivative exposure value.

The standardised method is used to determine the exposure value of repos – exposures are measured by calculating the difference between the current market value of the asset repo'ed and the cash received plus interest accumulated, net of collateral posted or received. The risk-weighted exposures for derivatives and repos are calculated by applying standardised risk weights associated with the particular counterparty.

Credit valuation adjustment (CVA)

The CVA is an adjustment to the fair value of a derivative contract reflecting the value of counterparty credit risk inherent in that contract. The standardised approach takes account of the external credit ratings of derivative counterparties and incorporates the derivative exposure value and effective maturity of exposures using the calculation prescribed by the CRR.

Operational risk

The standardised approach measures the capital requirement as a percentage of the average net interest and non-interest income. This requires a firm's activities to be split into a number of defined business lines with a specific percentage applied to the income of each business line. The Group adopts this approach, deriving the requirement from the three year average of the aggregate adjusted income of the business.

Market risk

The standardised approach for market risk applies mainly to the trading book positions of institutions. As the Group has no trading activities these are not applicable.

While the Group has exposure to interest rate risk in the banking book, the CRR imposes no Pillar 1 requirement in relation to this. As such, the Group's only exposure to market risk is in relation to foreign currency exposure. However, as this is below the de-minimis limit for CRD IV, the Group has no Pillar 1 market risk capital requirement.

Pillar 2 capital requirements

Pillar 2 describes the supervisory review process and the assessment of additional capital resources required to cover specific risks faced by firms that have not been covered by the minimum regulatory requirements as set out in Pillar 1.

The PRA sets additional minimum requirements through the issuance of bank specific Individual Capital Guidance (ICG). Through the ICG, the PRA provides guidance on the Pillar 2A own funds requirement which is expressed as the higher of a variable component addressing additional risks faced by the Group and the Basel I floor, a transitional capital minimum requirement based on the Basel I framework.

The PRA may also set a further buffer requirement determining capital to be held against future periods of stress as described under Pillar 2B below.

Pillar 2A

Key to the PRA's ICG setting process is the Group's assessment of the amount of capital needed, a process known as the Internal Capital Adequacy Assessment Process (ICAAP). The Group has been given an ICG by the PRA and maintains capital at a level which exceeds this requirement. From 1 January 2015 at least 56.25% of Pillar 1 and Pillar 2A must be covered by CET1 capital.

The ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk, operational risk and market risk by assessing the material risks not covered or fully captured under Pillar 1. The ICAAP document is subject to a robust review process, approved by the Board and submitted to the PRA.

The supplementary assessments as part of the ICAAP are:

- Credit Concentration Risk - the risk of losses arising as a result of concentrations of exposures due to imperfect diversification. This imperfect diversification can arise from the small size of a portfolio or a large number of exposures to specific obligors (single name concentration) or from imperfect diversification with respect to economic sectors or geographical regions;

- Credit Risk – underestimation. There are asset classes for which the standardised approach is considered to underestimate the risk. Potential underestimation is quantified against benchmark internal ratings based approaches and included in Pillar 2 credit risk;

- Interest Rate Risk in the Banking Book – the risk of losses arising from changes in the interest rates associated with banking book items;

- Operational Risk – to the extent not covered by Pillar 1, the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and including legal risk; and

- Business Risk – the risk arising from changes in the business, including the potential risk that the Group may not be able to execute its business plan and/or strategy. It also includes potential risks arising from a firm's remuneration policy.

Pillar 2B

Forecast capital positions are subjected to extensive stress analyses to determine the adequacy of the Group's capital resources under stressed conditions. Under Pillar 2B the PRA uses the outputs from some of these stress analyses to inform the setting of the Group's PRA buffer assessment, defining a minimum level of capital buffers over and above the minimum regulatory requirements that should be maintained in non-stressed conditions as mitigation against potential future periods of stress. The PRA requires this buffer to remain confidential between the Group and the PRA.

Regulatory capital buffers

There is a requirement to maintain a countercyclical buffer of up to 2.5% from 1 January 2016. This buffer is designed to require banks to hold additional capital to remove or reduce the build up of systemic risk in times of excessive market wide credit expansion, providing additional loss absorbing capacity. The buffer is determined by reference to buffer rates for the individual countries where the Group has credit risk exposures.

The Financial Policy Committee (FPC) of the Bank of England is responsible for setting the UK countercyclical rate and for recognising rates set by other jurisdictions, or for recommending higher rates. The FPC have announced that the UK countercyclical rate will remain at 0% until at least June 2017 when a reassessment of the current level will be undertaken. Institutions will have 12 months from any announcement to manage the implementation of the countercyclical buffer.

Foreign exposures qualifying for the countercyclical buffer make up less than the de minimis level of 2% of the total exposures, therefore the Group treats all exposures as arising in the UK. See Appendix 4 for further analysis.

The FPC can also set sectoral capital requirements which are temporary increases to banks' capital requirements on exposures to specific sectors, if the FPC judges that excessive lending to those sectors poses risks to financial stability. No sectoral capital requirements currently apply to the Group.

There are two other CET1 capital buffers phased in over the period from 2016 to 1 January 2019. The capital conservation buffer is a general buffer of 2.5% of risk-weighted assets designed to build up capital buffers outside periods of stress. During 2016 this was set at 0.625%, increasing to 1.25% from 1 January 2017. The framework for a systemic risk buffer for ring-fenced banks will be applied to individual institutions by the PRA and will be introduced, like ring-fencing rules, from 2019. Given the scale of the Group it is likely to attract a systemic risk buffer of 0%.

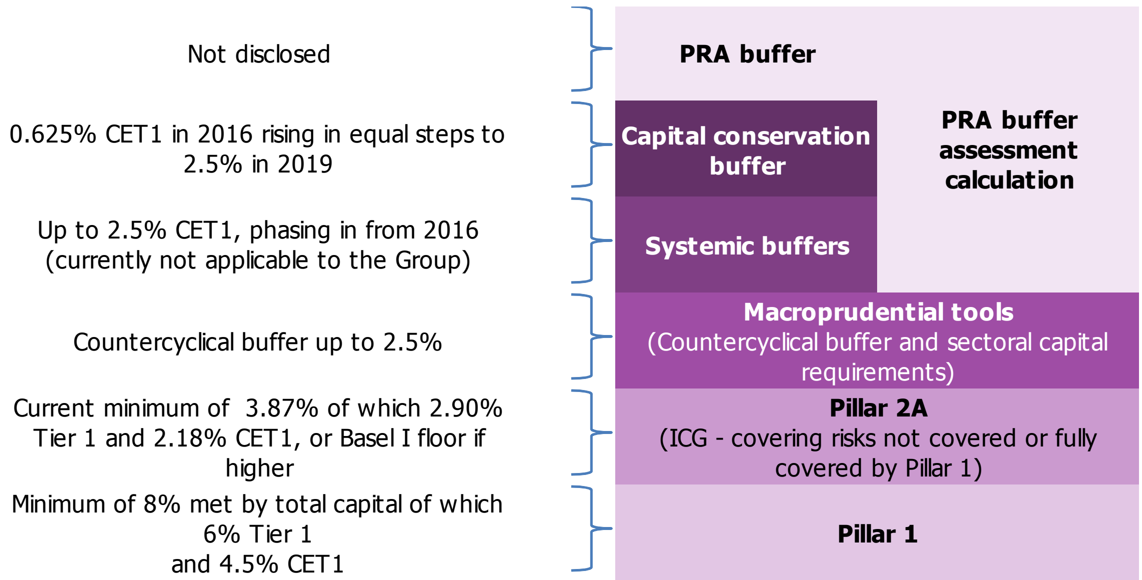
The PRA buffer takes into account the extent to which these CRD IV buffers already capture the risks identified in the PRA buffer assessment. The excess of the PRA buffer assessment over the capital conservation buffer and any systemic buffers is treated as the PRA buffer. Where the PRA buffer assessment is less than the capital conservation buffer and systemic buffers, no PRA buffer will be applied.

All buffers are required to be met with CET1 capital. The requirement for the PRA buffer to be met by CET1 capital will be phased in from 2016 to 1 January 2019. For 2016, 25% of the PRA buffer must be met by CET1 capital, rising to 100% by 2019. Where there is a breach of the PRA buffer this would trigger a discussion between the bank and the PRA to agree what action is required. Where the capital conservation buffer and systemic buffers are binding, a breach of these buffer requirements would give rise to automatic constraints upon any discretionary capital distributions or variable remuneration awards by the Group.

The following table summarises all regulatory capital requirements for the Group:

Table 13: Summary of CRD IV capital requirements

Requirement or buffer	Calculation method	Quality of capital	Impact on the Group
Pillar 1	Fixed percentage of RWAs based on Article 92 of CRR	4.5% of RWAs met by CET1 capital 6.0% of RWAs met by Tier 1 capital 8.0% of RWAs met by total capital	As shown in Pillar 1 capital requirements section
Pillar 2A	Percentage of RWAs or Basel I floor if higher	56.25% of Pillar 2A met by CET1 capital 75% of Pillar 2A met by Tier 1 capital 100% of Pillar 2A met by total capital	Total capital requirement of 3.87% of RWAs, or Basel I floor if higher
Macroprudential tools (countercyclical buffer and sectoral capital requirements)	Expressed as a percentage of RWAs	All to be met by CET1 capital	Set by the PRA, currently 0%
Systemic buffers	Expressed as a percentage of RWAs	All to be met by CET1 capital	Currently not applicable to the Group
Capital conservation buffer	Expressed as a percentage of RWAs	All to be met by CET1 capital	Rising from 0.625% in 2016, to 2.5% in 2019
PRA buffer	Expressed as a percentage of RWAs	25% of CET1 in 2016 rising to 100% by 2019	PRA buffer is set by the PRA and is confidential



Pillar 3

Pillar 3 aims to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes. CRD IV sets out the minimum disclosures required under Pillar 3.

The Basel Committee on Banking Supervision (the BCBS) published revised Pillar 3 disclosure standards in January 2015. The EBA published a consultation paper setting out how to implement those standards in line with Part 8 of the CRR in June 2016, with the final Guidelines published in December 2016. This introduced new guidance and templates and will apply for reporting periods ending 31 December 2017.

The Guidelines do not replace the existing disclosure requirements under CRD IV, but limit the scope of the new templates to globally significant institutions and those institutions that are significant within their own country. While the Group is not of sufficient size to fall within the scope of the Guidelines, they will be applied where considered appropriate.

Leverage framework

The EBA leverage ratio regime comes into force in 1 January 2018. At present the Group has no minimum leverage requirement as it is currently exempt from the UK Leverage Framework Regime, as its retail deposit levels are less than £50 billion.

The leverage ratio is calculated by dividing Tier 1 capital resources by a defined measure of on-balance sheet assets and off-balance sheet items. In August 2016 the EBA confirmed that a 3.0% minimum leverage ratio requirement will be introduced from 1 January 2018. At this time the Group is expected to meet the minimum requirement.

Minimum Requirements for Own funds and Eligible Liabilities

Minimum Requirements for Own funds and Eligible Liabilities (MREL) were applicable from 1 January 2016 and will be phased in fully by 1 January 2022. The Bank of England provided MREL guidance to the Group during 2016, as well as guidance on the transitional arrangements until 1 January 2022. Prior to 31 December 2019, MREL will be equal to an institution's minimum regulatory capital requirements. From 1 January 2020 until 31 December 2021 compliance with MREL will require the Group to hold a combination of existing regulatory capital and other MREL qualifying instruments equivalent to 18% of risk-weighted assets. The Group is working towards implementation of these requirements and has reflected requirements in strategic plans.

7. Capital management

This section details the Group's approach to capital management, focusing on measures including CET1, AT1, Tier 2 and the leverage ratio.

Risk appetite

The Group maintains a high-quality capital base, targeting capital ratios which support business development and the risks inherent in the strategic plan.

The Group's capital planning approach is focused on maintaining sufficient capital while optimising value for shareholders.

Mitigation

The Group has capital management procedures that are designed to ensure compliance with risk appetite and regulatory requirements and are positioned to meet anticipated future changes to capital requirements.

The Group is able to generate capital through profit retention by raising equity through, for example, a rights issue or debt exchange and by raising Tier 1 and Tier 2 capital. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting lending strategy, risk hedging strategies and through business disposals. If necessary, this can include limiting new business.

Monitoring

Capital is actively managed with regulatory requirements being key factors in the Group's planning processes and stress analysis. A minimum of a three year forecast of the Group's capital position, based upon the strategic plan, is produced at least annually to inform the capital strategy. Shorter term forecasts are more frequently undertaken to understand and respond to variations in the Group's actual performance against the plan.

Regular reporting of actual and projected ratios is undertaken, including submissions to the Asset and Liability Committee, the Risk Management Committee and the Board.

Analysis of capital resources

The following table sets out the capital resources of the Group.

Table 14: Group capital resources

	2016 £m	2015 £m
Common Equity Tier 1		
Share capital and share premium	**654.6**	654.6
Other equity instruments	**384.1**	156.5
Other reserves	**(27.4)**	(15.6)
Retained earnings	**659.2**	544.8
Total equity per balance sheet	**1,670.5**	1,340.3
Regulatory capital adjustments		
Net liabilities of companies outside the regulatory Group	**5.4**	4.5
Foreseeable distribution on Additional Tier 1 securities and ordinary share capital	**(4.9)**	(2.1)
Foreseeable dividends on ordinary share capital	**(15.5)**	(13.7)
Other equity instruments	**(384.1)**	(156.5)
Cash flow hedge reserve	**31.5**	15.3
Intangible assets	**(80.6)**	(64.4)
Prudential valuation adjustment	**(1.2)**	-
Deferred tax on brought forward tax losses	**(7.3)**	(18.0)
Excess of expected loss over impairment	**(41.1)**	(35.4)
Common Equity Tier 1 capital	**1,172.7**	1,070.0
Additional Tier 1 securities	**384.1**	156.5
Total Tier 1 capital	**1,556.8**	1,226.5
Tier 2 capital		
General credit risk adjustments	**11.9**	7.6
Total Tier 2 capital	**11.9**	7.6
Total own funds	**1,568.7**	1,234.1
Pillar 1 Risk-weighted assets		
Retail mortgages	**4,764.5**	3,952.9
Unsecured lending	**1,847.4**	1,192.7
Wholesale	**133.2**	195.2
Other assets	**201.7**	196.3
Counterparty credit risk	**59.5**	21.7
Credit valuation adjustments	**22.6**	14.3
Securitisation exposures in the banking book	**10.6**	12.1
Operational risk	**655.3**	525.2
Total risk-weighted assets	**7,694.8**	6,110.4
Common Equity Tier 1 ratio	**15.2%**	17.5%
Tier 1 ratio	**20.2%**	20.1%
Total capital ratio	**20.4%**	20.2%

Please see Appendix 2 for the CRD IV disclosure template as published by the EBA in Implementing Technical Standard 2013/01.

Table 15: Movements in capital resources

	Common Equity Tier 1	Additional Tier 1 capital	Tier 2 capital	Total
	£m	£m	£m	£m
At 1 January 2016	**1,070.0**	**156.5**	**7.6**	**1,234.1**
Movement in retained earnings	**114.4**	**-**	**-**	**114.4**
Movement in available-for-sale reserve	**4.4**	**-**	**-**	**4.4**
Movement in reserves of companies outside the regulatory Group	**0.9**	**-**	**-**	**0.9**
Movement in intangible assets	**(16.2)**	**-**	**-**	**(16.2)**
Movement in excess of expected loss over impairment	**(5.7)**	**-**	**-**	**(5.7)**
Movement in deferred tax on tax losses carried forward	**10.7**	**-**	**-**	**10.7**
Movement in prudential valuation adjustment	**(1.2)**	**-**	**-**	**(1.2)**
Additional foreseeable distributions on AT1 notes	**(2.8)**	**-**	**-**	**(2.8)**
Increase in foreseeable distributions	**(1.8)**	**-**	**-**	**(1.8)**
Issuance of additional Tier 1 notes	**-**	**227.6**	**-**	**227.6**
Movement in general provisions	**-**	**-**	**4.3**	**4.3**
At 31 December 2016	**1,172.7**	**384.1**	**11.9**	**1,568.7**

Capital resources increased as a result of strong profit generation together with the issuance of AT1 notes of £230.0 million (less issue costs of £2.4 million) and reduced deferred tax on tax losses carried forward. This was partly offset by investment in intangible assets and foreseeable distributions. Tier 2 capital is comprised of general provisions (under the CRD IV definition) on credit cards.

Capital securities

Virgin Money Holdings (UK) plc issued Additional Tier 1 securities of £160.0 million to investors in July 2014, which have a discretionary coupon of 7.875% per annum. A further £230.0 million of Additional Tier 1 securities were issued to investors in November 2016, which have a discretionary coupon of 8.75% per annum.

The main features of both securities can be found in Appendix 3 of this document and the full terms and conditions can be found on the Investor Relations section of the website at http://uk.virginmoney.com/virgin/investor-relations/debt-investors/additional-tier-1/additional-tier-1-terms/.

Leverage ratio

The CRR introduced a new balance sheet metric, the leverage ratio, from 1 January 2014. The EBA will impose a minimum leverage ratio of 3.0% from 2018. The Group's leverage ratio as at 31 December 2016 was 4.4% (2015: 4.0%).

Table 16: Leverage ratio

	2016	2015
	£m	£m
Tier 1 capital	**1,556.8**	1,226.5
Exposures measure		
Total regulatory balance sheet assets	**35,060.9**	30,233.2
Removal of accounting values for derivatives	**(104.2)**	(82.3)
Exposure value for derivatives	**(29.4)**	61.8
Exposure value for securities financing transactions (repos)	**222.4**	261.7
Off-balance sheet items	**714.5**	659.5
Other regulatory adjustments	**(98.7)**	(102.5)
Total exposure	**35,765.5**	31,031.4
Leverage ratio	**4.4%**	4.0%

Exposure values associated with derivatives and repos have been adjusted using the current CRD IV rules. For the purposes of the leverage ratio, the derivative measure is calculated as the replacement cost for the current exposure plus an add on for potential future exposure.

Off-balance sheet items are made up of undrawn credit facilities including such facilities that may be cancelled unconditionally at any time. Credit conversion factors, subject to a floor of 10% have been applied to these items in accordance with the CRD IV rules.

Other regulatory adjustments consist of adjustments that have been applied to the Tier 1 capital (such as intangible assets, deferred tax on tax losses carried forward and excess expected losses) which are also applied to the leverage ratio exposure measure. This ensures consistency between the Tier 1 capital numerator and the total exposure denominator of the ratio.

Appendix 5 shows detailed leverage ratio disclosures made in accordance with the EBA's Implementing Technical Standard EBA/ITS/2014/04/rev1.

8. Pillar 1 capital requirements overview

This section provides further details of the calculation of the Pillar 1 capital requirements for the Group.

Group risk-weighted assets and Pillar 1 capital requirements

As described on pages 17 to 18 the Pillar 1 capital requirements of the Group are made up of credit risk, counterparty credit risk (including credit valuation adjustment) and operational risk elements.

The following table sets out the risk-weighted assets and Pillar 1 capital requirements of the Group.

Table 17: Risk-weighted assets and capital requirements

	Risk-weighted asset amounts		Pillar 1 capital requirements
	2016	2015	**2016**
	£m	£m	**£m**
Credit Risk (excluding counterparty credit risk)	**6,907.6**	5,487.1	**552.6**
Of which standardised approach	**2,143.1**	1,534.2	**171.4**
Of which the AIRB approach	**4,764.5**	3,952.9	**381.2**
Counterparty Credit Risk	**82.1**	36.0	**6.6**
Of which mark-to-market	**25.2**	21.6	**2.0**
Of which the standardised approach	**34.3**	0.1	**2.8**
Of which CVA	**22.6**	14.3	**1.8**
Securitisation exposures in banking book	**10.6**	12.1	**0.8**
Of which standardised approach	**10.6**	12.1	**0.8**
Operational risk	**655.3**	525.2	**52.5**
Of which standardised approach	**655.3**	525.2	**52.5**
Amounts below the thresholds for deduction (subject to 250% risk weight)	**39.2**	50.0	**3.1**
Total	**7,694.8**	6,110.4	**615.6**

In the table above, amounts below the thresholds for deduction relate to deferred tax assets that don’t relate to tax losses carried forward. As the value of these assets are below the CRR threshold, they are not deducted from own funds, but instead are risk-weighted at 250%. In the credit risk section these exposures have been included within the ‘other assets’ category.

Risk-weighted assets movement

The following table sets out the movements in the Group's risk-weighted assets split between book size, model changes and other movements.

Table 18: Risk-weighted assets movement

	AIRB mortgages	Standardised lending (credit cards)	Other standardised assets[1]	Credit valuation adjustment	Operational risk	Total
	£m	£m	£m	£m	£m	£m
Risk-weighted assets at 1 January 2016	3,952.9	1,192.7	425.3	14.3	525.2	6,110.4
Book size	1,168.1	655.8	-	-	-	1,823.9
Other movements	(356.5)	(1.1)	(20.3)	8.3	130.1	(239.5)
Risk-weighted assets at 31 December 2016	4,764.5	1,847.4	405.0	22.6	655.3	7,694.8

[1] This includes non-CVA counterparty credit risk

Movements in the AIRB mortgage risk-weighted assets are described in table 43 in Appendix 1.

Movements in other standardised assets reflect changes in the wholesale asset portfolio.

Operational risk is calculated using the Standardised approach, based on the average Group income over the past three years. The year-on-year movement reflects the increasing Group income from 2012 to 2015.

Segmental risk-weighted assets

Risk-weighted assets split by business segment are shown in the table below.

Table 19: Segmental risk-weighted assets

	2016		2015	
	Risk-weighted assets	**Pillar 1 capital requirement**	Risk-weighted assets	Pillar 1 capital requirement
	£m	**£m**	£m	£m
Mortgages and savings	**5,204.5**	**416.4**	4,284.5	342.8
Credit cards	**2,012.3**	**161.0**	1,334.7	106.8
Financial services	**50.4**	**4.0**	51.6	4.1
Central functions	**427.6**	**34.2**	439.6	35.1
Total	**7,694.8**	**615.6**	6,110.4	488.8

9. Pillar 1 capital requirements - credit risk

This section details the Group's credit risk profile and includes detailed credit risk exposure disclosures.

Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off-balance sheet).

Risk appetite

The Group has appetite for high-quality credit exposures including affordable retail lending and liquid wholesale investments.

Exposures

The principal sources of credit risk arise from loans and advances to customers and debt securities. The credit risk exposures of the Group are set out on page 30.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Loans and advances expose the Group to customer re-mortgage risk, for example, in the interest only retail mortgage portfolio. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. These exposures are not considered to be material, interest only mortgage management strategies are detailed on page 159 of the Annual Report and Accounts.

The Group's unsecured portfolio has grown in line with expectation and within strict underwriting criteria.

Growth in buy-to-let lending has been undertaken in a controlled manner, with Board oversight against risk appetite. The buy-to-let lending policy is targeted towards retail customers rather than professional landlords, with specific restrictions in place on total exposures by loan amount and number of properties.

Credit risk in the wholesale portfolio arises from debt securities, derivatives and foreign exchange activities.

Measurement

The Group uses models to measure credit risk exposures including statistical models for the mortgage AIRB approach. Models are supported by both internal and external data. For all other exposures the Group applies standardised risk weightings.

Mitigation

Credit policy

The Risk function uses risk appetite to set out the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, key risk indicators, and review and challenge exceptions to planned outcomes. They test the adequacy of credit risk infrastructure and governance processes throughout the Group. Counterparty exposures are regularly reviewed and appropriate interventions are used where necessary. Risk Assurance perform independent risk-based reviews, and provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

Controls over rating systems

The Group has an established Independent Model Validation 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.

Credit underwriting

The Group uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits on the levels of debt allowed.

The Group rejects any application for a product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group's approach to underwriting applications takes into account the total unsecured debt held by a customer and their affordability.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value (LTV) of less than 95%. All originations to 31 December 2016 which were between 90% and 95% LTV were only permitted under the Help to Buy loan guarantee scheme. The Group has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Table 20: Maximum LTVs for residential lending

Loan size from	To	Maximum LTV
£1	**£500,000**	**95% (purchase)**
		90% (remortgage)
£500,001	**£1,000,000**	**80%**

Buy-to-let mortgages are limited to a maximum of 75% LTV and residential interest only mortgages are limited to a maximum of 70% LTV, regardless of loan size.

Monitoring

The Group produces regular portfolio monitoring reports for review by senior management. The Risk function in turn produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

- appropriate risk differentiation capability is provided;
- generated ratings remain as accurate and robust as practical; and
- appropriate risk estimates are assigned to grades and pools.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Details of the monitoring of rating models are provided in Appendix 1.

Credit risk exposure by exposure class

For the purposes of these disclosures, credit exposure for the AIRB portfolios refers to the calculated EAD. As detailed on page 8, the EAD calculation includes amounts where customers have contractual rights to draw down further balances and estimates of interest accruals to the point of default.

The following table sets out the exposures for the various types of asset held by the Group, and the average exposures during the year.

Table 21: Group exposures, risk weights and average exposures

2016	**Exposure**	**Risk-weighted assets**	**Average risk weight**	**Average exposure in period**
	£m	**£m**	**%**	**£m**
AIRB				
Retail exposures secured by real estate collateral	**32,389.6**	**4,764.5**	**14.7**	**30,897.7**
Standardised				
Credit cards and other retail exposures	**2,446.8**	**1,835.1**	**75.0**	**2,138.9**
Items in default	**12.3**	**12.3**	**100.0**	**12.0**
Central governments and central banks	**1,098.5**	**-**	**-**	**1,073.3**
Multilateral development banks	**129.3**	**-**	**-**	**211.6**
Institutions	**492.5**	**100.5**	**20.4**	**667.9**
Covered bonds	**327.1**	**32.7**	**10.0**	**443.1**
Equities	**7.9**	**7.9**	**100.0**	**7.1**
Other assets	**175.5**	**193.8**	**110.4**	**190.4**
Total standardised	**4,689.9**	**2,182.3**	**46.5**	**4,744.3**
Total	**37,079.5**	**6,946.8**	**18.7**	**35,642.0**

2015	Exposure	Risk-weighted assets	Average risk weight	Average exposure in period
	£m	£m	%	£m
AIRB				
Retail exposures secured by real estate collateral	27,997.5	3,952.9	14.1	26,141.1
Standardised				
Credit cards and other retail exposures	1,574.6	1,180.9	75.0	1,227.0
Items in default	11.8	11.8	100.0	7.7
Central governments and central banks	1,286.9	-	-	1,345.4
Multilateral development banks	203.7	-	-	291.9
Institutions	626.1	141.7	22.6	623.9
Covered bonds	535.3	53.5	10.0	408.4
Equities	4.6	4.6	100.0	2.1
Other assets	173.0	191.7	110.8	164.7
Total standardised	4,416.0	1,584.2	35.9	4,071.1
Total	**32,413.5**	**5,537.1**	**17.1**	**30,212.2**

AIRB exposures are made up solely of residential mortgages. The increase in 2016 reflects the Group's organic growth in mortgage lending.

Standardised exposures include credit card lending and wholesale investments. Credit card exposures increased following organic growth in the credit card book during 2016.

During the year, the Group made further use of the Funding for Lending Scheme (FLS) facility to support liquidity management. As a result holdings of other categories of high quality liquid assets reduced in the year.

Credit risk exposure by industry

The tables below give details of the distributions of exposures by industry or counterparty type.

Table 22: Credit risk exposures by industry or counterparty type

As at 31 December 2016	Mortgages – individuals £m	Other lending – individuals £m	Financial/ Sovereign £m	Other assets £m	Total £m
AIRB					
Retail exposures secured by real estate collateral	**32,389.6**	**-**	**-**	**-**	**32,389.6**
Standardised					
Credit cards and other retail exposures	**-**	**2,446.8**	**-**	**-**	**2,446.8**
Items in default	**-**	**12.3**	**-**	**-**	**12.3**
Central governments and central banks	**-**	**-**	**1,098.5**	**-**	**1,098.5**
Multilateral development banks	**-**	**-**	**129.3**	**-**	**129.3**
Institutions	**-**	**-**	**492.5**	**-**	**492.5**
Covered bonds	**-**	**-**	**327.1**	**-**	**327.1**
Equities	**-**	**-**	**-**	**7.9**	**7.9**
Other assets	**-**	**-**	**-**	**175.5**	**175.5**
Total	**32,389.6**	**2,459.1**	**2,047.4**	**183.4**	**37,079.5**

As at 31 December 2015	Mortgages – individuals £m	Other lending – individuals £m	Financial/ Sovereign £m	Other assets £m	Total £m
AIRB					
Retail exposures secured by real estate collateral	27,997.5	-	-	-	27,997.5
Standardised					
Credit cards and other retail exposures	-	1,574.6	-	-	1,574.6
Items in default	-	11.8	-	-	11.8
Central governments and central banks	-	-	1,286.9	-	1,286.9
Multilateral development banks	-	-	203.7	-	203.7
Institutions	-	-	626.1	-	626.1
Covered bonds	-	-	535.3	-	535.3
Equities	-	-	-	4.6	4.6
Other assets	-	-	-	173.0	173.0
Total	**27,997.5**	**1,586.4**	**2,652.0**	**177.6**	**32,413.5**

Credit risk exposure by geographical area

The tables below give details of the geographical distributions of exposures.

Table 23: Credit risk exposures by geographical area

As at 31 December 2016	**UK**	**Europe**	**Rest of the world**	**Total**
	£m	**£m**	**£m**	**£m**
AIRB				
Retail exposures secured by real estate collateral	**32,389.6**	**-**	**-**	**32,389.6**
Standardised				
Credit cards and other retail exposures	**2,446.8**	**-**	**-**	**2,446.8**
Items in default	**12.3**	**-**	**-**	**12.3**
Central governments and central banks	**1,098.5**	**-**	**-**	**1,098.5**
Multilateral development banks	**-**	**46.1**	**83.2**	**129.3**
Institutions	**114.2**	**116.6**	**261.7**	**492.5**
Covered bonds	**327.1**	**-**	**-**	**327.1**
Equities	**6.4**	**-**	**1.5**	**7.9**
Other assets	**175.5**	**-**	**-**	**175.5**
Total	**36,570.4**	**162.7**	**346.4**	**37,079.5**

As at 31 December 2015	UK	Europe	Rest of the world	Total
	£m	£m	£m	£m
AIRB				
Retail exposures secured by real estate collateral	27,997.5	-	-	27,997.5
Standardised				
Credit cards and other retail exposures	1,574.6	-	-	1,574.6
Items in default	11.8	-	-	11.8
Central governments and central banks	1,286.9	-	-	1,286.9
Multilateral development banks	-	145.9	57.8	203.7
Institutions	265.3	184.8	176.0	626.1
Covered bonds	535.3	-	-	535.3
Equities	4.6	-	-	4.6
Other assets	173.0	-	-	173.0
Total	**31,849.0**	**330.7**	**233.8**	**32,413.5**

Credit risk exposure by residual maturity

The following tables give details of the contractual residual maturities of exposures.

Table 24: Credit risk exposures by residual maturity

As at 31 December 2016	< 1 year	Residual maturity 1-5 yrs	> 5 years	Total
	£m	£m	£m	£m
AIRB				
Retail exposures secured by real estate collateral	**183.5**	**855.7**	**31,350.4**	**32,389.6**
Standardised				
Credit cards and other retail exposures	**2,446.8**	**-**	**-**	**2,446.8**
Items in default	**12.3**	**-**	**-**	**12.3**
Central governments and central banks	**781.2**	**-**	**317.3**	**1,098.5**
Multilateral development banks	**-**	**80.3**	**49.0**	**129.3**
Institutions	**492.5**	**-**	**-**	**492.5**
Covered bonds	**-**	**202.9**	**124.2**	**327.1**
Equities	**7.9**	**-**	**-**	**7.9**
Other assets	**175.5**	**-**	**-**	**175.5**
Total	**4,099.7**	**1,138.9**	**31,840.9**	**37,079.5**

As at 31 December 2015	< 1 year	Residual maturity 1-5 yrs	> 5 years	Total
	£m	£m	£m	£m
AIRB				
Retail exposures secured by real estate collateral	125.3	874.5	26,997.7	27,997.5
Standardised				
Credit cards and other retail exposures	1,574.6	-	-	1,574.6
Items in default	11.8	-	-	11.8
Central governments and central banks	877.4	-	409.5	1,286.9
Multilateral development banks	4.7	82.4	116.6	203.7
Institutions	583.2	25.3	17.6	626.1
Covered bonds	47.5	316.7	171.1	535.3
Equities	4.6	-	-	4.6
Other assets	173.0	-	-	173.0
Total	**3,402.1**	**1,298.9**	**27,712.5**	**32,413.5**

Exposures subject to the standardised approach

The Group uses the standardised approach to calculate risk-weighted assets on all exposures apart from retail mortgages.

The allocation of capital to credit risk within Treasury investments is calculated under the standardised approach as per CRD IV. For these exposures the Group uses credit ratings provided by the recognised credit rating agencies Standard and Poor's, Moody's and Fitch.

The following table shows the risk weights applied to credit risk exposures subject to the standardised approach, by exposure class, together with the risk-weighted asset value.

Table 25: Standardised exposures by risk weight

As at 31 December 2016					**Risk Weight**				
Exposure Class	0%	10%	20%	50%	75%	100%	250%	Total	Unrated
Central governments or central banks	1,098.5	-	-	-	-	-	-	1,098.5	-
Multilateral development banks	129.3	-	-	-	-	-	-	129.3	-
Institutions	-	-	485.8	6.7	-	-	-	492.5	-
Retail (credit cards)	-	-	-	-	2,446.8	-	-	2,446.8	2,446.8
Exposures in default	-	-	-	-	-	12.3	-	12.3	12.3
Covered bonds	-	327.1	-	-	-	-	-	327.1	-
Equities	-	-	-	-	-	7.9	-	7.9	7.9
Other items	5.2	-	-	-	-	154.6	15.7	175.5	175.5
Total	**1,233.0**	**327.1**	**485.8**	**6.7**	**2,446.8**	**174.8**	**15.7**	**4,689.9**	**2,642.5**

As at 31 December 2015					**Risk Weight**				
Exposure Class	0%	10%	20%	50%	75%	100%	250%	Total	Unrated
Central governments or central banks	1,286.9	-	-	-	-	-	-	1,286.9	-
Multilateral development banks	203.7	-	-	-	-	-	-	203.7	-
Institutions	-	-	571.2	54.9	-	-	-	626.1	-
Retail (credit cards)	-	-	-	-	1,574.6	-	-	1,574.6	1,574.6
Exposures in default	-	-	-	-	-	11.8	-	11.8	11.8
Covered bonds	-	535.3	-	-	-	-	-	535.3	-
Equities	-	-	-	-	-	4.6	-	4.6	4.6
Other items	10.8	-	0.6	-	-	141.6	20.0	173.0	173.0
Total	**1,501.4**	**535.3**	**571.8**	**54.9**	**1,574.6**	**158.0**	**20.0**	**4,416.0**	**1,764.0**

Wholesale credit risk exposures by credit rating

The following tables give details of the credit grading of the Group's treasury exposures.

Table 26: Standardised wholesale exposures by credit rating

As at 31 December 2016	Exposure by external rating			
	AAA to AA-	A+ to A-	BBB+ to BBB-	Total
	£m	£m	£m	£m
Central governments and central banks	**1,098.5**	**-**	**-**	**1,098.5**
Multilateral development banks	**129.3**	**-**	**-**	**129.3**
Institutions	**361.8**	**124.0**	**6.7**	**492.5**
Covered bonds	**327.1**	**-**	**-**	**327.1**
Total	**1,916.7**	**124.0**	**6.7**	**2,047.4**

As at 31 December 2015	Exposure by external rating			
	AAA to AA-	A+ to A-	BBB+ to BBB-	Total
	£m	£m	£m	£m
Central governments and central banks	1,286.9	-	-	1,286.9
Multilateral development banks	203.7	-	-	203.7
Institutions	311.7	299.4	15.0	626.1
Covered bonds	535.3	-	-	535.3
Total	2,337.6	299.4	15.0	2,652.0

Exposures in equities

The Group holds a small quantity of equity exposures.

Table 27: Exposures in equities

	2016	2015
	£m	£m
Other equities	**7.9**	4.6

The Group accounts for equities as available-for-sale assets. They are measured at fair value, or cost, where their fair value cannot be reliably measured. The Group made realised gains of £5.3 million and unrealised gains of £5.0 million recognised in CET1 capital during the year.

Collateral for secured retail and wholesale exposures

The sole collateral type for secured loans and advances to customers is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement. Derivative transactions with wholesale counterparties are collateralised under a Credit Support Annex (CSA) in conjunction with the ISDA Master Agreement.

The CSA allows margin calls to be made on the net mark-to-market value of derivative exposures with a particular counterparty. All interest rate derivative relationships are subject to margin calls on a daily basis. Collateral held or paid under the CSAs is in the form of cash and government securities in GBP, USD and Euros. A large proportion of derivative exposure is cleared at Qualifying Central Counterparties (QCCPs) which replaces exposure to individual counterparties with an exposure against the Central Counterparty (CCP). As permitted under the Standardised approach, the Group recognises the risk mitigating effect of these CSAs in its Pillar 1 capital calculations.

In order to minimise credit loss the Group will receive additional collateral from certain counterparties in the event their credit rating falls below contractually set triggers.

It is the Group's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

Fair value of collateral

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the table below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

Table 28: Fair value of collateral against secured loans, capped at loan value

As at 31 December 2016	**Residential mortgage loans**		**Residential buy-to-let mortgage loans**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**
Neither past due nor impaired	**24,046.6**	**100.0**	**5,441.7**	**100.0**	**29,488.3**	**100.0**
- of which in receipt of forbearance	***231.5***	***100.0***	***25.7***	***100.0***	***257.2***	***100.0***
Past due and not impaired	**151.3**	**100.0**	**17.6**	**100.0**	**168.9**	**100.0**
Impaired	**83.7**	**99.8**	**9.0**	**100.0**	**92.7**	**99.8**
- of which in possession	***0.3***	***100.0***	***0.1***	***100.0***	***0.4***	***100.0***
Total	**24,281.6**	**100.0**	**5,468.3**	**100.0**	**29,749.9**	**100.0**

As at 31 December 2015	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Neither past due nor impaired	20,836.9	100.0	4,379.8	100.0	25,216.7	100.0
- of which in receipt of forbearance	*238.6*	*100.0*	*8.8*	*100.0*	*247.4*	*100.0*
Past due and not impaired	145.2	100.0	15.0	100.0	160.2	100.0
Impaired	77.3	99.6	7.0	100.0	84.3	99.6
- of which in possession	*0.9*	*100.0*	*0.1*	*100.0*	*1.0*	*100.0*
Total	21,059.4	100.0	4,401.8	100.0	25,461.2	100.0

At 31 December 2016 cash collateral of £181.1 million (2015: £94.0 million) had been pledged by the Group and £10.7 million (2015: £10.6 million) has been received as cash collateral by the Group. As at 31 December 2016 £75.7 million (2015: nil). has been received as collateral in the form of securities by the Group.

Credit risk impairments and debt management

The categorisation of credit risk is detailed in the table below:

Table 29: Categorisation of credit risk by impairment level

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.
Neither past due nor impaired and in forbearance	Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions.
Past due and not impaired	Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets, as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending.
Arrears	For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.
Impaired assets	Loans that are in arrears or where there is objective evidence of impairment, including changes in customer behaviour or circumstances, and where the carrying amount of the loan exceeds the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due. All fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount.

Debt management for customers in financial difficulty

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support customers and act in their best long-term interests. The Group offers a range of tools and assistance to support customers who are encountering financial difficulties. The circumstances of each customer are considered separately and the action taken judged as being affordable and sustainable for the customer.

Customers are assisted through the Debt Management function 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, which require restructuring.

One component of the management approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears. To assist mortgage customers in financial distress, the Group benefits from Income Support for Mortgage Interest, a Government sponsored programme for households. This does not affect the assessment of impairment.

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan. This ensures that customers are provided with a sustainable and affordable solution that allows them a realistic opportunity to repay their debt in the short to medium term. In addition, the Group will advise customers to contact debt management companies such as Citizens Advice Bureau, Stepchange and Payplan. These companies do not charge any fees and will offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Forbearance and provisioning

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses behavioural scoring to assess customers' credit risk and the models take a range of potential indicators of customer financial distress into account.

The performance of provisioning models is monitored and challenged on an ongoing basis in line with the Retail Credit Provisioning Policy. Regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected.

The table below indicates the level of impaired and past due exposures by exposure class, and of the levels of provisions against them. All exposures are located in the UK.

Table 30: Analysis of past due and impaired loans and advances to customers

As at 31 December 2016	**Impaired exposures**	**Past due but not impaired**	**General impairment provisions**	**Specific impairment provisions**
	£m	**£m**	**£m**	**£m**
Retail exposures secured by real estate collateral	**92.9**	**168.9**	**-**	**10.6**
Credit cards	**32.4**	**-**	**11.8**	**27.6**
Other retail exposures	**-**	**-**	**0.1**	**-**
Total	**125.3**	**168.9**	**11.9**	**38.2**

As at 31 December 2015	Impaired exposures	Past due but not impaired	General impairment provisions	Specific impairment provisions
	£m	£m	£m	£m
Retail exposures secured by real estate collateral	84.6	160.2	-	8.7
Credit cards	27.4	-	7.5	23.6
Other retail exposures	-	-	0.1	-
Total	112.0	160.2	7.6	32.3

Total impaired assets increased by £13.3 million in the year to 31 December 2016. This increase reflects growth in the book, despite improved arrears performance. Impaired assets as a proportion of total loans remained stable for secured lending at 0.3% and improved for unsecured loans from 1.7% at 31 December 2015 to 1.3% at 31 December 2016.

Table 31: Analysis of movements in impairment provisions

	Retail mortgages	**Credit cards**	**Other retail exposures**	**Total**
	£m	**£m**	**£m**	**£m**
General impairment provisions				
At 1 January 2016	**-**	**7.5**	**0.1**	**7.6**
Increase in provision during year	**-**	**4.3**	**-**	**4.3**
Amounts written off during the year	**-**	**-**	**-**	**-**
At 31 December 2016	**-**	**11.8**	**0.1**	**11.9**
Specific impairment provisions				
At 1 January 2016	**8.7**	**23.6**	**-**	**32.3**
Increase in provision during year	**2.7**	**36.3**	**-**	**39.0**
Amounts written off during the year	**(0.8)**	**(32.3)**	**-**	**(33.1)**
At 31 December 2016	**10.6**	**27.6**	**-**	**38.2**

10. Pillar 1 capital requirements - credit risk – securitisation

This section details the Group's exposure to and interest in securitisation arrangements.

The Group is a participant in the securitisation market, operating as an originator and an investor in third party securitisations. As an originator, the Group undertakes securitisation activities principally to provide funding diversification, giving access to a wide range of investors in different geographic areas. Securitisation also serves to generate liquidity from residential mortgage loans. As an investor, the Group invests directly in third party asset backed securities as part of its liquidity management activity.

Originated securitisations

The Group has securitised certain mortgage loans by transferring the loans to special purpose vehicles (SPVs) controlled but not legally owned by the Group.

The Group administers the SPV and the originating Group company receives fees from the SPV for continuing to service the loans. The Group also acts as the cash manager for the transactions, operates as the basis rate swap provider and the start up loan provider and provides a guaranteed investment contract bank account.

Notes issued as part of a securitisation are divided into separate tranches depending upon their level of subordination. The most junior tranches are retained by the Group. This means that any shortfall in income would firstly be borne by any reserve funds within the structure and would then be borne as losses by the Group as junior noteholders. This means there is effectively no significant risk transfer of credit risk away from the Group, and as such the Group does not benefit from lower regulatory capital requirements in respect of these securitised assets.

Within the Group's financial statements, the treatment of SPVs is assessed in accordance with International Financial Reporting Standard 10. The accounting policies are described in more detail in Note 1 to the consolidated financial statements in the 2016 Virgin Money Group Annual Report and Accounts.

Securitisation programmes and activity

Table 32: Securitisation activity during the year

As at 31 December 2016	**Securities issued**	**Of which retained**	**Currency**
	£m	**£m**	
Gosforth Funding 2016-1 plc	**1,553.2**	**750.1**	**Euro, US Dollar, Sterling**
Gosforth Funding 2016-2 plc	**1,026.1**	**551.9**	**Euro, Sterling**
Total	**2,579.3**	**1,302.0**	

As at 31 December 2015	Securities issued	Of which retained	Currency
	£m	£m	
Gosforth Funding 2015-1 plc	1,388.9	638.9	Sterling
Total	1,388.9	638.9	

For all funding raised in currencies other than Sterling, the Group enters into cross-currency derivatives which swap the foreign currency liabilities back to Sterling.

As at 31 December 2016 the total outstanding externally issued securitisation debt was £2,299.9 million (2015: £1,746.1 million) and the total outstanding retained securitisation debt was £2,322.5 million (2015: £1,722.7 million). There were no assets awaiting securitisation at 31 December 2016 (2015: nil). During the year, Gosforth Funding 2011-1 plc, Gosforth 2012-1 plc and Gosforth Funding 2012-2 plc repaid all outstanding securitised notes in full.

All retained securitisation debt is detailed in the table below.

Table 33: Retained securitisations

As at 31 December 2016

Issuer	Currency	Notes	Retained Amount £m	Moody's	Fitch
Gosforth Funding 2011-1 plc	GBP	Class M	-	Aa1(sf)	AAsf
Gosforth Funding 2011-1 plc	GBP	Class Z	-	Unrated	Unrated
Gosforth Funding 2012-1 plc	GBP	Class A	-	Aaa	AAAsf
Gosforth Funding 2012-1 plc	GBP	Class M	-	Aa1(sf)	AAsf
Gosforth Funding 2012-1 plc	GBP	Class Z	-	Unrated	Unrated
Gosforth Funding 2012-2 plc	GBP	Class A2	-	Aaa	AAAsf
Gosforth Funding 2012-2 plc	GBP	Class M	-	Aaa(sf)	AAAsf
Gosforth Funding 2012-2 plc	GBP	Class Z	-	Unrated	Unrated
Gosforth Funding 2014-1 plc	GBP	Class A2	250.0	Aaa(sf)	AAAsf
Gosforth Funding 2014-1 plc	GBP	Class M	55.6	Aa1(sf)	AAsf
Gosforth Funding 2014-1 plc	GBP	Class Z	83.3	Unrated	Unrated
Gosforth Funding 2015-1 plc	GBP	Class A2	500.0	Aaa(sf)	AAAsf
Gosforth Funding 2015-1 plc	GBP	Class M	55.6	Aa1(sf)	AAsf
Gosforth Funding 2015-1 plc	GBP	Class Z	83.3	Unrated	Unrated
Gosforth Funding 2016-1 plc	USD	Class A1a	9.2	Aaa(sf)	AAAsf
Gosforth Funding 2016-1 plc	GBP	Class A1b	13.3	Aaa(sf)	AAAsf
Gosforth Funding 2016-1 plc	EURO	Class A2a	16.1	Aaa(sf)	AAAsf
Gosforth Funding 2016-1 plc	GBP	Class A2b	552.5	Aaa(sf)	AAAsf
Gosforth Funding 2016-1 plc	GBP	Class M	62.2	Aa2(sf)	AA+sf
Gosforth Funding 2016-1 plc	GBP	Class Z	93.1	Unrated	Unrated
Gosforth Funding 2016-2 plc	EURO	Class A1a	5.6	Aaa(sf)	AAAsf
Gosforth Funding 2016-2 plc	GBP	Class A1b	15.7	Aaa(sf)	AAAsf
Gosforth Funding 2016-2 plc	GBP	Class A2	419.1	Aaa(sf)	AAAsf
Gosforth Funding 2016-2 plc	GBP	Class M	41.2	Aa1(sf)	AAsf
Gosforth Funding 2016-2 plc	GBP	Class Z	66.7	Unrated	Unrated
Total			**2,322.5**		

As at 31 December 2015

Issuer	Currency	Notes	Retained Amount £m	Moody's	Fitch
Gosforth Funding 2011-1 plc	GBP	Class M	38.4	Aa1(sf)	AAsf
Gosforth Funding 2011-1 plc	GBP	Class Z	102.5	Unrated	Unrated
Gosforth Funding 2012-1 plc	GBP	Class A	16.0	Aaa	AAAsf
Gosforth Funding 2012-1 plc	GBP	Class M	32.1	Aa1(sf)	AAsf
Gosforth Funding 2012-1 plc	GBP	Class Z	85.4	Unrated	Unrated
Gosforth Funding 2012-2 plc	GBP	Class A2	185.6	Aaa	AAAsf
Gosforth Funding 2012-2 plc	GBP	Class M	88.1	Aaa(sf)	AAAsf
Gosforth Funding 2012-2 plc	GBP	Class Z	146.8	Unrated	Unrated
Gosforth Funding 2014-1 plc	GBP	Class A2	250.0	Aaa(sf)	AAAsf
Gosforth Funding 2014-1 plc	GBP	Class M	55.6	Aa1(sf)	AAsf
Gosforth Funding 2014-1 plc	GBP	Class Z	83.3	Unrated	Unrated
Gosforth Funding 2015-1 plc	GBP	Class A2	500.0	Aaa(sf)	AAAsf
Gosforth Funding 2015-1 plc	GBP	Class M	55.6	Aa1(sf)	AAsf
Gosforth Funding 2015-1 plc	GBP	Class Z	83.3	Unrated	Unrated
Total			**1,722.7**		

The Group utilises the services of several External Credit Assessment Institutions (ECAIs) including Moody's and Fitch to rate the securitisation transactions in issue. The ratings assigned assess the ability of the structure to allow for the timely payment of interest and the ultimate payment of principal of each of the rated notes. As part of the ratings process each of the agencies is committed to ongoing transaction monitoring to ensure that, in their view, the assigned ratings remain an appropriate reflection of the issued notes' credit risk.

There were no changes to the ratings assigned to any of the notes in issue during 2016 by Fitch or Moody's. On 13 January 2017, the Gosforth Funding 2014-1 plc M notes were upgraded from AAsf to AA+sf.

Risks inherent in securitised assets

The Group's securitisation programmes are made up of residential mortgages, where credit risk is the primary risk driver to the underlying asset pool. The processes undertaken by the Group to monitor changes in the credit risk of securitised mortgages are the same as unsecuritised mortgages and are described in Appendix 1.

Both the notes in issue and the underlying asset pool are exposed to market risk in the form of interest rate risk. The notes in issue may also be exposed to foreign exchange market risk. In order to mitigate interest rate and market risk to which the securitised assets may be exposed, the Group enters into interest rate swap agreements and cross currency swap agreements.

Liquidity risk arises where insufficient funds are received by the SPVs to service payments to the noteholders as they fall due. The Group is under no obligation to support any losses that may be incurred by the securitisation transactions or holders of the notes issued and do not intend to provide such further support. The parties holding the notes in issue are entitled to obtain payment of the principal and interest only to the extent that the resources of the securitisation transactions are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form.

Gross securitised exposure

The following table shows the total balance sheet value of loans securitised, the impaired and past due amounts of those loans and the losses recognised during the year.

Table 34: Total and impaired securitised assets

As at 31 December 2016	**Balance sheet value**	**Impaired and past due**	**Losses**
	£m	**£m**	**£m**
Retail mortgages	**4,907.8**	**9.5**	**0.1**

As at 31 December 2015	Balance sheet value	Impaired and past due	Losses
	£m	£m	£m
Retail mortgages	3,669.5	18.4	0.2

Purchased securitisations

All investments in securitisation exposures are held within the non-trading book of the Group. Risk-weighted exposures reported for purchased securitised assets at 31 December 2016 are calculated in line with CRR under the standardised approach.

The following table gives details of the positions in the securitised exposures of other issuers purchased by the Group.

Table 35: Purchased securitisation positions

	2016		2015	
	Exposures	**Risk-weighted assets**	Exposures	Risk-weighted assets
	£m	**£m**	£m	£m
Exposures risk-weighted at 20% (Credit Rating of AA- or higher)	**52.9**	**10.6**	60.6	12.1

Where appropriate, the Group utilises the services of the above ECAIs to rate purchased positions for risk weight allocation purposes.

11. Pillar 1 capital requirements - counterparty credit risk

This section describes the Group's approach to, and measurement of, counterparty credit risk.

Counterparty credit risk is the risk that the counterparty to a transaction could default during the life of the transaction. For the Group, this applies to derivative, central counterparty and asset repurchase agreements (repos).

Counterparty credit risk is monitored daily by the Wholesale Credit Risk team and reported to Treasury Risk Committee (TRC) monthly. TRC is a sub-committee of the Risk Management Committee (RMC) and receives monthly updates on counterparty credit risk.

The duration of the derivative and the credit quality of the counterparty are both factored into the internal capital and credit limits for counterparty credit exposures.

A two notch ratings downgrade could result in the Group being required to post additional collateral under derivative CSA contracts.

The Group measures derivative counterparty credit exposure value under the counterparty credit risk mark-to-market method. This exposure value is derived by adding the gross positive fair value of the contract (replacement cost) to the contract's potential future credit exposure, which is derived by applying a standardised multiple based on the contracts residual maturity to the notional value of the contract.

The exposure of repos is measured by calculating the difference between the value of the asset repo'ed and the cash received from the counterparty.

Wrong way risk occurs where exposure to a counterparty is adversely correlated with the credit quality of that counterparty. The Group has no such exposure, as it has no appetite for credit derivative positions which are the key drivers of such a risk.

The table below details over the counter (OTC) derivative exposures.

Table 36: Derivative exposures

	2016 £m	2015 £m
Gross positive fair values of derivative contracts	**104.2**	82.3
Netting with gross negative fair value of derivative contracts	**(25.4)**	(70.4)
Potential future incremental exposure	**61.2**	49.9
Collateral received	**(86.4)**	(10.6)
Net OTC derivative exposures	**53.6**	51.2

Total credit risk exposures in relation to counterparty credit risk are shown below.

Table 37: Standardised approach counterparty credit risk exposures

As at 31 December 2016	Risk Weight										
Exposure Class	0%	4%	10%	20%	50%	75%	100%	150%	250%	Unrated	Total
Institutions	-	76.4	-	8.8	44.8	-	-	-	-	-	**130.0**
Central governments and central banks	-	-	75.7	-	-	-	-	-	-	-	**75.7**
Other items	173.0	-	-	-	49.4	-	-	-	-	-	**222.4**
Total exposure	**173.0**	**76.4**	**75.7**	**8.8**	**94.2**	**-**	**-**	**-**	**-**	**-**	**428.1**
Total risk-weighted assets											**59.5**

As at 31 December 2015	Risk Weight										
Exposure Class	0%	4%	10%	20%	50%	75%	100%	150%	250%	Unrated	Total
Institutions	-	0.3	-	13.1	38.0	-	-	-	-	-	**51.4**
Central governments and central banks	-	-	-	-	-	-	-	-	-	-	**-**
Other items	261.7	-	-	-	-	-	-	-	-	-	**261.7**
Total exposure	**261.7**	**0.3**	**-**	**13.1**	**38.0**	**-**	**-**	**-**	**-**	**-**	**313.1**
Total risk-weighted assets											**21.7**

Table 38: Analysis by contract type

	Exposures		**Risk-weighted assets**	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Interest rate contracts	**51.6**	49.8	**12.5**	21.4
Equity contracts	**4.7**	1.4	**1.2**	0.3
Foreign exchange contracts	**98.7**	-	**19.1**	-
Central counterparties	**50.7**	0.2	**2.0**	-
Securities financing transactions (repos)	**222.4**	261.7	**24.7**	-
Sub-total	**428.1**	313.1	**59.5**	21.7
Credit valuation adjustment	-	-	22.6	14.3
Total	**428.1**	313.1	**82.1**	36.0

The Group entered into foreign exchange derivative agreements during the year, giving rise to £98.7m additional derivative exposures.

The Group's increased use of Central Counterparties to clear derivative exposures has given rise to the increase in balances with central counterparties, which represents the initial margin deposited with the counterparty.

12. Capital requirements - market risk

This section describes the Group's approach to, and measurement of, market risk.

Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises only as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets. As a result, interest rate risk in the banking book (IRRBB) is the only material market risk for the Group.

Risk appetite

The Group has limited risk appetite for exposures to IRRBB, in terms of both potential changes to economic value, and changes to expected net interest income or earnings.

Capital requirement

The Group's Pillar 1 market risk capital requirement is limited to its foreign exchange exposure which is immaterial and falls below the de minimis limit within CRD IV. As such it has no Pillar 1 market risk capital requirement. The rest of this section therefore relates to market risk measured through the Group's Pillar 2 add on.

Exposures

Interest rate mismatch risk arises from the different re-pricing characteristics of the Group's assets, liabilities and off-balance sheet positions. Interest rate mismatch risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, the variation of volume of business written in response to changes in interest rate and optionality in customers' ability to complete or redeem their products.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The primary rates that the Group is exposed to are the Bank Base Rate and LIBOR. If the spread between these rates moves adversely, the Group may experience volatility in income on unhedged exposures.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates which may differ to what was expected.

Optionality risk arises predominantly in retail activities, as customer balances amortise more quickly or slowly than anticipated due to economic conditions or customers' response to changes in economic conditions.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. This includes maintaining liquid assets and wholesale funding. The Group has minimal appetite for foreign currency risk.

Measurement

The Group uses stress scenarios to quantify the impact to economic value and earnings arising from a shift to interest rates. These include interest rate re-pricing gaps, earnings sensitivity analysis and open foreign exchange positions.

During April 2016, the Basel Committee on Banking Supervision (BCBS) published standards relating to the management of IRRBB. The Group shall maintain IRRBB management practices in line with regulatory expectations.

Interest rate risk exposure is measured as follows:

- Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Group's capital position.
- Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period, measuring the adverse change to net interest income from a movement in interest rates.

IRRBB is measured considering both positive and negative instantaneous shocks to interest rates. The measurement is enhanced with non-parallel stress scenarios (basis risk) and behavioural volume stresses (pipeline and optionality risk). Both EaR and CaR are controlled by a defined risk appetite limit and supporting metrics.

The disclosures on the following page show CaR and EaR measurements based on a two percent parallel stress for interest rate mismatch risk, subject to a floor at 0%, with complementary stress scenarios in other risk categories. The use of this standardised parallel stress is intended to provide comparability in reporting, consistent with the objectives of the regulatory bodies. The magnitude of stress used within the Group's internal risk appetite differs from the standardised regulatory stress, based on observed rate movements and internally defined exposure holding periods.

The Group has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

Mitigation

Treasury is responsible for managing interest rate risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour.

The Group's participation in the Government's Term Funding Scheme could expose the Group to increased basis mismatch exposure as funding is linked to the Bank Base Rate. The Group mitigates basis risk through product strategy, creating natural offsets where possible. When required, the Group uses basis derivatives to maintain the residual exposure within risk appetite.

Monitoring

The Board Risk Committee regularly reviews market risk exposure as part of the wider risk management framework.

Table 39: Capital at Risk

	2016		2015	
	Positive rate shock	**Negative rate shock[1]**	Positive rate shock	Negative rate shock[1]
	£m	**£m**	£m	£m
Interest rate mismatch risk	**(1.6)**	**(0.7)**	(3.8)	3.1
Basis risk	**-**	**-**	-	-
Pipeline risk	**5.7**	**7.1**	8.9	4.7
Optionality risk	**30.1**	**7.7**	27.1	12.3
Total interest rate risk – Capital at Risk	**34.2**	**14.1**	32.2	20.1

[1] Market rate (BBR, LIBOR and swaps) stresses are subject to a floor of 0%.

CaR as at 31 December 2016 decreased to £14.1 million from £20.1 million at 31 December 2015 in a negative rate shock scenario. The impact of a negative rate shock has reduced due to the lower rate environment, particularly the 25 basis point cut to the BoE Base Rate that was made in August 2016. Therefore, the impact of further potential rate cuts is lower, assuming rates do not go below 0%. CaR in a positive rate shock scenario is broadly consistent across all sources of IRRBB risk.

Table 40: Earnings at Risk

	2016 Positive rate shock	Negative rate shock[1]	2015 Positive rate shock	Negative rate shock
	£m	**£m**	£m	£m
Interest rate mismatch risk	**1.7**	**1.4**	4.0	2.9
Basis risk	**10.4**	**17.6**	(0.2)	0.1
Pipeline risk	**3.0**	**2.3**	3.8	1.7
Optionality risk	**8.6**	**0.3**	8.3	0.8
Total interest rate risk – Earnings at Risk	**23.7**	**21.6**	15.9	5.5

[1] Market rate (BBR, LIBOR and swaps) stresses are subject to a floor of 0%.

EaR has increased year-on-year by £7.8 million in a positive rate shock scenario and by £16.1 million in a negative rate shock scenario due to changes made in the way the Group measures the exposure to basis risk. The scenarios used have been updated to better capture basis risk in the current low rate environment. The Group's underlying IRRBB risk exposure, after removing the impact of changes to basis risk stress scenarios, is materially unchanged.

The Capital and Earnings at Risk measures are based on a parallel stress to the yield curve for interest rate mismatch risk with complementary stress scenarios in other risk categories. The Group recognises that a parallel interest rate stress has inherent limitations and supplements this methodology with additional stress tests and balance sheet limits.

13. Capital requirements - operational risk

This section describes the Group's approach to, and measurement of, operational risk.

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;
- external fraud arising from an act of deception or omission;
- cyber risk arising from malicious attacks on the Group via technology, networks and systems;
- service disruption;
- failure of a third party corporate partner or strategic supplier; and
- normal business operational risk including transaction processing, information capture and implementation of change.

Measurement

A variety of measures is used such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root causes of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

Mitigation

The Group's control environment is regularly reviewed. Reporting on material risks is discussed monthly by senior management. Risks are managed through a range of strategies – such as avoidance, mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

- investment in IT to ensure continued availability, security and resilience of infrastructure;
- investment in information security capability to protect customers and the Group;
- investing in protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the financial crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. Through Group-wide policies and operational control frameworks, the Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and

- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive committees, in accordance with delegated authorities which are regularly reviewed and refreshed. Risk exposure is discussed regularly at the Operational Risk, Conduct Risk and Compliance Committee, and matters are escalated to the Chief Risk Officer, the Risk Management Committee and the Board Risk Committee, where appropriate. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and debated by executive management.

Key operational risks are appropriately insured and the insurance programme is monitored and reviewed regularly, with recommendations being made to executive management prior to each renewal. Insurers are monitored on an ongoing basis to minimise counterparty risk. A process is in place to manage insurer rating changes.

Operational risk capital requirement

The standardised approach measures the capital requirement as a percentage of the average net interest and non-interest income. The Group adopts this approach, deriving from the three year average of the aggregate risk-weighted income of the underlying business. This requires a firm’s activities to be split into a number of defined business lines with a specific risk weight applied to the income of each business line.

At 31 December 2016, as a result of this approach, the Group Pillar 1 capital requirement for operational risk was £52.5 million (2015: £42.0 million) represented by risk-weighted assets of £655.3 million (2015:£525.2 million).

Appendix 1. Advanced Internal Ratings Based (AIRB) approach

Scope of the AIRB permission

The Group's AIRB Waiver Application Pack was approved by the FSA on 1 January 2010 for capital adequacy monitoring and reporting from 1 January 2010 onwards. The scope of this permission covers the retail business of retail exposures secured by real estate collateral (mortgage portfolio). Asset classes not falling within the scope of the Group's AIRB permission are treated under the standardised approach.

Overview of the AIRB models

The Group's AIRB approach provides risk sensitive modelling using complex techniques to generate an internal estimate for the credit risk capital requirement. The requirements specified by the AIRB approach require the Group to use an internal assessment of the probability of a customer defaulting (PD). In addition, the AIRB approach requires the Group to derive direct estimates of EAD amounts and internal estimates of LGD in a downturn. These approaches are subject to regulatory floors in addition to the internal model assessments.

The PD, LGD and EAD of credit risk exposures form the base inputs to the regulatory risk weight calculation used to derive the risk-weighted assets at an account level. From this, the minimum capital requirements are calculated (being 8% of the RWA), reflecting the credit risk capital required to cover any unexpected losses across the portfolio.

An expected loss (EL) is derived by multiplying the PD, LGD and EAD risk components together, aligning to long run average PDs and downturn LGDs. As such the EL calculated represents an estimate of the monetary amount the business expects to lose from a customer defaulting within a 12 month outcome window, irrespective of current economic conditions. Where expected losses exceed accounting impairment provisions linked to the underlying credit risk exposures the resultant excess expected loss (EEL) is deducted from CET1 capital.

The Group uses the AIRB model outputs to inform both credit risk management and day-to-day credit related decision making within the business (the Use Test). Application of an AIRB approach requires PRA approval in the form of a waiver permission.

Development and monitoring of AIRB models

The predictive modelling function is responsible for the development, validation, implementation, monitoring and use of credit rating models for the AIRB approach. In order to ensure the integrity and independence of these models, the credit risk control function has clearly segregated duties from those responsible for originating exposures. The Credit Risk Committee has been established as the principal forum for independently overseeing the Group's credit rating models, to ensure that the systems are producing consistent and accurate results in line with the Group's objectives and PRA minimum requirements. The Group's independent model validation team provides review and challenge of the credit rating models and is independent from the credit risk control function.

Internal application of the AIRB approach

The Group has extensive data histories, which have enabled it to build in-house credit rating models for the residential mortgage portfolio. Scorecards are used to assess customer performance at application and subsequently via behavioural scores. Bureau data is utilised at application and a combination of bureau and internal performance data is used for ongoing behavioural scoring. Behavioural scores are grouped into score ranges and used to assign a point-in-time PD across the portfolio. The point-in-time PDs are transformed through a variable scalar model to derive a long run average (LRA) regulatory PD. The EAD model conservatively calculates outstanding drawings available to the customer up to the point of default. The LGD model accounts for recoveries, addressing house price volatility, distressed sale discount, associated costs and time to recovery.

The ratings system uses a through the cycle approach. The models determine long run average PD, downturn LGD and EAD for each segment in order to calculate expected losses and risk-weighted assets. In addition, the models are used to inform risk appetite, influence lending strategy and support determination of the level of impairment provisions.

The rating models group customers into segments differentiated by a number of factors, which include product type, LTV and measures of affordability. For each segment a long run average PD, downturn LGD and EAD are estimated from a combination of recent and historic data. Data covering the period back to the early 1990s is utilised in the derivation of the PD, LGD and EAD. All models incorporate an appropriate level of conservatism to account for uncertainty around model estimates over an economic cycle or in downturn conditions. The adequacy of this conservatism is robustly challenged through the Group's internal governance process and ultimately by the PRA.

Analysis of AIRB exposures by exposure class

Table 41: AIRB exposures and risk-weighted assets by exposure class

	2016		2015	
Retail AIRB	**Exposures £m**	**Risk-weighted assets £m**	Exposures £m	Risk-weighted assets £m
Retail exposures secured by real estate collateral				
Buy-to-let	**5,912.3**	**649.3**	4,832.5	556.8
Standard residential lending	**26,477.3**	**4,115.2**	23,165.0	3,396.1
Total	**32,389.6**	**4,764.5**	27,997.5	3,952.9

The following tables detail the Group's exposures for its sole AIRB exposure class of retail exposures secured by real estate collateral. These relate to EAD, and include all on and off-balance sheet exposures. The risk bands are segmented based upon three characteristics: mortgage type (residential buy-to-let and standard residential), borrower type (single or joint) and LTV.

Table 42: AIRB exposures by risk band

As at 31 December 2016

Risk band	LRA PD	Exposure	Downturn LGD	Risk-weighted assets	Risk-weighted assets	Average time on book	Undrawn commitments
	%	£m	%	%	£m	months	£m
BTL 1a	0.44%	2,019.4	8.40%	5.06%	102.8	27	145.2
BTL 2a	1.01%	1,457.3	15.13%	16.68%	244.6	25	82.7
BTL 3a	1.82%	23.0	9.39%	16.91%	3.9	131	3.5
BTL 4a	2.61%	39.0	9.14%	16.92%	6.6	132	3.9
BTL 1b	0.80%	1,394.7	8.19%	6.42%	90.1	33	92.9
BTL 2b	1.68%	921.7	14.59%	20.11%	186.6	30	49.8
BTL 3b	3.81%	23.1	8.94%	21.75%	5.1	131	2.6
BTL 4b	5.52%	33.2	8.20%	22.16%	7.4	131	2.7
BTL default	100%	0.9	23.61%	240.56%	2.2	82	-
Total buy-to-let		5,912.3			649.3		383.3
Standard 1a	0.56%	3,652.9	5.58%	3.88%	141.7	65	338.1
Standard 2a	0.93%	6,760.7	9.05%	8.83%	596.2	47	401.4
Standard 3a	1.47%	4,218.6	12.72%	17.03%	717.6	54	220.1
Standard 4a	1.77%	2,538.4	16.53%	25.32%	642.1	47	127.2
Standard 5a	2.20%	2,747.3	20.05%	36.93%	1,013.4	39	240.0
Standard 1b	0.79%	1,318.3	5.60%	4.81%	63.3	77	125.5
Standard 2b	1.30%	2,033.9	8.84%	10.00%	203.2	60	137.5
Standard 3b	1.56%	1,420.4	12.36%	15.92%	225.8	67	97.6
Standard 4b	1.84%	833.7	15.41%	20.54%	171.0	61	60.0
Standard 5b	2.47%	937.8	18.86%	33.31%	312.0	63	94.2
Standard default	100%	15.3	18.11%	188.41%	28.9	126	-
Total standard		26,477.3			4,115.2		1,841.6
Total		32,389.6			4,764.5		2,224.9

As at 31 December 2015

Risk band	LRA PD	Exposure	Downturn LGD	Risk-weighted assets	Risk-weighted assets	Average time on book	Undrawn commitments
	%	£m	%	%	£m	months	£m
BTL 1a	0.44%	1,573.5	8.81%	5.25%	82.6	24	114.3
BTL 2a	1.01%	1,216.2	15.22%	16.62%	202.2	20	97.8
BTL 3a	1.82%	28.5	10.60%	19.13%	5.4	118	4.2
BTL 4a	2.61%	46.8	10.78%	19.88%	9.3	120	4.7
BTL 1b	0.80%	1,098.9	8.50%	6.91%	76.0	31	75.0
BTL 2b	1.68%	798.5	14.46%	20.02%	159.9	26	50.8
BTL 3b	3.80%	29.3	10.21%	24.41%	7.1	119	3.6
BTL 4b	5.53%	38.8	9.88%	27.17%	10.5	119	3.0
BTL default	100.00%	2.0	18.11%	192.23%	3.8	67	-
Total buy-to-let		**4,832.5**			**556.8**		**353.4**
Standard 1a	0.56%	3,235.4	5.54%	3.75%	121.4	66	318.1
Standard 2a	0.93%	5,920.4	9.25%	8.82%	522.0	48	433.8
Standard 3a	1.48%	3,918.7	12.79%	16.88%	661.6	52	245.6
Standard 4a	1.78%	2,206.3	16.53%	23.94%	528.2	48	187.2
Standard 5a	2.20%	1,951.5	19.64%	35.65%	695.6	47	158.4
Standard 1b	0.78%	1,190.0	5.50%	4.72%	56.2	78	111.1
Standard 2b	1.30%	1,874.5	8.88%	9.99%	187.3	60	143.7
Standard 3b	1.56%	1,338.8	12.16%	14.23%	190.5	67	84.9
Standard 4b	1.84%	756.8	15.14%	19.63%	148.5	63	53.5
Standard 5b	2.47%	746.3	17.99%	30.42%	227.1	75	47.0
Standard default	100.00%	26.3	20.71%	219.78%	57.7	122	-
Total standard		**23,165.0**			**3,396.1**		**1,783.3**
Total		**27,997.5**			**3,952.9**		**2,136.7**

Movements in AIRB risk-weighted assets

Table 43: Risk-weighted assets flow statements of credit risk exposures under IRB

	Risk-weighted assets amounts	Capital requirements
	£m	£m
Risk-weighted assets as at 1 January 2016	**3,952.9**	**316.3**
Asset size	**1,168.1**	**93.7**
Asset quality	**(356.5)**	**(28.5)**
Risk-weighted assets as at 31 December 2016	**4,764.5**	**381.2**

In the table above, asset size is defined as organic changes in book size and composition (including the origination of new business and maturing loans) but excluding changes in book size due to acquisitions and disposal of entities.

Asset quality is defined as changes in the assessed quality of the institution's assets due to changes in borrower risk, such as rating grade migration or similar effects.

The Group's mortgage portfolio exposure increased during 2016, this resulted in an increase in risk-weighted assets of £1,168.1m. This has been offset by a reduction in risk-weighted assets of £356.5m associated with an improvement in asset quality caused by lower arrears emergence and increased property values linked to growth in HPI.

AIRB model performance – regulatory expected loss versus accounting actual loss

Risk and capital management practices are informed and evaluated by analysis of credit loss experience and the quantitative assessment of portfolio behaviour. This analysis includes a comparison of the expected loss (EL) calculated by the AIRB risk rating models with the impairment allowance reported within financial statements.

It is important to consider the difference in definition and scope of regulatory EL with measures of impairment under IFRS when comparing these metrics. Examples of such differences are summarised below:

- EL is based on long run estimates of PD over a one year outcome horizon, determined via statistical analysis of historical default experience. Impairment allowances are recognised for incurred losses at the balance sheet date. Point in time estimates of default are used in the determination of impairment allowances;

- EL uses the economic downturn calibration of the LGD component of the capital models. Impairment allowances are measured using point in time estimates of future cash flows; and

- EL is based on estimates of EAD and therefore it incorporates expected future drawings of committed credit lines, while impairment allowances are recognised in respect of financial assets recognised on the balance sheet and in respect of committed credit lines where a loss is probable.

The following table shows the regulatory EL measure, compared with impairment provision by AIRB exposure class.

Table 44: AIRB expected loss and impairment provision

As at 31 December 2016	**Regulatory expected loss**	**Impairment provision**
	£m	**£m**
Retail exposures secured by real estate collateral	**51.7**	**10.6**

As at 31 December 2015	Regulatory expected loss	Impairment provision
	£m	£m
Retail exposures secured by real estate collateral	44.1	8.7

AIRB model performance

Back-testing methodologies are applied to assess model performance. Results from these exercises have shown that models continue to perform satisfactorily. During 2016, the majority of modelled outcomes have been higher than actual outcomes and evidence an appropriately prudent calibration. The PD and LGD values are outputs from the Group's point-in-time calibrations. In conducting the PD back-testing process the model estimate is compared to the total defaults observed during the year that have emerged from the population not in default at 1 January 2016. The actual LGD value is calculated from recorded losses following repossession and subsequent sale of the property during the year. In addition, the actual LGD value is augmented with the latest LGD estimate for those defaulted accounts which are still in the workout process at the end of the period. In 2016, the actual LGD was marginally higher than estimated as a result of a small number of exceptional cases with high LGD. The EAD ratio is calculated by comparing the exposure of new defaults with the EAD estimate 12 months prior to defaulting. Where the estimated EAD is greater than the actual exposure at the point of default, the ratio will be greater than one.

The following table shows the forecast and actual PD and LGD as well as the ratio of estimated to actual EAD by AIRB exposure class.

Table 45: AIRB model performance

As at 31 December 2016	**PD of total portfolio**		**LGD of defaulted assets**		**EAD of defaulted assets**
	Estimated[1]	**Actual[2]**	**Estimated[3]**	**Actual[4]**	**Ratio of estimated to actual**
	%	**%**	**%**	**%**	
Retail exposures secured by real estate collateral	**0.46%**	**0.09%**	**3.09%**	**3.26%**	**1.04**

As at 31 December 2015	PD of total portfolio		LGD of defaulted assets		EAD of defaulted assets
	Estimated[1]	Actual[2]	Estimated[3]	Actual[4]	Ratio of estimated to actual
	%	%	%	%	
Retail exposures secured by real estate collateral	0.48	0.14	2.60	4.42	1.01

1 *This estimate is the output from the Group's point-in-time model as at 1 January 2016 (comparative 1 January 2015) and is based on the total number of accounts not in default.*

2 *Actual default is calculated as the total of emergent defaults during 2016 (comparative 1 January 2015) measured as a proportion of the total number of accounts not in default at 1 January 2016.*

3 *This estimate is the exposure weighted output from the Group's point-in-time model as at 1 January 2016 (comparative 1 January 2015) and is based on the total default population at that time.*

4 *This value is calculated from accounts in default at 1 January 2016 (comparative 1 January 2015). The observed loss is defined as the loss following repossession and subsequent sale of the property within the year. This value uses the latest LGD estimate to determine the percentage of loss for those defaulted accounts which are still in the workout process at the end of the period.*

The continued growth of the Group's mortgage portfolio has not been at the expense of asset quality. Mortgage asset quality has been maintained – arrears rates have fallen over the year and the indexed LTV of the book has remained relatively static, increasing from 55.0% to 55.4%.

Levels of defaults and subsequent repossessions remain low. The AIRB models have been calibrated with an appropriate level of conservatism given the short observation period of the transferred portfolio and the small population of defaulted loans. During 2016 the observed default rates have remained significantly lower than the point-in-time calibrations.

The observed LGD is higher than estimated; this is a result of low estimates due to positive house price forecast and an increase in the observed figure due to volatility caused by low volumes and a small number of exceptional cases with higher than average forced sale discount. Over time, emergent data can be used to recalibrate the point-in-time models to improve their alignment with the risk profile within the portfolio. Subsequently, the Group expects levels of actual and estimate to converge as the mortgage book seasons further.

Appendix 2. EBA own funds template

The following table shows the make-up of own funds of the Group and Virgin Money plc in the format prescribed in Regulation (EU) 1423/2013. Any blank cells in the template have been removed from this disclosure.

Table 46: Own funds disclosure template

As at 31 December 2016		Virgin Money Holdings (UK) plc regulated group	Virgin Money plc
		£m	£m
	Common Equity Tier 1 capital: instruments and reserves		
1	Capital instruments and the related share premium accounts	**654.6**	**1,400.0**
2	Retained earnings	**644.2**	**82.9**
3	Accumulated other comprehensive income (and other reserves)	**(27.4)**	**4.1**
6	Common Equity Tier 1 capital before regulatory adjustments	**1,271.4**	**1,487.0**
	Common Equity Tier 1 capital: regulatory adjustments		
7	Additional value adjustments (negative amount)	**(1.2)**	**(1.2)**
8	Intangible assets (net of related tax liability) (negative amount)	**(80.6)**	**(80.6)**
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount	**(7.3)**	**(7.3)**
11	Fair value reserves related to gains or losses on cash flow hedges	**31.5**	**-**
12	Negative amounts resulting from the calculation of expected loss amounts	**(41.1)**	**(41.1)**
28	Total regulatory adjustments to Common Equity Tier 1	**(98.7)**	**(130.2)**
29	Common Equity Tier 1 capital	**1,172.7**	**1,356.8**
	Additional Tier 1 capital: instruments		
30	Capital instruments and the related share premium accounts	**384.1**	**230.0**
31	of which: classified as equity under applicable accounting standards	**384.1**	**230.0**
36	Additional Tier 1 capital before regulatory adjustments	**384.1**	**230.0**
44	Additional Tier 1 capital	**384.1**	**230.0**
45	Tier 1 capital	**1,556.8**	**1,586.8**
	Tier 2 capital: instruments and provisions		
50	Credit risk adjustments	**11.9**	**11.9**
51	Tier 2 capital before regulatory adjustments	**11.9**	**11.9**
58	Tier 2 capital	**11.9**	**11.9**
59	Total capital	**1,568.7**	**1,598.7**
60	Total risk-weighted assets	**7,694.8**	**7,603.1**

	Capital ratios and buffers		
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**15.2%**	**17.8%**
62	Tier 1 (as a percentage of total risk exposure amount)	**20.2%**	**20.9%**
63	Total capital (as a percentage of total risk exposure amount)	**20.4%**	**21.0%**
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**5.1%**	**5.1%**
65	of which: capital conservation buffer requirement	**0.6%**	**0.6%**
66	of which: countercyclical buffer requirement	**0.0%**	**0.0%**
67	of which: systemic risk buffer requirement	**0.0%**	**0.0%**
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	**0.0%**	**0.0%**
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**10.1%**	**12.7%**
	Applicable caps on the inclusion of provisions in Tier 2		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38(3) are met)	**15.7**	**14.4**
	Applicable caps on the inclusion of provisions in Tier 2		
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**11.9**	**11.9**
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	**26.8**	**26.5**

Appendix 3. Capital instrument key features

Table 47: Capital instruments' main features template

1	Issuer	**Virgin Money Holdings (UK) plc**	**Virgin Money Holdings (UK) plc**	**Virgin Money plc**
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)	**XS1090191864**	**XS1516312409**	**N/A**
3	Governing law(s) of the instrument	**English**	**English**	**English**
	Regulatory treatment			
4	Transitional CRR rules	**AT1**	**AT1**	**AT1**
5	Post-transitional CRR rules	**AT1**	**AT1**	**AT1**
6	Eligible at solo/(sub-)consolidated/ solo & (sub-)consolidated	**Consolidated**	**Consolidated**	**Solo & Consolidated**
7	Instrument type (types to be specified by each jurisdiction)	**AT1**	**AT1**	**AT1**
8	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	**£156.5m**	**£227.6m**	**£230.0m**
9	Nominal amount of instrument	**£160,000,000**	**£230,000,000**	**£230,000,000**
9a	Issue price	**100.00**	**100.00**	**100.00**
9b	Redemption price	**100.00**	**100.00**	**100.00**
10	Accounting classification	**Shareholders' equity**	**Shareholders' equity**	**Shareholders' equity**
11	Original date of issuance	**31 July 2014**	**10 November 2016**	**10 November 2016**
12	Perpetual or dated	**Perpetual**	**Perpetual**	**Perpetual**
13	Original maturity date	**n/a**	**n/a**	**n/a**
14	Issuer call subject to prior supervisory approval	**Yes**	**Yes**	**Yes**
15	Optional call date, contingent call dates and redemption amount	**31 July 2019 at par or at any time upon a Tax Event or a Capital Disqualification Event (full exclusion) at par**	**10 November 2021 at par or at any time upon a Tax Event or a Capital Disqualification Event (whole or any part) at par**	**10 November 2021 at par or at any time upon a Tax Event or a Capital Disqualification Event (whole or any part) at par**
16	Subsequent call dates, if applicable	**Following the First Call date any Interest Payment Date thereafter: 31 January, 30 April, 31 July and 31 October**	**Following the First Call date any Interest Payment Date thereafter: 10 May and 10 November**	**Following the First Call date any Interest Payment Date thereafter: 10 May and 10 November**
	Coupons / dividends			
17	Fixed or floating dividend/coupon	**Fixed**	**Fixed**	**Fixed**
18	Coupon rate and any related index	**7.875%**	**8.75%**	**8.75%**
19	Existence of a dividend stopper	**No**	**No**	**No**
20 a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	**Fully discretionary**	**Fully discretionary**	**Fully discretionary**

20 b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	**Fully discretionary**	**Fully discretionary**	**Fully discretionary**
21	Existence of step up or other incentive to redeem	**No**	**No**	**No**
22	Noncumulative or cumulative	**Non-cumulative**	**Non-cumulative**	**Non-cumulative**
23	Convertible or non-convertible	**Convertible**	**Convertible**	**Non-convertible**
24	If convertible, conversion trigger(s)	**Group's Common Equity Tier 1 ratio falls below 7%**	**Group's Common Equity Tier 1 ratio falls below 7%**	**N/A**
25	If convertible, fully or partially	**Always Fully**	**Always Fully**	**N/A**
26	If convertible, conversion rate	**£3.50**	**£2.96**	**N/A**
27	If convertible, mandatory or optional conversion	**Mandatory**	**Mandatory**	**N/A**
28	If convertible, specify instrument type convertible into	**Common Equity Tier 1**	**Common Equity Tier 1**	**N/A**
29	If convertible, specify issuer of instrument it converts into	**Virgin Money Holdings (UK) plc**	**Virgin Money Holdings (UK) plc**	**N/A**
30	Write-down features	**No**	**No**	**Yes**
31 - 34	If write-down, write-down trigger(s), full/partial, PWD/TWD	**N/A**	**N/A**	**Group's or Virgin Money plc CET1 ratio falls below 7%**
32	If write-down, full or partial	**N/A**	**N/A**	**Full**
33	If write-down, permanent or temporary	**N/A**	**N/A**	**Permanent**
34	If temporary write-down, description of write-up mechanism	**N/A**	**N/A**	**N/A**
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	**N/A**	**N/A**	**MTN**
36	Non-compliant transitioned features	**No**	**No**	**No**
37	If yes, specify non-compliant features	**N/A**	**N/A**	**N/A**

Appendix 4. Disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical buffer

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates (based on the geographical distribution of relevant exposures) to the overall capital requirement of the Group. The following tables disclose information relevant for the calculation of the countercyclical buffer as at 31 December 2016 in accordance with Regulation (EU) 2015/1555.

Table 48: Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer – consolidated group

	General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
As at 31 December 2016	Exposure value for Standardised approach	Exposure value for IRB	Sum of long and short positions of trading book exposures for Standardised approach	Value of trading book exposures for internal models	Exposure value for Standardised approach	Exposure value for IRB	Of which: general credit exposures	Of which: trading book exposures	Of which: sec'n exposures	Total	Own funds req'ts weights	Counter-cyclical capital buffer rate
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	%	%
Breakdown by country:												
UK	2,969.6	32,389.6	-	-	52.9	-	547.7	-	0.8	548.5	100.0%	0%
Total	2,969.6	32,389.6	-	-	52.9	-	547.7	-	0.8	548.5	100.0%	0%

Credit exposures relevant to the calculation of the countercyclical buffer consist of exposures to retail lending (including mortgages and credit cards), covered bonds, securitisation exposures and other assets. All other exposures are excluded.

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Group's aggregate risk weighted exposures, all exposures have been allocated to the UK.

Table 49: Amount of institution specific countercyclical capital buffer – consolidated group

Total risk exposure amount	£548.5m
Institution specific countercyclical buffer rate	0%
Institution specific countercyclical buffer requirement	-

Table 50: Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer – Virgin Money plc

As at 31 December 2016	General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
	Exposure value for Standardised approach	Exposure value for IRB	Sum of long and short positions of trading book exposures for Standardised approach	Value of trading book exposures for internal models	Exposure value for Standardised approach	Exposure value for IRB	Of which: general credit exposures	Of which: trading book exposures	Of which: sec'n exposures	Total	Own funds req'ts weights	Counter-cyclical capital buffer rate
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	%	%
Breakdown by country:												
UK	3,031.5	32,389.6	-	-	52.9	-	546.3	-	0.8	547.1	100.0%	0%
Total	3,031.5	32,389.6	-	-	52.9	-	546.3	-	0.8	547.1	100.0%	0%

Credit exposures relevant to the calculation of the countercyclical buffer consist of exposures to retail lending (including mortgages and credit cards), covered bonds, securitisation exposures and other assets. All other exposures are excluded.

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Virgin Money plc's aggregate risk weighted exposures, all exposures have been allocated to the UK.

Table 51: Amount of institution specific countercyclical capital buffer – Virgin Money plc

Total risk exposure amount	£547.1m
Institution specific countercyclical buffer rate	0%
Institution specific countercyclical buffer requirement	-

Appendix 5. Analysis of leverage ratio

The following tables show the Group and Virgin Money plc detailed leverage ratio disclosures made in accordance with the EBA's Implementing Technical Standard EBA/ITS/2014/04/rev1. Any blank cells in the template have been removed from this disclosure.

Table 52: Summary reconciliation of accounting assets and leverage ratio exposures

As at 31 December 2016		Virgin Money Holdings (UK) plc (Consolidated) £m	Virgin Money plc (Solo) £m
1	Total assets as per published financial statements	**35,055.6**	**34,915.2**
2	Adjustments for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**5.3**	**151.6**
4	Adjustment for derivative financial instruments	**(133.6)**	**(132.8)**
5	Adjustments for securities financing transactions "SFTs"	**222.4**	**222.4**
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**714.5**	**714.5**
7	Other adjustments	**(98.7)**	**(176.6)**
8	**Total leverage ratio exposure**	**35,765.5**	**35,694.3**

Table 53: Leverage ratio common disclosures

As at 31 December 2016		£m	£m
On-balance sheet exposures (excluding derivatives and SFTs)			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**34,956.7**	**34,967.1**
2	Asset amounts deducted in determining Tier 1 capital	**(98.7)**	**(176.6)**
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**34,858.0**	**34,790.5**
Derivative exposures			
4	Replacement cost associated with all derivatives transactions(i.e. net of eligible cash variation margin	**78.8**	**76.2**
5	Add on amounts for PFE associated with *all* derivatives transactions (mark-to-market method)	**86.8**	**81.3**
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(195.0)**	**(190.6)**
11	Total derivative exposures	**(29.4)**	**(33.1)**
Securities financing transaction exposures			
14	Counterparty credit risk exposure for SFT assets	**222.4**	**222.4**
16	Total securities financing transaction exposures	**222.4**	**222.4**
Other off-balance sheet exposures			
17	Off-balance sheet exposures at gross notional amount	**5,287.7**	**5,287.7**
18	Adjustments for conversion to credit equivalent amounts	**(4,573.2)**	**(4,573.2)**
19	**Other off-balance sheet exposures**	**714.5**	**714.5**
Capital and total exposures			
20	**Tier 1 capital**	**1,556.8**	**1,586.8**
21	**Total leverage ratio exposures**	**35,765.5**	**35,694.3**
Leverage ratio			
22	**Leverage ratio**	**4.4%**	**4.4%**
Choice on transitional arrangements and amount of derecognised fiduciary items			
EU-23	Choice on transitional arrangements for the definition of the capital measure		**Fully phased in**

Table 54: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

As at 31 December 2016		CRR leverage ratio exposures	
		Virgin Money Holdings (UK) plc (Consolidated)	Virgin Money plc (Solo)
		£m	£m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures), of which:	**34,956.7**	**34,967.1**
EU-3	Banking book exposures, of which:	**34,956.7**	**34,967.1**
EU-4	Covered bonds	**327.1**	**327.1**
EU-5	Exposures treated as sovereigns	**1,098.5**	**1,098.5**
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**129.3**	**129.3**
EU-7	Institutions	**711.3**	**659.7**
EU-8	Secured by mortgages of immovable properties	**29,920.0**	**29,920.0**
EU-9	Retail exposures	**2,434.8**	**2,434.8**
EU-11	Exposures in default	**12.3**	**12.3**
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	**323.4**	**385.4**

Table 55: Free format text boxes for disclosure on qualitative items

1	**Description of the processes used to manage the risk of excessive leverage**

Leverage is actively managed with the ratio being a key factor in the Group's planning processes and stress analysis. A minimum of a three year forecast of the Group's leverage position, based on the strategic plan, is produced at least annually. Shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against plan.

2	**Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers**

The main factor impacting the leverage ratio during 2016 was the increased capital arising from the AT1 issuance. This, together with increased retained earnings was offset by the increased total assets arising from the increased lending activities of the Group.

Appendix 6. Analysis of encumbered assets

The following tables show the Group analysis of encumbered assets in accordance with the EBA Guidelines on disclosure of encumbered and unencumbered assets (EBA/GL/2014/03). Any blank cells in these templates have been removed from this disclosure.

Table 56: Asset encumbrance – assets

As at 31 December 2016	Carrying amount of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	£m	£m	£m
Assets of the reporting institution	**8,695.0**	**25,103.2**	**n/a**
Equity instruments	**-**	**7.8**	**7.8**
Debt securities	**-**	**978.5**	**978.5**
Other assets	**-**	**626.8**	**n/a**

No collateral has been received by the Group for the purposes of the EBA asset encumbrance disclosure guidelines.

Table 57: Asset encumbrance – Encumbered assets/collateral received and associated liabilities

As at 31 December 2016	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	£m	£m
Carrying amount of selected financial liabilities	**4,373.4**	**4,605.4**

Asset encumbrance – Information on importance of encumbrance

Asset values reported in the tables above are median values based on twelve months of data. The Group's assets are used to support collateral requirements for central bank operations, third-party repurchase agreements, swap transactions, securitisation, the Funding for Lending Scheme and the Term Funding Scheme. Assets that have been set aside for such purposes are classified as encumbered and cannot be used for other purposes.

Under the terms and conditions of collateralisation agreements entered into for securing liabilities, assets are deemed encumbered if they cannot be freely withdrawn. Cash reserves supporting secured funding structures are also not available for encumbrance due to legal reasons. All assets included in the "Other Assets" category, although classed as unencumbered, are deemed not available for encumbrance in the normal course of business due to the nature of these assets.

Any excess collateral provided above the minimum collateral required is deemed unencumbered unless it cannot be freely withdrawn. No assets are encumbered through transactions between entities of the Group. All remaining assets are deemed available for encumbrance.

During 2016, both the value and proportion of encumbered assets increased. The increase reflects higher non-retail funding, including two securitisation transactions and drawings from the Term Funding Scheme. This was partly offset by a reduction in the use of the Funding for Lending Scheme.

Appendix 7. Group remuneration disclosures

Approach to remuneration

Virgin Money's Group Remuneration Policy is designed to support the delivery of the Group's long term corporate strategy in a manner that is compliant with the Prudential Regulation Authority's Remuneration Code (the Code). The Group Remuneration Policy is based on principles which are applicable to all employees within the Group and in particular the principle that the remuneration framework should support the delivery of the Group's wider strategic goals. The Policy supports Virgin Money's aim of building a bank that makes everyone better off by motivating colleagues to secure the long term success of the business and create a valuable return for shareholders in a meaningful and well balanced way. The Group ensures its approach to remuneration, and in particular variable pay, is aligned with clear risk principles which aim to drive sustainable growth, with absolutely no reward for inappropriate risk taking. Strong performance is rewarded in line with best practice in the UK listed financial services sector.

The Group is mindful of the views of shareholders and engagement with shareholders is a key part of the process for determining a fair and appropriate remuneration policy.

Material Risk Takers

The Remuneration Code and European Regulatory Technical Standards require the Group to identify 'Material Risk Takers'. Material Risk Takers are deemed to have, or potentially have, a material impact on the risk profile of the Group or a significant entity within the Group. The Material Risk Takers population in 2016 totalled 54 including all Directors.

The following groups of individuals have been identified as meeting the criteria for Material Risk Takers, i.e. those colleagues who are deemed to have, or potentially have, a material impact on the risk profile of the Group or a significant entity within the Group:

- Executive directors and non-executive directors;
- all members of the Virgin Money Executive Committee (ExCo);
- senior Risk colleagues;
- senior Finance colleagues (including Treasury);
- those colleagues who sit on a committee responsible for specific risk categories and/or product development; and
- other highly remunerated individuals whose activities could have an impact on the Group's risk profile.

The remuneration for these colleagues is governed under the Group remuneration policy.

The Remuneration Committee

The Remuneration Committee of the board of directors of the Group (the Committee) is responsible for determining and recommending to the Board for approval a Group remuneration policy that aligns with the Group's risk principles and is consistent with the Group's corporate strategy. It determines the remuneration of the Chairman and members of the Executive Team, including payments and awards under annual bonus plans, share incentive schemes, pension schemes and any other compensation arrangements (including terms for departing Material Risk Takers). The Committee undertakes periodic reviews of the Remuneration Policy (at least annually) to ensure continued compliance and alignment with the Remuneration Code.

The Group has a clear governance structure, with the Committee reviewing all reward decisions for Executive Directors, Executive Committee members, senior risk and compliance officers and any other Material Risk Takers or high earners. The Remuneration Committee works closely with the Risk Committee in moderation of the variable pay pool and performance assessment, to ensure both adequately reflect the Group's risk appetite and to assess whether any adjustment is required.

The Remuneration Committee's Terms of Reference are available from the Company Secretary and are on the Virgin Money website. These were last updated in February 2017.

The Committee members during the year were:

- Marilyn Spearing (Chair from 1 January 2016);
- Norman McLuskie; and
- Geeta Gopalan.

Only members of the Committee have the right to attend and vote at Committee meetings. However, other individuals (such as the CEO and the People Director) may be invited to attend meetings when appropriate or necessary, but are excluded from discussions relating to their own remuneration arrangements.

The Committee appoints independent consultants to provide advice on specific matters according to their particular expertise.

During 2016, the Remuneration Committee took external advice from Deloitte, the Committee's independent consultants in relation to Directors' remuneration from the 2016 AGM. PwC, the Committee's previous advisers, also provided advice until the 2016 AGM.

Deloitte and PwC are members of the Remuneration Consultants Group and comply with the professional body's code of conduct. This supports the Remuneration Committee's view that the advice received was objective and independent.

The Committee meets at least four times a year and at such other times as the Committee Chair or any member of the Committee may request. The Committee met on six occasions during 2016.

During 2016, the Committee considered the following remuneration matters:

- Final performance conditions for the FY16 annual bonus and LTIP;
- FY17 annual bonus and LTIP design and performance measures;
- Executive awards vesting in 2016;
- review of the Directors' Remuneration Report; and
- consideration of remuneration governance in light of regulatory changes.

Design characteristics of the remuneration system

The Group regularly reviews its approach to senior remuneration to ensure the overall package is fair, competitive and supportive of the Group's strategy. The Group ensures it remains competitive in the financial services market through regular market reviews. The Group's remuneration strategy aims to motivate individual out-performance against objectives. The annual individual performance assessment process and the structure of the Group's remuneration ensure that the highest performing colleagues receive remuneration outcomes against comparable companies. Risk considerations are a material factor in the determination of pay.

Remuneration is delivered in a proportion of fixed and variable components. The variable elements are subject to appropriate limits (capped at 2:1 variable to fixed ratio) as approved by shareholders. Variable pay awards for senior colleagues and Material Risk Takers are subject to deferral in line with the Code to promote longer term risk awareness.

Base salary

All Material Risk Takers receive salaries (save for Non-Executive Directors who receive fees), determined to reflect the role of the individual taking account of responsibilities and experience. Base salaries are reviewed annually, taking into account individual performance and market information.

Fixed allowance

During 2016 the Group introduced an additional fixed element into the remuneration package for specific senior executives. This took the form of a fixed allowance delivered in cash and / or shares on a monthly basis. The Fixed Allowance ensures that total fixed remuneration is commensurate with role and provides a competitive reward package in line with regulatory requirements and with an appropriate balance of fixed and variable remuneration.

Annual Bonus and Deferred Bonus Share Plan

All Material Risk Takers (excluding Non-Executive Directors) are eligible to be considered for an annual bonus. Annual bonuses are discretionary and are based on Group and individual performance within the year. The determination of measures and their weighting are set annually and awards are determined by the Remuneration Committee at the end of the financial year. The annual bonus opportunity is based on performance against key financial measures determined at the beginning of each financial year as well as performance against non-financial measures.

In line with regulatory requirements a proportion of any bonus is deferred (as per the 'deferral and vesting' section below). The mechanism for making the bonus deferral is the Deferred Bonus Share Plan (DBSP). Deferral levels are set at the time of award and in line with regulatory requirements (see below).

Long-term incentives

The Group's Long Term Incentive Plan (LTIP) is designed to reward delivery of the Group's strategy and growth in shareholder value over a multi-year period and aligns senior colleagues' interests with those of shareholders while supporting the long-term success of the Group.

Performance conditions are normally tested over a period of three financial years and, subject to the achievement of any performance conditions, Awards will vest according to timetables designed to comply with regulatory requirements. The performance conditions will be aligned to the Company's long term strategy.

Deferral and vesting

Variable pay deferral levels are set at the time of award and in line with regulatory requirements. For 2016, this means that, for Material Risk Takers receiving a variable pay award that exceeds 33% of total pay:

- at least 40% of total variable pay is deferred;
- at least 50% of variable pay is paid in shares; and
- vested shares are subject to a six month retention period.

The ultimate release of deferred amounts is governed by a robust risk assessment framework. Both clawback and malus provisions can be applied by the Committee both during and after any relevant performance period to adjust (including to nil) any variable pay awarded, paid or deferred. A performance adjustment may include, but is not limited to:

- reducing an employee's bonus outcome for the current year;
- reducing the amount of any unvested deferred variable remuneration (including LTIP awards) to which an employee is entitled;
- requiring the repayment on demand of any cash and share awards received at any time during the seven year period after the date of the awards; and
- requiring a bonus which has been awarded but not yet paid to be forfeited.

In the case of firm-wide adjustment, measures may also include:

- reducing the overall annual bonus pool; and/or
- reducing overall unvested/unpaid awards.

The following non-exhaustive list outlines the circumstances in which malus and/or clawback measures will be triggered:

- where an employee has participated in or was responsible for conduct which resulted in significant losses to the firm, as determined by the Remuneration Committee;
- where an employee has significantly failed to meet appropriate standards of fitness and propriety, taking into account their seniority, experience, remuneration and level of responsibility;
- where the firm or the relevant business unit has suffered a material downturn in the financial performance;

- where the firm or the relevant business unit has suffered a material failure of risk management;
- where the firm has reasonable evidence of fraud or material dishonesty by the employee;
- where the firm becomes aware of any material wrongdoing on the part of the employee that would have resulted in the relevant award not being made had it known about such material wrongdoing at the time the relevant award was made;
- where the firm becomes aware of a material error in assessing the employee's performance against the relevant performance conditions at the time that the award was made; and
- the employee has acted in any manner which in the opinion of the Remuneration Committee has brought or is likely to bring the firm into material disrepute or is materially adverse to the interests of the firm.

The above principles apply to all variable pay for all Virgin Money's Material Risk Takers.

The Committee has discretion, in exceptional circumstances, to amend targets, measures, or number of shares under award if an event happens (for example, a major transaction or capital raising) that, in the opinion of the Committee, causes the original targets or measures to be no longer appropriate or such adjustment to be reasonable. The Committee also has the discretion to reduce the vesting level of any award if it deems that the outcome is not consistent with performance delivered.

Link between pay and performance and the performance criteria used

The Group's approach to reward is to ensure that all elements of pay are aligned with the long-term interests of the Group and a prudent approach to risk management while being sufficiently competitive to attract, retain and motivate the most talented individuals in the financial services sector.

Colleagues are appraised annually for their entire role, the behaviours they exhibit, the achievement of the objectives they are set and their competencies. This holistic appraisal drives variable pay awards and any future pay increases.

For variable pay, performance is measured against financial and non-financial targets (functional where appropriate). The financial scorecard is the same for all senior executives thus ensuring a Group oriented view on performance and risk. Non-financial performance metrics include effective risk management.

The following metrics and criteria were used by the Committee to determine the size of the overall variable remuneration pool:

- the Committee considered the key financial performance measures, including profit before tax, and other non-financial measures;
- the Committee reviewed underlying business performance against the corporate scorecard to ensure that the outcomes are appropriate;
- the Chief Risk Officer provided the Committee (via the Board Risk Committee) with an independent risk assessment report to consider whether and to what extent the variable remuneration pool should be subject to risk adjustment; and
- the Chief Financial Officer and the People Director also provided the Committee with an assessment of financial and individual performance to identify any significant instances when the operation of the malus provisions might be appropriate.

Remuneration for Material Risk Takers

The following tables display the 2016 remuneration for Virgin Money's Executive, Non-Executive and Senior Management and colleagues whose professional activities may have a material impact on the risk profile of the Group.

Fixed and variable remuneration

The table below shows total fixed and variable remuneration awarded to Material Risk Takers in 2016 broken down between Senior Management and Other Material Risk Takers. The data has not been broken down by business area due to size and scale of some operations.

Table 58: Remuneration of Material Risk Takers

2016

Remuneration of Material Risk Takers[1]	Senior management	Material Risk Takers	Total
Number of Material Risk Takers	8	46	54
	£m	£m	£m
Total fixed	2.1	10.9	13.0
Total variable	1.9	11.0	12.9
Total remuneration	4.0	21.9	25.9
Variable remuneration awarded in:			
- Cash	0.3	2.5	2.8
- Shares[2]	1.5	8.5	10.0
- Share linked instruments	0.0	0.0	0.0
Deferred remuneration outstanding[3]	4.2	15.5	19.7
Deferred remuneration awarded for 2016	1.2	6.5	7.7
Deferred remuneration paid out in 2016[4]	1.1	2.9	4.0
Sign on payments	0.0	0.0	0.0
Severance payments[5]	0.0	0.0	0.0

1 Numbers within this table have been rounded to the nearest £0.1m
2 Material Risk Takers are required to hold the net number of shares from any share-based award for a period of six months
3 Includes 2016 deferred remuneration plus all outstanding remuneration awards made prior to 2016, based on value at time of award. Values for LTIP awards are based on an on target performance assumption of 80% of maximum value
4 Includes outstanding deferred remuneration awards made prior to 2016 where they vested in 2016, based on the value of awards at the time of vesting.
5 One severance payment was made to a Material Risk Taker during the year. This payment was for less than £50,000 and therefore is rounded to £0.0m in the table above.

Analysis of high earners by band

During 2016, 8 Material Risk Takers received total remuneration in excess of €1 million. The table below shows the breakdown by band.

Table 59: Analysis of high earners

2016

Number of Material Risk Takers paid €1 million[1,2] or more for 2016	Material Risk Takers
€1.0m - €1.5m	5
€1.5m - €2.0m	1
€2.0m - €2.5m	1
€2.5m - €3.0m	0
€3.0m - €3.5m	1
€3.5m - €4.0m	0
€4.0m - €4.5m	0

1 Converted to Euros using the exchange rate of €1=£0.84815
2 Values for LTIP awards based on an on target performance assumption of 80% of maximum value

Further details on the remuneration policies and practices of the Group, including the key components of the Group's remuneration structure for Directors' remuneration can be found in the Directors' Remuneration Report contained in the 2016 Virgin Money Group Annual Report and Accounts.

Recruitment policy for the selection of members of the management body

The Remuneration Committee will take into account all relevant factors, including the calibre and experience of the individual and the market from which they are recruited, while being mindful of the best interests of the Group and its shareholders and seeking not to pay more than is necessary. This would normally be determined in line with the following principles:

- where practicable, the Remuneration Committee will look to align the remuneration package for any new appointments with the Group remuneration policy;

- to facilitate a recruitment, the Remuneration Committee may need to 'buy-out' remuneration arrangements forfeited or forgone on leaving a previous employer, including long-term awards, deferred awards, in year and prior year annual bonuses and other contractual entitlements; and

- the value of the buy-out awards will broadly be the equivalent of or less than the value of the award being bought-out in accordance with regulatory requirements, these buy-out awards will take into consideration relevant factors including, but not limited to:

    - the form of the award;

    - any performance conditions to those awards; and

    - the vesting profile of the awards and the likelihood of vesting.

The Group has developed and agreed a Board Diversity and Inclusion Policy which sets out a commitment to gender representation on the Board being no less than 25% female, which the Group has achieved.

Appendix 8. Virgin Money plc Pillar 3 disclosures

Virgin Money plc capital resources

In accordance with Article 13 of the CRR, this Appendix sets out the reduced Pillar 3 disclosures of Virgin Money plc (the Company, in this Appendix 8), the significant subsidiary of the Virgin Money Group. The Company's capital is managed in the same way as the Group. For a discussion of capital management, the ICAAP process and Pillar 2 capital for the Company, see pages 17 to 21 in the main body of this report.

Table 60: Virgin Money plc capital resources

	2016	2015
	£m	£m
Common Equity Tier 1		
Ordinary share capital	**1,400.0**	1,400.0
Retained reserves	**57.1**	(71.0)
Other equity instruments	**230.0**	-
Other reserves	**4.1**	(0.3)
Total equity per balance sheet	**1,691.2**	1,328.7
Regulatory capital adjustments		
Net assets of SPVs	**28.6**	15.3
Foreseeable distribution on AT1 securities	**(2.8)**	-
Other equity instruments	**(230.0)**	-
Intangible assets	**(80.6)**	(63.0)
Deferred tax on tax losses carried forward (after consolidation of SPVs)	**(7.3)**	(18.0)
Prudential valuation adjustment	**(1.2)**	-
Excess of expected loss over impairment	**(41.1)**	(35.4)
Common Equity Tier 1 capital	**1,356.8**	1,227.6
Additional Tier 1 securities	**230.0**	-
Total Tier 1 capital	**1,586.8**	1,227.6
Tier 2 capital		
General credit risk adjustments	**11.9**	7.6
Total Tier 2 capital	**11.9**	7.6
Total available capital resource	**1,598.7**	1,235.2
Pillar 1 risk-weighted assets		
Retail mortgages	**4,764.5**	3,952.9
Unsecured lending	**1,847.4**	1,192.7
Wholesale	**132.8**	183.9
Other assets	**183.7**	281.2
Counterparty credit risk	**57.8**	21.2
Credit valuation adjustments	**21.7**	13.9
Operational risk	**595.1**	413.7
Total risk-weighted assets	**7,603.0**	6,059.5
Common Equity Tier 1 ratio	**17.8%**	20.3%
Tier 1 ratio	**20.9%**	20.3%
Total capital ratio	**21.0%**	20.4%

The share capital of Virgin Money plc comprises 1.4 billion shares with nominal value of £1, giving rise to ordinary share capital of £1.4 billion. There is no associated share premium.

Please see Appendix 2 for the CRD IV disclosure template as published by the EBA in Implementing Technical Standard 2013/01.

Table 61: Virgin Money plc movements in capital resources

	Common Equity Tier 1	Additional Tier 1	Tier 2 capital
	£m	£m	£m
At 1 January 2016	**1,227.6**	**-**	**7.6**
Movements in retained earnings	**128.1**	**-**	**-**
Movement in net assets of SPVs	**13.3**	**-**	**-**
Movement in foreseeable distribution on AT1 securities	**(2.8)**	**-**	**-**
Movement in intangible assets	**(17.6)**	**-**	**-**
Movement in deferred tax on tax losses carried forward	**10.7**	**-**	**-**
Prudential valuation adjustment	**(5.7)**	**-**	**-**
Movement in excess of expected loss over impairment	**4.4**	**-**	**-**
Movement in available-for-sale reserve	**(1.2)**	**-**	**-**
Issue of Additional Tier 1 notes	**-**	**230.0**	**-**
Movement in general provisions	**-**	**-**	**4.3**
At 31 December 2016	**1,356.8**	**230.0**	**11.9**

The increase in capital resources during the year is mainly as a result of the issuance of AT1 notes during the year, together with movements in retained earnings.

CET1 capital comprises ordinary share capital and allowable reserves after deducting regulatory adjustments such as intangible assets and expected losses in excess of provisions in respect of the Company's AIRB mortgage portfolio.

The Company issued AT1 securities of £230 million to Virgin Money Holdings (UK) plc on 10 November 2016, which have a discretionary coupon of 8.75% per annum.

The main features of these securities as set out in Implementing Technical Standard 2013/01 can be found in Appendix 3. The full terms and conditions are equivalent to those issued by Virgin Money Holdings (UK) plc on 10 November 2016, with the exception that notes are not convertible, but are written off if a trigger event occurs

Tier 2 capital is comprised of general provisions (under the CRD IV definition) on credit cards.

Virgin Money plc Pillar 1 capital requirements

The following table sets out the risk-weighted assets and Pillar 1 capital requirements of the Company.

Table 62: Virgin Money plc risk-weighted assets and capital requirements

As at 31 December 2016	**Risk-weighted asset amounts**		**Pillar 1 capital requirements**
	2016	2015	**2016**
	£m	£m	**£m**
Credit risk (excluding counterparty credit risk)	**6,881.6**	5,548.6	**550.6**
Of which standardised approach	**2,117.1**	1,595.7	**169.4**
Of which the AIRB approach	**4,764.5**	3,952.9	**381.2**
Counterparty credit risk	**79.6**	35.1	**6.3**
Of which mark to market	**22.5**	21.1	**1.8**
Of which the standardised approach	**35.4**	0.1	**2.8**
Of which CVA	**21.7**	13.9	**1.7**
Securitisation exposures in banking book	**10.6**	12.1	**0.8**
Of which standardised approach	**10.6**	12.1	**0.8**
Operational risk	**595.1**	413.7	**47.6**
Of which standardised approach	**595.1**	413.7	**47.6**
Amounts below the thresholds for deduction (subject to 250% risk weight)	**36.1**	50.0	**2.9**
Total	**7,603.0**	**6,059.5**	**608.2**

In the table above, amounts below the thresholds for deduction relate to deferred tax assets that don't relate to tax losses carried forward. As the value of these assets are below the CRR threshold, they are not deducted from own funds, but instead are risk-weighted at 250%.

The following table sets out the movements in the Company's credit risk-weighted assets split between book size, model changes and other movements.

Table 63: Virgin Money plc risk-weighted assets movement

	AIRB mortgages	**Other standardised lending**	**Other standardised assets**	**Credit valuation adjustment**	**Operational risk**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Risk-weighted assets at 1 January 2016	**3,952.9**	**1,192.7**	**486.3**	**13.9**	**413.7**	**6,059.5**
Book size	**1,168.1**	**655.8**	**-**	**-**	**-**	**1,823.9**
Other movements	**(356.5)**	**(1.1)**	**(112.0)**	**7.8**	**181.4**	**(280.4)**
Risk-weighted assets at 31 December 2016	**4,764.5**	**1,847.4**	**374.3**	**21.7**	**595.1**	**7,603.0**

[1] This includes non-CVA counterparty credit risk

Movements in the AIRB mortgage risk-weighted assets are described in Table 43 in Appendix 1.

Operational risk is calculated using the Standardised approach, based on the average Company income over the past three years. The year-on-year increase reflects the increasing income from 2012 to 2015.

Virgin Money plc leverage ratio

The CRR introduced a new balance sheet metric, the leverage ratio, from 1 January 2014. The EBA will impose a minimum leverage ratio of 3.0% from 2018. The Company's leverage ratio as at 31 December 2016 was 4.4% (2015: 4.0%).

Table 64: Virgin Money plc leverage ratio

As at 31 December	2016 £m	2015 £m
Tier 1 capital	**1,586.8**	1,227.6
Exposures measure		
Total regulatory balance sheet assets	**35,066.8**	30,214.0
Removal of accounting values for derivatives	**(99.7)**	(80.8)
Exposure value for derivatives	**(33.1)**	58.4
Exposure value for securities financing transactions	**222.4**	261.7
Off-balance sheet items	**714.5**	659.5
Other regulatory adjustments	**(176.6)**	(101.1)
Total exposures	**35,694.3**	**31,011.7**
Leverage ratio	**4.4%**	**4.0%**

Regulatory balance sheet assets include an adjustment for SPVs not included in the statutory balance sheet.

Exposure values associated with derivatives and repos have been adjusted using the delegated act definition of the exposure measure. For the purposes of the leverage ratio, the derivative measure is calculated as the replacement cost for the current exposure plus an add on for potential future exposure.

Off-balance sheet items are made up of undrawn credit facilities including such facilities that may be cancelled unconditionally at any time. Credit conversion factors, subject to a floor of 10% have been applied to these items in accordance with the CRD IV rules.

Other regulatory adjustments consist of adjustments that have been applied to the Tier 1 capital (such as intangible assets, deferred tax on tax losses carried forward and excess expected losses) which are also applied to the leverage ratio exposure measure. This ensures consistency between the Tier 1 capital and total exposures components of the ratio.

Appendix 5 shows detailed leverage ratio disclosures made in accordance with the EBA's Implementing Technical Standard EBA/ITS/2014/04/rev1.

Virgin Money plc credit risk

For the purposes of these disclosures, credit exposure for the AIRB portfolios refers to the calculated EAD. The EAD calculation includes amounts where customers have contractual rights to draw down further balances and estimates of interest accruals to the point of default.

The following table sets out the exposures for the various types of asset held by the Company at 31 December, and the average exposures during the year.

Table 65: Virgin Money plc credit risk exposures, risk weights and average exposures

2016	**Exposure**	**Risk-weighted assets**	**Average risk weight**	**Average exposure in period**
	£m	**£m**	**%**	**£m**
AIRB				
Retail exposures secured by real estate collateral	**32,389.6**	**4,764.5**	**14.7**	**30,897.7**
Standardised				
Credit cards and other retail exposures	**2,446.8**	**1,835.1**	**75.0**	**2,138.9**
Items in default	**12.3**	**12.3**	**100.0**	**12.0**
Central governments and central banks	**1,098.5**	**-**	**-**	**1,073.3**
Multilateral development banks	**129.3**	**-**	**-**	**211.6**
Institutions	**442.9**	**89.3**	**20.2**	**640.4**
Covered bonds	**327.1**	**32.7**	**10.0**	**443.1**
Equities	**7.9**	**7.9**	**100.0**	**7.1**
Other assets	**237.4**	**175.9**	**74.1**	**205.9**
Total standardised	**4,702.2**	**2,153.2**	**45.8**	**4,732.3**
Total	**37,091.8**	**6,917.7**	**18.7**	**35,630.0**

2015	Exposure	Risk-weighted assets	Average risk weight	Average exposure in period
	£m	£m	%	£m
AIRB				
Retail exposures secured by real estate collateral	27,997.5	3,952.9	14.1	26,141.1
Standardised				
Credit cards and other retail exposures	1,574.6	1,180.9	75.0	1,227.0
Items in default	11.8	11.8	100.0	7.7
Central governments and central banks	1,286.9	-	-	1,345.4
Multilateral development banks	203.7	-	-	291.9
Institutions	515.7	118.3	22.9	484.5
Covered bonds	535.3	53.5	10.0	408.4
Equities	4.6	4.6	100.0	2.1
Other assets	262.7	276.6	105.3	272.8
Total standardised	4,395.3	1,645.7	37.4	4,039.8
Total	**32,392.8**	**5,598.6**	**17.3**	**30,180.9**

Credit risk exposure by industry

The tables below give details of the distributions of exposures by industry or counterparty type.

Table 66: Virgin Money plc credit risk exposures by industry or counterparty type

As at 31 December 2016	Mortgages – individuals £m	Other lending – individuals %	Financial/ Sovereign £m	Other assets £m	Total £m
AIRB					
Retail exposures secured by real estate collateral	32,389.6	-	-	-	32,389.6
Standardised					
Credit cards and other retail exposures	-	2,446.8	-	-	2,446.8
Items in default	-	12.3	-	-	12.3
Central governments and central banks	-	-	1,098.5	-	1,098.5
Multilateral development banks	-	-	129.3	-	129.3
Institutions	-	-	442.9	-	442.9
Covered bonds	-	-	327.1	-	327.1
Equities	-	-	7.9	-	7.9
Other assets	-	-	-	237.4	237.4
Total	**32,389.6**	**2,459.1**	**2,005.7**	**237.4**	**37,091.8**

As at 31 December 2015	Mortgages – individuals £m	Other lending – individuals %	Financial/ Sovereign £m	Other assets £m	Total £m
AIRB					
Retail exposures secured by real estate collateral	27,997.5	-	-	-	27,997.5
Standardised					
Credit cards and other retail exposures	-	1,574.6	-	-	1,574.6
Items in default	-	11.8	-	-	11.8
Central governments and central banks	-	-	1,286.9	-	1,286.9
Multilateral development banks	-	-	203.7	-	203.7
Institutions	-	-	515.7	-	515.7
Covered bonds	-	-	535.3	-	535.3
Equities	-	-	-	4.6	4.6
Other assets	-	-	-	262.7	262.7
Total	**27,997.5**	**1,586.4**	**2,541.6**	**267.3**	**32,392.8**

Geographical distribution of exposures

The tables below give details of the geographical distributions of exposures.

Table 67: Virgin Money plc credit risk exposures by geographical area

As at 31 December 2016	UK £m	Europe £m	Rest of the world £m	Total £m
AIRB				
Retail exposures secured by real estate collateral	**32,389.6**	**-**	**-**	**32,389.6**
Standardised				
Credit cards and other retail exposures	**2,446.8**	**-**	**-**	**2,446.8**
Items in default	**12.3**	**-**	**-**	**12.3**
Central governments and central banks	**1,098.5**	**-**	**-**	**1,098.5**
Multilateral development banks	**0.0**	**46.1**	**83.2**	**129.3**
Institutions	**64.6**	**116.6**	**261.7**	**442.9**
Covered bonds	**327.1**	**-**	**-**	**327.1**
Equities	**6.4**	**-**	**1.5**	**7.9**
Other	**237.4**	**-**	**-**	**237.4**
Total	**36,582.7**	**162.7**	**346.4**	**37,091.8**

As at 31 December 2015	UK £m	Europe £m	Rest of the world £m	Total £m
AIRB				
Retail exposures secured by real estate collateral	27,997.5	-	-	27,997.5
Standardised				
Credit cards and other retail exposures	1,574.6	-	-	1,574.6
Items in default	11.8	-	-	11.8
Central governments and central banks	1,286.9	-	-	1,286.9
Multilateral development banks	-	145.9	57.8	203.7
Institutions	199.0	140.8	175.9	515.7
Covered bonds	535.3	-	-	535.3
Equities	4.6	-	-	4.6
Other assets	262.7	-	-	262.7
Total	31,872.4	286.7	233.7	32,392.8

Exposures by residual maturity

The following tables give details of the contractual residual maturities of exposures.

Table 68: Virgin Money plc credit risk exposures by residual maturity

As at 31 December 2016	**Residual maturity**			
	< 1 year	**1-5 yrs**	**> 5 years**	**Total**
	£m	**£m**	**£m**	**£m**
AIRB				
Retail exposures secured by real estate collateral	**183.5**	**855.7**	**31,350.4**	**32,389.6**
Standardised				
Credit cards and other retail exposures	**2,446.8**	**-**	**-**	**2,446.8**
Items in default	**12.3**	**-**	**-**	**12.3**
Central governments and central banks	**781.2**	**-**	**317.3**	**1,098.5**
Multilateral development banks	**-**	**80.3**	**49.0**	**129.3**
Institutions	**442.9**	**-**	**-**	**442.9**
Covered bonds	**-**	**202.9**	**124.2**	**327.1**
Equities	**7.9**	**-**	**-**	**7.9**
Other assets	**237.4**	**-**	**-**	**237.4**
Total	**4,112.0**	**1,138.9**	**31,840.9**	**37,091.8**

As at 31 December 2015	Residual maturity			
	< 1 year	1-5 yrs	> 5 years	Total
	£m	£m	£m	£m
AIRB				
Retail exposures secured by real estate collateral	125.3	874.5	26,997.7	27,997.5
Standardised				
Credit cards and other retail exposures	1,574.6	-	-	1,574.6
Items in default	11.8	-	-	11.8
Central governments and central banks	877.4	-	409.5	1,286.9
Multilateral development banks	4.7	82.4	116.6	203.7
Institutions	472.7	25.4	17.6	515.7
Covered bonds	47.5	316.7	171.1	535.3
Equities	4.6	-	-	4.6
Other assets	262.7	-	-	262.7
Total	3,381.3	1,299.0	27,712.5	32,392.8

Provisioning

For a discussion of credit impairment for the Company see pages 37 to 38 in the main body of the narrative.

The table below indicates the level of impaired and past due exposures by exposure class, and of the levels of provisions against them. All exposures are located in the UK.

Table 69: Virgin Money plc analysis of past due and impaired loans and advances to customers

As at 31 December 2016	**Impaired exposures**	**Past due but not impaired**	**General impairment provisions**	**Specific impairment provisions**
	£m	**£m**	**£m**	**£m**
Retail exposures secured by real estate collateral	**92.9**	**168.9**	**-**	**10.6**
Credit cards	**32.4**	**-**	**11.8**	**27.6**
Other retail exposures	**-**	**-**	**0.1**	**-**
Total	**125.3**	**168.9**	**11.9**	**38.2**

As at 31 December 2015	Impaired exposures	Past due but not impaired	General impairment provisions	Specific impairment provisions
	£m	£m	£m	£m
Retail exposures secured by real estate collateral	84.6	160.2	-	8.7
Credit cards	27.4	-	7.5	23.6
Other retail exposures	-	-	0.1	-
Total	**112.0**	**160.2**	**7.6**	**32.3**

Total impaired assets increased by £13.3 million in the year to 31 December 2016. This increase reflects growth in the book, despite improved arrears performance. Impaired assets as a proportion of total loans remained stable for secured lending at 0.3% and improved for unsecured loans from 1.7% at 31 December 2015 to 1.3% at 31 December 2016.

Table 70: Virgin Money plc analysis of movements in impairment provisions

	Retail mortgages	Credit cards	Other retail exposures	Total
	£m	£m	£m	£m
General impairment provisions				
At 1 January 2016	-	7.5	0.1	7.6
Increase in provision during year	-	4.3	-	4.3
Amounts written off during the year	-	-	-	-
At 31 December 2016	-	11.8	0.1	11.9
Specific impairment provisions				
At 1 January 2016	8.7	23.6	-	32.3
Increase in provision during year	2.7	36.3	-	39.0
Amounts written off during the year	(0.8)	(32.3)	-	(33.1)
At 31 December 2016	10.6	27.6	-	38.2

Virgin Money plc remuneration disclosures

Virgin Money plc has the same remuneration policy as the rest of the Group, and so for the individual Company disclosures please see Appendix 7.

Appendix 9. Supplementary information – analysis of directorships

The following table shows the number of directorships held by the members of the management body of Virgin Money plc.

Table 71: Analysis of directors as at 31 December 2016

	Number of directorships
Glen Moreno	3
Jayne-Anne Gadhia	1
Geeta Gopalan	2
Marian Martin	2
Colin Keogh	4
Norman McLuskie	1
Marilyn Spearing	1

In the table above, in line with the CRD IV rules, multiple directorships within the same Group are treated as a single role and directorships with bodies that don't predominantly pursue commercial objectives are also excluded.

Further details of the Directors and other members of the management body of the Group can be found on pages 74 to 78 of the 2016 Virgin Money Group Annual Report and Accounts. Details of the recruitment policy for Directors can be found in the Nominations Committee section of the Corporate Governance report within the Annual Report and Accounts.

Glossary

AIRB approach	A CRD IV approach for measuring exposure to retail credit risks. The method of calculating credit risk capital requirements uses internal PD, LGD and EAD models. AIRB approaches may only be used with PRA permission.
Basel III	Global regulatory standard on Bank Capital Adequacy, Stress Testing and Market and Liquidity proposed by the Basel Committee on Banking Supervision in 2010. See also **CRD IV**.
Capital at Risk (CaR)	Approach set out for the quantification of interest rate risk expressed as the impact to the present value of the Group's capital under interest rate sensitivity analysis.
Charge off	Charge off occurs on outstanding credit card balances which are deemed irrecoverable. This involves the removal of the balance and associated provision from the balance sheet with any remaining outstanding balance recognised as a loss.
Company	Virgin Money Holdings (UK) plc. In Appendix 8, Virgin Money plc.
Conduct risk	The risk that the Group's operating model, culture or actions result in unfair outcomes for customers.
Common Equity Tier 1 capital (CET1)	The highest form of regulatory capital under Basel III that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
CET 1 ratio	CET 1 capital expressed as a percentage of total risk-weighted assets.
CRD IV	In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in.
Credit Valuation Adjustment (CVA)	These are adjustments to the fair values of derivative assets to reflect the credit worthiness of the counterparty.
Earnings at Risk (EaR)	Approach set out for the quantification of interest rate risk expressed as the impact to forecast net interest income under interest rate sensitivity analysis.
Expected Loss (regulatory)	Regulatory expected loss represents the anticipated loss, in the event of a default, on a credit risk exposure modelled under the AIRB approach. Expected loss is determined by multiplying the associated PD, LGD and EAD.
Exposure at default (EAD)	An estimate of the amount expected to be owed by a customer at the time of a customer's default.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties; or for where the contractual terms have been cancelled for credit cards. Forbearance options are determined by assessing the customer's personal circumstances.
Funding for Lending Scheme (FLS)	The Bank of England launched the Funding for Lending scheme in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to businesses by lowering interest rates and increasing access to credit.
Funding risk	The inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.
Impaired assets	Loans that are in arrears, or where there is objective evidence of impairment, and where the carrying amount of the loan exceeds the expected recoverable amount.
Interest rate risk	The risk of a reduction in the present of the current balance sheet or earnings as a result of an adverse movement in interest rates.
Interest rate risk in the banking book (IRRBB)	The risk of a reduction in the present value of the current balance sheet or earnings as a result of an adverse movement in interest rates arising as a consequence of carrying out and supporting core business activities.

Internal capital adequacy assessment process (ICAAP)	The part of the Pillar 2 assessment to be undertaken by a bank. The ICAAP allows financial institutions to assess the level of capital that adequately supports all relevant current and future risks in their business. In undertaking an ICAAP, a financial institution should be able to ensure that it has appropriate processes in place to ensure compliance with CRD IV.
Leverage ratio	Total Tier 1 capital expressed as a percentage of Total assets (adjusted in accordance with CRD IV).
Liquidity risk	The inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet the Group's contractual obligations to make payments as they fall due.
Long run average probability of default	An estimate of the likelihood of a borrower defaulting on their credit obligations over a forward looking 12 month period, with the estimates based on default experience across a full economic cycle rather than current economic conditions.
Loss Given Default (LGD)	A parameter used to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Pillar 1	The part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.
Pillar 2	The part of CRD IV that ensures financial institutions hold adequate capital to support the relevant risks in their business. It also encourages financial institutions to develop and use enhanced risk management techniques in monitoring and managing their risks.
Pillar 3	The part of CRD IV that sets out the information banks must disclose in relation to their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.
Probability of Default (PD)	The probability of a customer defaulting over a defined outcome period. Default occurs where a borrower has missed 6 months of mortgage repayments or 3 months of credit card repayments, or the borrower is deemed to be unlikely to repay their loan. The outcome period varies for assessment of capital requirements and for assessment of provisions..
Repurchase Agreements (Repos)	A form of short-term funding where one party sells a financial asset to another party with an agreement to repurchase at a specific price and date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).
Ring-fenced bank	The Financial Services (Banking Reform) Act 2013 introduces a ring-fence for UK retail banks from 2019, with the aim of separating core banking services critical to individuals and small and medium-sized enterprises from wholesale and investment banking services.
Risk appetite	The risk appetite sets limits on the amount and type of risk that the Group is willing to take in order to meet its strategic objectives.
Risk-weighted assets (RWAs)	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules and are used to assess capital requirements and adequacy.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities through an SPV.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings of obligators (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines.
Tier 1 capital	A measure of banks financial strength defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to deductions including in respect of material holdings in financial companies.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 capital	A further component of regulatory capital defined by the PRA for the Group. It comprises eligible collective assessed impairment allowances under CRD IV.

Write off	Mortgages: may be written off where the outstanding balance or shortfall from sale of property is deemed irrecoverable. Assets written off will be deducted from the balance sheet.

Abbreviations

AIRB	Advanced Internal Ratings Based	**EBA**	European Banking Authority	**LGD**	Loss given default
AT1	Additional Tier 1	**ECAI**	External Credit Assessment Institution	**LIBOR**	London Inter-Bank Offered Rate
BBR	Bank Base Rate	**EL**	Expected loss	**LRA**	Long run average
BOE	Bank of England	**FCA**	Financial Conduct Authority	**LTIP**	Long-Term Incentive Plan
CET1	Common Equity Tier 1 capital	**FLS**	Funding for Lending	**LTV**	Loan to Value
CCR	Counterparty credit risk	**FPC**	Financial Policy Committee	**OTC**	Over the Counter
CRR	Capital Requirements Regulation	**HPI**	House Pricing Index	**PD**	Probability of Default
CRD	Capital Requirements Directive	**IFRS**	International Financial Reporting Standards	**PRA**	Prudential Regulation Authority
CSA	Credit Support Annexes	**IRRBB**	Interest rate risk in the banking book	**RMBS**	Residential Mortgage Backed Securities
CVA	Credit Valuation Adjustment	**ISDA**	International Swaps and Derivatives Association	**SPV**	Special Purpose Vehicle
EAD	Exposure at default				

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