Registered No. 06952311

Virgin Money plc

Annual Report and Accounts
for the year ended 31 December 2017

Contents

Company information

NON-EXECUTIVE DIRECTORS	Glen Moreno Darren Pope (appointed 1 March 2017) Norman McLuskie Colin Keogh Marilyn H Spearing (retired 3 May 2017) Geeta Gopalan Eva Eisenschimmel (appointed 25 January 2017)
EXECUTIVE DIRECTORS	Jayne-Anne Gadhia CBE – Chief Executive Marian Martin – Chief Risk Officer Peter Bole – Chief Financial Officer (appointed 30 January 2017)
COMPANY SECRETARY	Katie Marshall
COMPANY NUMBER	06952311
REGISTERED OFFICE	Jubilee House Gosforth Newcastle-upon-Tyne NE3 4PL
INDEPENDENT AUDITORS	PricewaterhouseCoopers LLP Atria One 114 Morrison Street Edinburgh EH3 8EX

Strategic report

Virgin Money plc (Virgin Money, the Company) is a wholly owned subsidiary of Virgin Money Holdings (UK) plc (Holdings, the Group). The Company is a UK based retail bank focused primarily on providing residential mortgages, savings and credit cards. The Company provides award-winning customer service through a range of channels, including digital (online and mobile), intermediaries, contact centres, a national network of 74 Stores and 7 customer Lounges.

Summary of Company results

The Company's financial performance in 2017 demonstrated continued progression across the three strategic pillars of growth, quality and returns.

Gross mortgage lending of £8.4 billion was combined with strong retention performance to deliver mortgage balances of £33.7 billion at year end. Card balances increased by 23.6 per cent to end 2017 at £3.0 billion. This was in line with expected growth and continued to demonstrate the strength of the franchise. The growth in mortgage and card balances was funded predominantly through growth in deposits as the Company's retail savings franchise performed well, with balances reaching £30.8 billion at year end.

The Company's operating platforms continued to support increasing scale of customer activity which, in turn, enhanced operational leverage. Underlying total income growth of 14.0 per cent significantly exceeded the 0.9 per cent growth in operating expenses. This continued improvement in operational leverage also reflected disciplined cost management and helped to create the capacity for increased investment in the business.

The quality of lending continued to be underpinned by the consistent application of the Company's risk appetite. This was reflected in a cost of risk of 13 basis points which was in line with the prior year, despite a slightly greater proportion of credit card balances.

Leverage and total capital ratios remained above regulatory requirements at 4.1 per cent and 19.1 per cent respectively. The Company's liquidity and funding profile benefitted from a successful issuance from the Group's established Gosforth Residential Mortgage Backed Securities (RMBS) programme and the Company continued to access the Term Funding Scheme (TFS).

The combination of strong lending growth, improved operational leverage and a low cost of risk delivered a 36.3 per cent increase in underlying profit before tax to £253.3 million (2016: £185.9 million). Statutory profit before tax increased by 64.7 per cent to £263.1 million (2016: £159.7 million).

As a consequence of this continued progression, measures of shareholder returns materially improved, with return on tangible equity increasing by 1.5 percentage points to 11.7 per cent.

Market overview

UK Gross Domestic Product (GDP) is estimated to have increased by 1.7 per cent in 2017. Consumption growth has been subdued reflecting the squeeze in real incomes following the depreciation of Sterling in the aftermath of the EU referendum. Partially offsetting that, net trade has picked up supported by Sterling's depreciation and the strength of global growth.

The level of unemployment in the UK fell to a 42-year low of 4.3 per cent and was one of the major economic success stories of 2017. Despite this, real wage growth has remained subdued, as inflation has increased to its highest level in five years. In light of the recovery in GDP growth and reduction in spare capacity in the economy, the Bank of England increased interest rates for the first time in a decade in November 2017 in order to bring inflation back towards the 2 per cent target.

The housing market was resilient in 2017 and is expected to see modest growth in 2018. Increasing employment and a gradual pickup in real wages should support the demand for mortgages. The mortgage market is expected to remain highly competitive in 2018. As a result of ring-fencing, high street banks may deploy excess ring-fenced deposits into UK mortgage lending. The Company expects smaller lenders will seek to protect their market share.

Credit card balances in the UK grew by 5.1 per cent in 2017. Although the Bank of England has highlighted risks from the rapid growth in consumer credit, a recent FCA study notes that this growth has been driven by borrowers with higher credit scores who may be less likely to suffer financial distress.

A combination of regulatory concern over the pace of growth in unsecured lending and concerns around consumer indebtedness in the UK is expected to see this rate of growth moderating. The recent Bank of England credit conditions survey has also highlighted the potential for an increase in impairments across the sector. Reflecting a more cautious outlook, the Company expects the market to continue to reduce the length of interest-free promotional periods on new credit cards being issued. Total outstanding balances on credit cards are expected to continue growing at a rate below recent trends.

Strategic report

Summary Income Statement

	2017 £m	2016 £m	Change
Net interest income	**594.7**	519.3	14.5%
Underlying other income	**34.9**	33.2	5.1%
Underlying total income	**629.6**	552.5	14.0%
Operating expenses	**(332.1)**	(329.0)	0.9%
Impairment	**(44.2)**	(37.6)	17.6%
Underlying profit before tax	**253.3**	185.9	36.3%
Fair value gains/(losses) on financial instruments	**9.8**	(26.2)	(137.4)%
Statutory profit before tax	**263.1**	159.7	64.7%

Summary Balance Sheet

At 31 December	2017 £m	2016 £m	Change
Assets			
Cash and balances at central banks	**2,579.0**	786.3	228.0%
Loans and receivables	**37,223.1**	32,939.3	13.0%
Available-for-sale financial assets	**902.4**	858.8	5.1%
Other	**314.4**	330.8	(5.0)%
Total assets	**41,018.9**	34,915.2	17.5%
Liabilities and equity			
Deposits from banks	**5,377.7**	2,129.7	152.5%
Customer deposits	**30,808.4**	28,106.3	9.6%
Amounts due to securitisation special purpose vehicles	**2,300.4**	2,143.6	7.3%
Other	**653.2**	844.4	(22.6)%
Total liabilities	**39,139.7**	33,224.0	17.8%
Total equity	**1,879.2**	1,691.2	11.1%
Total liabilities and equity	**41,018.9**	34,915.2	17.5%

Alternative performance measures

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The analysis of other income, total income and profit before tax in this Strategic Report is presented on an underlying basis which excludes the impact of fair value gains/losses on financial instruments.

Fair value gains and losses on financial instruments reflect the results of hedge accounting and the fair value movements on derivatives in economic hedges to the extent that they either do not meet the criteria for hedge accounting or give rise to hedge ineffectiveness. Where these derivatives are held to maturity, fair value movements recorded in this heading represent timing differences that will reverse over their lives and therefore excluding these from the underlying profit better represents the underlying performance of the Company.

The Company also calculates a number of metrics included in this Strategic Report relating to its financial performance and financial position which are Alternative Performance Measures (APMs). These metrics are commonly reported throughout the banking industry and provide relevant information to investors and other external stakeholders. The bases of calculation of these metrics are set out in footnotes to the relevant tables where they appear.

APMs do not have standardised definitions and may not be directly comparable to measures defined within IFRS.

Strategic report

Balance sheet growth

At 31 December	2017 £m	2016 £m	Change
Loans and advances to customers	**37,099.9**	32,708.9	13.4%
Customer deposits	**30,808.4**	28,106.3	9.6%
Wholesale funding (including government funding)	**7,969.2**	4,567.4	74.5%
Wholesale funding <1 year maturity	**1,215.8**	861.7	41.1%
High Quality Liquid Assets[1]	**5,264.4**	4,222.6	24.7%

1 These include Funding for Lending drawings which are held off-balance sheet but are available for repo and hence count towards liquidity resources.

The continuing strength of the Company's lending franchise delivered 13.4 per cent growth in loans and advances to customers in 2017. This lending was funded by continued growth in the Company's retail and wholesale funding, as well as further drawings from the TFS. Total customer deposits grew by 9.6 per cent to £30,808.4 million at 31 December 2017, in excess of market growth of 3.5 per cent. The Company re-priced four tranches of existing deposits of approximately £15 billion during 2017, and all were completed with lower than expected attrition.

In September 2017 a successful issuance of RMBS was completed through the Group's 'Gosforth' franchise. This included dollar and sterling tranches and raised sterling equivalent funding of approximately £750 million. The Company will continue to diversify and build out funding sources in the coming year in line with the long term aim of wholesale funding providing up to 20 per cent of total funding. In July 2017 the Company received authorisation from the FCA for a regulated covered bonds programme, and expect that the inaugural issuance will take place during 2018.

The Company continued to make use of the TFS in 2017, with total drawings at 31 December 2017 of £4,236.0 million. The scheme provides a cost effective source of funding, supporting lending growth and further strengthening of the Company's liquidity position.

The liquidity position remained strong throughout the year, with high quality liquid assets at £5,264.4 million at 31 December 2017. This reflects an increase in cash and balances held at the central bank. The Company held increased levels of liquidity at 31 December 2017, reflected in an increase in balances held at the central bank in part due to the repayment of £650.2 million of Funding for Lending Scheme (FLS) drawings which have been replaced by on balance sheet liquidity.

Income benefited from growth in asset balances

	2017 £m	2016 £m	Change
Net interest income	**594.7**	519.3	14.5%
Underlying other income[2]	**34.9**	33.2	5.1%
Underlying total income[2]	**629.6**	552.5	14.0%

2 Excluding fair value gains/(losses) on financial instruments.

Net interest income increased by 14.5 per cent to £594.7 million, driven by balance growth across the mortgage and credit card books.

Credit cards made an increasing contribution in the year, benefitting from further growth in the credit cards portfolio. Mortgage spreads were at levels lower than 2016, driven by competition as well as lower funding costs, in part as a result of the TFS. As a result, new mortgage lending in 2017 was priced at an average spread of 168 basis points, compared to 187 basis points in 2016. However, further optimisation of the funding base continued to support margins in a competitive environment.

Underlying other income increased by 5.1 per cent to £34.9 million. This included the gain of £6.1 million from the sale of the Company's investment in Vocalink in the first half of 2017. Excluding the gain from the sale of Vocalink and the gain of £5.3 million on the investment held in Visa Europe during the first half of 2016, underlying other income increased by 3.2 per cent.

Costs remain tightly controlled

		2017	2016	Change
Operating expenses	£m	**332.1**	329.0	0.9%
Cost:income ratio[3]	%	**52.7**	59.5	(6.8)pp

3 Operating expenses divided by underlying total income

Set against underlying total income growth of 14.0 per cent, growth in operating expenses in 2017 was constrained to just 0.9 per cent. This reduced the cost:income ratio by 6.8 percentage points to 52.7 per cent.

Efficiency improvements continued across the business with the Company's ongoing programme of operational effectiveness and the ability to leverage central functions being key drivers.

This strong cost performance helped to create the capacity for increased investment in the business. The Company continued its investment into the core business and £38.3 million of capital expenditure was invested in the development of the new digital banking platform.

Impairments reflected a resilient economy and rigorous credit risk management

		2017	2016	Change
Mortgages				
Impairment charge	£m	**2.2**	2.8	(21.4)%
Cost of risk[4]	%	**0.01**	0.01	-
Cards				
Impairment charge	£m	**42.0**	34.8	20.7%
Cost of risk[4]	%	**1.51**	1.70	(19)bps
Total				
Impairment charge	£m	**44.2**	37.6	17.6%
Cost of risk[4]	%	**0.13**	0.13	–
Provisions as a % of arrears balances	%	**32.9**	29.4	3.5pp
Impaired loans as a % of loans and advances	%	**0.5**	0.4	0.1pp
Provisions as a % of impaired loans	%	**33.5**	40.0	(6.5)pp

4 Impairment charge divided by simple average gross loans for the year.

The cost of risk for mortgages was flat between 2016 and 2017 at 0.01 per cent and the impairment charge reduced by £0.6 million compared to the prior year. This performance reflected the high quality of the mortgage portfolio combined with the benign economic environment, leading to a continuing low level of defaults. The percentage of mortgages over three months in arrears was 0.12 per cent at the end of 2017 (2016: 0.15 per cent).

In credit cards, set against growth of 23.6 per cent in balances, the impairment charge for the portfolio increased by only 20.7 per cent to £42.0 million. The resulting cost of risk for credit cards decreased by 19 basis points to 1.51 per cent in 2017. This underlines the high credit quality of new and existing cards which continue to have a low rate of default. Performance of new cohorts of credit cards remained strong with all cohorts showing a cost of risk lower than or in line with previous vintages.

Provisions as a percentage of balances in arrears increased to 32.9 per cent (2016: 29.4 per cent) as the Company retained appropriate coverage of balances at risk of loss.

Impaired loans as a percentage of loans and advances increased marginally to 0.5 per cent in 2017 compared to 0.4 per cent in 2016. This was due to an increase in secured balances with qualitative impairment indicators, such as interest only expired terms or fraud cases, which are prudently categorised as impaired regardless of arrears status or expected recoverable amount.

Expired term loans which are more than six months past their maturity date have an average loan-to value (LTV) of 25.8 per cent and therefore do not require increased impairment provisions given the high level of collateral cover. The growth in these balances within the impaired loans category is therefore reflected in the reduced provision coverage of impaired loans.

Continued strong progression in returns

		2017	2016	Change
Return on tangible equity[5]	%	**11.7**	10.2	1.5pp

5 Underlying profit before tax (adjusted to deduct distributions on Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Company, divided by simple average tangible equity. Tangible equity is calculated as total equity less other equity instruments and intangible assets.

The strength of income growth and improved operational leverage, combined with the Company's asset quality, has driven material enhancement to returns in 2017. Return on tangible equity increased by 1.5 percentage points to 11.7 per cent in 2017. On a statutory basis, return on assets (profit attributable to equity owners divided by closing total assets) increased to 0.47 per cent in 2017, from 0.33 per cent in 2016.

Capital strength while investing in the future

		2017	2016	Change
Capital ratios and risk-weighted assets				
Common Equity Tier 1 (CET1) capital	£m	**1,489.1**	1,356.8	9.8%
Risk-weighted assets (RWAs)	£m	**9,093.4**	7,603.0	19.6%
- of which mortgage credit risk RWAs	£m	**5,790.5**	4,764.5	21.5%
- of which credit card credit risk RWAs	£m	**2,282.9**	1,847.4	23.6%
- of which all other RWAs	£m	**1,020.0**	991.1	2.9%
Common Equity Tier 1 ratio	%	**16.4**	17.8	(1.4)pp
Tier 1 ratio	%	**18.9**	20.9	(2.0)pp
Total capital ratio	%	**19.1**	21.0	(1.9)pp
Leverage ratio	%	**4.1**	4.4	(0.3)pp

During the year the Company generated capital, after distributions on AT1 securities and before investment, of £187.6 million. This was used to invest in the business and increase capital resources.

The net investment in intangible assets, including capital investment in the Company's digital banking platform, was £47.8 million. After further small balancing items, this resulted in an increase in CET1 capital of £132.3 million which was in turn used to support customer lending.

Lending growth resulted in a 19.6 per cent increase in RWAs to £9,093.4 million. In mortgages, growth in credit risk RWAs of 21.5 per cent was higher than balance growth of 13.2 per cent as the average mortgage risk weight density, as a percentage of balance sheet assets, increased to 17.2 per cent from 16.0 per cent in 2016, in line with expectations.

In credit cards, credit risk RWA growth was in line with asset growth as credit card RWAs are calculated using the standardised approach.

Other RWAs increased by 2.9 per cent. This reflected growth in operational risk RWAs in line with the standardised approach, where the growth in average income over the past three years is recognised in a higher level of operational RWAs. This was largely offset by a reduction in exposure to higher risk-weighted instruments and counterparties in the Company's liquid asset portfolio.

As a result of the above movements, the CET1 ratio reduced to 16.4 per cent at 31 December 2017 compared with 17.8 per cent at the end of 2016. This was in line with the expected development of the business.

The total capital ratio of 19.1 per cent also reduced in line with the movements described above and remains in excess of the Company's total regulatory requirements.

The leverage ratio was 4.1 per cent at the end of the year compared to 4.4 per cent at the end of 2016. The reduction reflected higher growth in leverage ratio eligible assets than in capital resources. Growth in eligible assets was due to increased customer balances and higher levels of on balance sheet liquidity as FLS was repaid.

IFRS 9

The Company is well placed for the transition to the new accounting requirements of IFRS 9. The Directors estimate the transition to IFRS 9 will reduce shareholders' equity by approximately £35 million after deferred tax as at 1 January 2018. The most significant impact on the Company arises from the changes to loan loss impairment with the introduction of an expected credit loss approach. Given the low LTV and high credit quality of the mortgage portfolio and high credit ratings of the wholesale book, the main impact will arise from the Company's credit card portfolio.

Future developments

The Company's central planning scenario for 2018 assumes a continuation of relatively benign economic conditions, modest economic growth and heightened competition as the market readjusts to a rising interest rate environment and regulatory changes. The macro and political environment, including the impact of the UK leaving the European Union, remains uncertain which adds a degree of caution to the Company's outlook.

The Bank of England increased interest rates for the first time in a decade in November 2017 and has indicated that the pace of interest rate increases is expected to be gradual.

In 2018 the Company expects to grow mortgage and cards lending at a single digit percentage rate. Cost discipline will continue as the Company invests in its strategic developments. The Company's lending discipline will support asset quality and, including the impact of IFRS 9, cost of risk is expected to be no higher than 20 basis points in 2018.

The Company will continue to make progress with the SME roll-out and the development of the digital bank over the course of 2018. Over time, these initiatives will significantly increase the breadth of the Company's proposition, drive new sources of income and reduce operating costs.

Principal risks and uncertainties

The most significant risks faced by the Company which could impact on the success of delivering its long-term strategic objectives are outlined below:

Principal risks	Key mitigating actions
Credit Risk	
Credit risk is the risk of loss resulting from a borrower or counterparty failing to pay amounts due. The Company provides residential and buy-to-let mortgages and credit cards to customers across the UK. There is a risk that any adverse changes in the macro-economic environment and/or the credit quality or behaviour of borrowers results in additional impairment losses, thereby reducing profitability. Wholesale exposures arise through the liquid asset portfolio and the use of derivative instruments to manage interest rate risk.	➢ the Company operates a well-defined Board approved credit risk appetite and applies risk limits reflected in the approved credit policy; ➢ a robust credit risk framework helps ensure that the credit quality and composition of portfolios remain within risk appetite limits. This is monitored and reported through governance committees regularly; ➢ stress and scenario testing allows the Company to confirm portfolio resilience; ➢ credit risk metrics are benchmarked against competitors and industry averages; ➢ customer behaviour is closely monitored with timely action taken in response to any adverse change; and ➢ credit risk arising from derivative and from secured financing transactions is mitigated by collateralising exposures on a daily basis.
Market Risk	
Market risk is the risk that unfavourable market movements lead to a reduction in earnings or value. The Company does not trade or make markets. Interest rate risk in the banking book is the only material category of market risk.	➢ the Company operates a well-defined Board approved risk appetite with associated limits and policy; ➢ exposures are mitigated through the use of natural offsets and derivatives; and ➢ stress and scenario testing focuses on the impacts of differing interest rate environments.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The management of third party relationships, cyber-crime and information security remains a key focus for the Company.

- risk appetite is focused on maturing the control environment and therefore managing operational risk;
- an ongoing programme of investment in security infrastructure is in place to mitigate threats including cyber-attack;
- the Company will continue to invest in and develop risk management frameworks, systems and processes which strengthen operational resilience; and
- the Company monitors external events impacting other financial services companies to inform stress testing.

Conduct and Compliance Risk

Conduct and compliance risk is defined as the risk that the Company's operating model, culture or actions result in unfair outcomes for customers. This could result in regulatory sanction, material financial loss or reputational damage if the Company fails to design and implement effective operational processes, systems and controls which maintain compliance with all applicable regulatory requirements.

- compliance is maintained through an effective and timely response to changes in the regulatory environment;
- the customer is placed at the heart of decision making by ensuring fair outcomes through comprehensive risk assessment and testing;
- the Company will continue to invest in and develop risk management frameworks, systems and processes; and
- the Company focuses on training to ensure colleague performance is aligned with the regulatory responsibilities and to enable an awareness of good customer outcomes.

Strategic and Financial Risk

Strategic risk is the risk of significant loss or damage arising from business decisions that impact the long-term interests of stakeholders or from an inability to adapt to external developments.

Financial risk is focused primarily on concentration risk. Credit concentration risk is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels.

Increased competition in the Company's key lending markets is leading to a reduction in asset spreads, creating additional financial risk. There is also the potential for increased competition in the deposit taking market as Bank of England funding schemes come to an end.

Financial performance can be impacted by adverse changes in customer behaviour.

- Board focus is on ensuring alignment of business development and planning with risk appetite;
- investment in processes, systems, recruitment and training to support new business developments;
- use of robust risk and project management disciplines to ensure that implementation is delivered safely;
- active focus on asset origination and portfolio management to manage margins and eliminate inappropriate concentration risk;
- the Company will maintain pricing discipline across the product range, ensuring that risk is appropriately rewarded within the Board approved risk appetite;
- regular validation and review of models is performed; and
- the Company continually monitors customer behaviour metrics to identify adverse trends.

Funding and Liquidity Risk

Liquidity risk represents the inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations to make payments as they fall due.

Funding risk represents the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.

- the Company operates a well-defined Board approved risk appetite and applies limits defined in funding and liquidity policies;
- liquid resources are maintained in adequate quantity and quality to meet stressed outflows;
- a prudent mix of funding sources is maintained with a maturity profile set in risk appetite and policy limits; and
- stress and scenario testing considers threats to funding plans and changes in consumer behaviour.

Capital Risk

Capital risk is defined as the risk that the Company has a sub-optimal amount or quality of capital or that capital is deployed inefficiently across the Company.

- the Company operates a well-defined Board approved risk appetite ensuring sufficient capital in excess of regulatory requirements is held;
- the capital management policy sets out minimum standards for the management of capital;
- capital procedures are subject to independent oversight; and
- stress and scenario testing assesses capital adequacy under a range of severe market-wide stress scenarios and idiosyncratic stress events.

Financial risk management, objectives and policies

Information regarding the financial risk management objectives and policies of the Company, in relation to the use of financial instruments, is given in note 30 to the financial statements. Additional information can be found in the Annual Report and Accounts of Virgin Money Holdings (UK) plc, the Company's ultimate parent, which does not form part of this report.

This report was approved by the Board on 26 February 2018 and signed on its behalf by:

Jayne-Anne Gadhia CBE
Chief Executive
Virgin Money plc
Registered No. 06952311

Directors' report

Results

The Company made a statutory profit before tax for the year ended 31 December 2017 of £263.1 million. This represents an increase of 64.7 per cent over the year ended 31 December 2016 (2016: £159.7 million).

Dividends

The Directors do not recommend a final dividend in respect of the year ended 31 December 2017.

Post balance sheet events

There have been no material post balance sheet events.

Going concern

The going concern status of the Company is dependent on successfully funding the balance sheet and maintaining adequate levels of capital. In order to satisfy themselves that the Company has adequate resources to continue to operate for a period of at least twelve months from the date of approval of this report, the Directors have considered:

> a number of key dependencies set out in the Strategic Report under Principal risks and uncertainties;

> the funding and liquidity positions as outlined in note 30 to the financial statements;

> the capital position as outlined in note 32 to the financial statements; and

> additionally have considered projections for the Company's capital and funding position.

Having considered these and made appropriate enquiries, the Directors consider that the Company has adequate reserves to continue in business for a period of at least twelve months from the date of approval of this report. As a result, it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Future developments

Information about future developments of the Company can be found in the Strategic Report. This information is incorporated into the Directors' Report by reference.

Financial risk management objectives and policies

Information in relation to financial reporting and financial risk management objectives and policies in relation to the use of financial instruments can be found in note 30 to the financial statements. This information is incorporated into the Directors' Report by reference.

Corporate Governance

Details of the corporate governance framework applying to the Company is set out in the Corporate Governance Report within the 2017 Virgin Money Group Annual Report and Accounts.

Employee engagement and employment of disabled persons

The Company's employees are integral to its success; it is through their engagement and advocacy that the Company is able to deliver strong and sustainable business performance. Information of matters relevant to employees, including financial and economic factors affecting the performance of the Company, is communicated on a frequent basis directly to employees. Feedback is sought from employees via numerous channels, including an annual third-party engagement survey and regular meetings with union representatives.

The Company adopts a performance-related approach to remuneration and all employees are eligible to participate in an annual bonus arrangement.

The Company aims to provide an environment which nurtures a high performing, diverse and committed workforce where employees can reach their full potential. The Company does not tolerate discrimination in the workplace on the grounds of sex, race, disability, age, sexual orientation or religious belief.

The Company believes a diverse workforce will drive better business outcomes and create a workplace that is more engaging, inclusive and accessible. In 2017, the Company signed the Time to Change pledge, aimed at making the Company a better place to work for individuals who have a mental health disability and achieved the highest (3rd tier) Disability Confident accreditation. The Company also extended access to learning materials for all employees through enhanced mobile technology and continued to upgrade technology to make flexible and home working easier.

Directors' report

Directors

The current composition of the Board of Directors together with details of appointments and resignations up to the date of this report are shown on page 1. This information is incorporated into the Directors' Report by reference.

Appointment and retirement of Directors

The appointment, retirement and/or replacement of Directors is governed by the Company's articles of association (the articles), and the Companies Act 2006 (the Act). The Company's articles may only be amended by a special resolution of the shareholders in a general meeting.

The Company, as a public limited company, is required to hold an Annual General Meeting (AGM) at which one third of its Directors must retire from office every year. At the Company's 2017 AGM Jayne-Anne Gadhia CBE, Glen Moreno and Norman McLuskie retired, submitted themselves for re-election and were duly re-elected.

Directors' indemnities

The Directors of the Company, including the former director who retired during the year, have entered into individual deeds of indemnity with the Company which constituted 'qualifying third party indemnity provisions' for the purposes of the Act. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force for the duration of a Director's period of office and for a period of six years thereafter. The deeds were in force during the whole of the financial year and remain in force at the date of this report. Deeds for the current Directors, and the former director who retired during the year, are available for inspection at the Company's registered office. In addition, the Company had appropriate Directors' and Officers' insurance cover, as well as Professional Indemnity insurance cover, in place throughout 2017.

Share capital, control and Directors' powers

Information about the share capital of the Company is shown in note 24 to the financial statements and is incorporated into this report by reference.

The powers of the Directors, including in relation to the issue or repurchase of the Company's shares, are set out in the Company's articles and the Act. The Company did not repurchase any of the issued Ordinary Shares during the year or up to the date of this report (2016: none).

There are no restrictions on the transfers of shares other than set out in the Company's articles or the Act. No shares are subject to a lien or charge.

Change of control

The Company is not a party to any significant contracts that are subject to change of control provisions in the event of a takeover bid, other than the Virgin Money Trademark Licence Agreement. This is the agreement under which Virgin Enterprises Limited (VEL) grants a perpetual licence to the Group providing the right to use the "Virgin" and "Virgin Money" trademarks. VEL has the right to terminate the agreement in the event of a change of control of the Group, other than a change of control pre-approved by VEL. VEL shall be entitled to withhold consent only in the event of a takeover by a third party who, in VEL's reasonable opinion is a direct competitor of VEL or any Virgin entity in the UK or whose reputation or financial standing is reasonably likely to materially damage the value or reputation of the "Virgin" marks.

There are no agreements between the Company and its Directors or employees providing compensation for loss of office or employment that occurs because of a takeover.

In the event of a takeover or other change of control (excluding an internal reorganisation), outstanding awards under the Group's share plans vest to the extent any applicable performance conditions have been met, and subject to applicable time pro-rating, in accordance with the rules of the plans.

Significant contracts

Details of related party transactions are set out in note 33 to the financial statements.

Research and development activities

During the ordinary course of business the Company invests in the development of platforms, products and services. During 2017 the Company has invested in the build of the digital bank.

Directors' report

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and applicable law.

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

> select suitable accounting policies and then apply them consistently;

> state whether applicable IFRS as adopted by the EU have been followed, subject to any material departures disclosed and explained in the financial statements;

> make judgements and estimates that are reasonable and prudent; and

> prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information of the Company included on the Virgin Money Group website, www.virginmoney.com. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the Annual Financial Report

Each of the Directors who is in office at the date of approval of this report, and whose names and functions are listed on page 1, confirms that to the best of his or her knowledge:

> the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and

> the Strategic Report and Directors' Report include a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that it faces.

Independent auditors and audit information

Each of the Directors who is in office at the date of this report, confirms that, so far as he or she is aware, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that he or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are also aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Act.

Resolutions concerning the reappointment of PricewaterhouseCoopers LLP as auditors and authorising the Group's Audit Committee to set the auditors' remuneration will be proposed at the 2018 AGM.

This report was approved by the Board on 26 February 2018 and signed on its behalf by:

Katie Marshall
Company Secretary
Virgin Money plc
Registered No. 06952311

Independent auditors' report to the members of Virgin Money plc

Report on the audit of the financial statements

Opinion

In our opinion, Virgin Money plc's financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2017 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Accounts (the Annual Report), which comprise: the income statement; the statement of comprehensive income; balance sheet; statement of changes in equity and cash flow statement; and the notes to the financial statements (excluding those items marked as unaudited in note 30 and note 32), which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company.

Other than those disclosed in note 5 to the financial statements, we have provided no non-audit services to the Company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview

- Overall materiality: £13,000,000 (2016: £7,988,000), based on 5% of profit before tax.
- We performed a full scope audit on the financial statements of Virgin Money plc.
- Key audit matters relevant to our audit were:
  - > Revenue recognition - Effective Interest Rate (EIR) accounting
  - > Impairment of loans and advances to customers
  - > Recognition of intangible assets
  - > Disclosure of impact of adoption of IFRS 9

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Company and the industry in which it operates, and considered the risk of acts by the Company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Independent auditors' report to the members of Virgin Money plc

Report on the audit of the financial statements (continued)

We focused on laws and regulations that could give rise to a material misstatement in the Company's financial statements, including, but not limited to, the Companies Act 2006, the Listing Rules, and UK tax legislation. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

Key audit matters
Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	*How our audit addressed the key audit matter*
Revenue recognition – Effective Interest Rate (EIR) accounting See note 1 of the financial statements for the disclosure of the related accounting policies and critical estimates and judgements. The Company's total loans and advances to customers balance of £37.1 billion and net interest income of £594.7 million include certain EIR adjustments as per the requirements of IAS 39. The vast majority of the income recognised by the Company is system generated and requires minimal judgement, therefore we focused our work in relation to revenue recognition on EIR accounting due to the inherent subjectivity and complexity involved in forecasting future customer behaviour on which the EIR adjustment calculation is based. Changes in assumptions used in the forecasting model could have a material impact on EIR adjustments and hence, the revenue recognised in any one accounting period. The most significant assumption for secured lending EIR is the estimation of the expected life of the product over which fees are spread. For unsecured lending, significant judgement is applied in calculating the EIR adjustment including setting assumptions relating to movements in customer balances over the expected life and the related future revenue associated with these balances in the context of the Company's historic experience. Key assumptions include retail spending levels and repayment rates.	Across both the secured and unsecured lending EIR calculation models, we tested controls over data input and checked the accuracy of model calculations. We also assessed controls over the setting and approving of key assumptions. We tested the impact of any changes in assumptions on the financial statements, ensuring these were calculated in accordance with IAS 39. In relation to secured lending EIR, we: • Substantively tested a sample of fees incorporated within the calculation to underlying secured lending agreements and considered the appropriateness of the inclusion of fees in the EIR calculation; and • Assessed the estimate of the expected life applied and forecast cash flows during this life by comparing to recent Company experience and expectations of future patterns. We concluded that, whilst there is significant judgement inherent in the secured EIR adjustment, the assumptions applied were within a reasonable range based on past experience and future assumptions. In relation to unsecured lending EIR, we: • Tested controls over the ongoing monitoring of actual credit card cash flows as compared with the forecast assumptions and compared 2017 experience with expected experience for that period on a sample basis; • Assessed the key forecast assumptions, including expected life, balance, repayment rate, volume of retail spend and interest income earned by comparing to recent experience;

Independent auditors' report to the members of Virgin Money plc

Report on the audit of the financial statements (continued)

Key audit matter	*How our audit addressed the key audit matter*
	• Performed sensitivity analyses of key judgements to understand the materiality of the impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset; and • Assessed the sufficiency of the disclosures in the financial statements relating to significant estimates made in the EIR calculation, including disclosure of sensitivities. We concluded that, whilst there is significant judgement inherent in the unsecured EIR adjustment, the assumptions applied were within a reasonable range based on past experience and future assumptions. We concluded that the disclosures in note 1 of the financial statements provide appropriate details of the degree and nature of estimation uncertainty and the impact on the financial statements of actual future customer experience differing from the assumptions made.
Impairment of loans and advances to customers See note 1 of the financial statements for the disclosure of the related accounting policies and critical estimates and judgements. The impairment provision of £59.4 million consists of provisions of £12.1 million in relation to secured lending and £47.3 million in relation to unsecured lending. Total loans and advances as at 31 December 2017 relating to secured lending was £34.0 billion and £3.1 billion for unsecured lending. We focused on this area because Management make subjective judgments over both the timing of recognition and the size of provisions for impairment of loans and advances. This judgement includes considering the completeness of the provisions and whether any specific judgemental overlays are appropriate to recognise the impact of emerging trends not captured in the impairment models. The Company has developed historic data based models that derive key assumptions used within the provision calculation such as probability of default (PD) and loss given default (LGD). The output of these models is then applied to the provision calculation with other information including the selection of an appropriate loss emergence period (LEP) and the exposure at default (EAD).	We assessed and tested the design and operating effectiveness of the controls over data flows, model governance and setting and approval of key assumptions used in the provisioning process. As part of our detailed work, we: • Assessed the provision calculation methodology applied in the context of industry practice and the requirements of accounting standards; • Tested key assumptions used within the models to internal and external information where appropriate; • Tested that the model calculations were consistent with our understanding of the Company's methodology and the requirements of accounting standards; and • Examined the basis for the judgemental overlays made to the results produced by models and assessing the rationale for the adjustments, as well as considering the completeness of the overlays. We found the approach taken in relation to the Company's impairment provisions to be consistent with the requirements of IAS 39 and judgements made were reasonable.
Recognition of intangible assets See note 1 of the financial statements for the disclosure of the related accounting policies. During 2017 certain technology project costs incurred by the Company were capitalised. These projects require cash and non-cash resources during development and management applies judgement in considering whether or not costs should be capitalised in the context of IAS 38.	We assessed the Company's capitalisation policy to check that it met the requirements of IAS 38. We tested the design and operating effectiveness of the control environment in relation to the recording and approval of project costs which form the basis of capitalisation accounting entries. We selected a sample of intangible assets and undertook the following procedures:

Report on the audit of the financial statements (continued)

Key audit matter	*How our audit addressed the key audit matter*
As technology and customer expectations continue to change there is a risk that certain technology assets may not generate the return that the Company had initially anticipated and therefore may be subject to impairment. At 31 December 2017, the Company's total net book value of intangible assets was £128.4 million.	• Substantively tested a selection of costs including those related to new projects to check that these meet the criteria of IAS 38 for capitalisation as intangible assets; • Discussed material capitalised assets with management to identify any that may be at higher risk of potential impairment; and • Where higher risk items were noted, we discussed the asset and related forecast economic benefits with management to inform our independent consideration as to whether any possible impairment triggers existed. One item was noted by management as requiring impairment resulting in a charge of £4.8 million to the income statement. This is disclosed in note 16. We found the accounting treatment applied in recognising capitalised costs was consistent with the requirements of IAS 38 and we did not identify any material matters which we considered necessary to report.
Disclosure of impact of adoption of IFRS 9 IFRS 9 became effective on 1 January 2018 and therefore does not affect the Balance Sheet and Income Statement of the Company as at 31 December 2017. However, under the requirements of IAS 8, the Company is required to disclose the estimated impact that new accounting standards will have on initial adoption. The Company has presented a transition disclosure in note 36. Management estimate that the transition to IFRS 9 will reduce shareholders'' equity by approximately £35 million after deferred tax as at 1 January 2018. The most significant impact of adopting IFRS 9 to the Company relates to a change in the way that credit losses are recognised, moving from an incurred loss to an expected loss basis for financial instruments held at Amortised Cost. The estimation of expected credit losses (ECL) for the disclosure required in these 2017 financial statements has required significant judgement to be applied in the development of lifetime PD, LGD and EAD models. This has required a more complex provision calculation methodology based on the application of differing levels of forecasting of losses. This is dependent on whether a significant increase in credit risk has occurred, as well as an adjustment applied for the impact of multiple economic scenarios in the future.	We read the disclosure as set out in note 36 to assess its compliance with the requirements of IAS 8. We also tested the completeness and accuracy of data inputs for the Company's material IFRS 9 models to identify any material inconsistencies with source system data. Our detailed work in auditing the estimated 2018 opening impairment provisions included: • Reading the model documentation papers and assessing the Company's methodology and modelling approach in the context of our understanding of IFRS 9; • Independently estimating model outputs based on the Company's methodology and data for material IFRS 9 models and comparing our outcomes with those of management; and • Comparing macroeconomic forecasts used by the Company for IFRS 9 purposes with third party market information. We found the disclosure in respect of the transition to IFRS 9 and the estimated impact this has on shareholders' equity to be consistent with the requirements of accounting standards.

Independent auditors' report to the members of Virgin Money plc

Report on the audit of the financial statements (continued)

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which it operates.

We updated our understanding of processes within the business in order to understand and evaluate the key financial processes and controls across the Company. Following our procedures, we were able to obtain sufficient appropriate audit evidence to form a basis for our audit opinion.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£13,000,000 (2016: £7,988,000).
How we determined it	5% of profit before tax.
Rationale for benchmark applied	Profit before tax is deemed as the most appropriate measure of business performance and hence an appropriate benchmark upon which to base our materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £650,000 (2016: £399,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Independent auditors' report to the members of Virgin Money plc

Report on the audit of the financial statements (continued)

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on page 12, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 4 May 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is two years, covering the years ended 31 December 2016 and 31 December 2017.

Catrin Thomas (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
26 February 2018

Virgin Money plc

Income statement

For the year ended 31 December 2017

	Note	2017 £m	2016 £m
Interest and similar income		**964.7**	951.7
Interest and similar expense		**(370.0)**	(432.4)
Net interest income	2	**594.7**	519.3
Fee and commission income	3	**21.6**	21.3
Fair value gains/(losses) on financial instruments	10	**9.8**	(26.2)
Other operating income	4	**13.3**	11.9
Other income		**44.7**	7.0
Total income		**639.4**	526.3
Operating expenses	5	**(332.1)**	(329.0)
Profit before tax from operating activities		**307.3**	197.3
Impairment	7	**(44.2)**	(37.6)
Profit before tax		**263.1**	159.7
Taxation	8	**(70.8)**	(44.1)
Profit for the year		**192.3**	115.6
Profit attributable to equity owners		**192.3**	115.6
Profit for the year		**192.3**	115.6

The accompanying notes are an integral part of these financial statements.

Virgin Money plc

Statement of comprehensive income

For the year ended 31 December 2017

	Note	2017 £m	2016 £m
Profit for the year		**192.3**	115.6
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	26	**14.0**	44.4
Income statement transfers in respect of disposals	26	**(13.5)**	(38.3)
Taxation	26	**(0.1)**	(1.7)
Other comprehensive income for the year, net of tax		**0.4**	4.4
Total comprehensive income for the year		**192.7**	120.0
Total comprehensive income attributable to equity owners		**192.7**	120.0

The accompanying notes are an integral part of these financial statements.

Virgin Money plc

Balance sheet

As at 31 December 2017

	Note	**31 Dec 2017 £m**	31 Dec 2016 £m
Assets			
Cash and balances at central banks		**2,579.0**	786.3
Derivative financial instruments	10	**22.0**	35.2
Loans and receivables:			
–Loans and advances to banks	11	**122.9**	229.7
–Loans and advances to customers	12	**37,099.9**	32,708.9
–Debt securities		**0.3**	0.7
		37,223.1	32,939.3
Available-for-sale financial assets	13	**902.4**	858.8
Intangible assets	16	**128.4**	80.6
Tangible fixed assets	17	**73.5**	75.8
Deferred tax assets	18	**10.4**	21.8
Other assets	19	**80.1**	117.4
Total assets		**41,018.9**	34,915.2
Liabilities			
Deposits from banks	20	**5,377.7**	2,129.7
Customer deposits	21	**30,808.4**	28,106.3
Derivative financial instruments	10	**93.1**	225.3
Amounts due to securitisation special purpose vehicles	12	**2,300.4**	2,143.6
Debt securities in issue	22	**302.8**	305.8
Current tax liabilities		**23.7**	16.8
Other liabilities	23	**233.6**	296.5
Total liabilities		**39,139.7**	33,224.0
Equity			
Share capital	24	**1,400.0**	1,400.0
Other equity instruments	25	**230.0**	230.0
Other reserves	26	**4.5**	4.1
Retained earnings		**244.7**	57.1
Total equity		**1,879.2**	1,691.2
Total liabilities and equity		**41,018.9**	34,915.2

Investment in subsidiaries was £nil in all years presented, refer to note 15 for further details.

The accompanying notes are an integral part of these financial statements.

The financial statements on pages 19 to 85 were approved and authorised for issue by the Board and were signed on its behalf on 26 February 2018.

Glen Moreno
Chair

Jayne-Anne Gadhia CBE
Chief Executive

Virgin Money plc

Statement of changes in equity

Attributable to equity holders

	Share capital £m	Other equity instruments £m	Other reserves £m	Retained earnings £m	Total equity £m
Balance at 1 January 2017	**1,400.0**	**230.0**	**4.1**	**57.1**	**1,691.2**
Comprehensive income					
Profit for the year	**–**	**–**	**–**	**192.3**	**192.3**
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	**–**	**–**	**0.4**	**–**	**0.4**
Total comprehensive income for the year	**–**	**–**	**0.4**	**192.3**	**192.7**
Transactions with equity holders					
Distributions on Additional Tier 1 securities	**–**	**–**	**–**	**(20.1)**	**(20.1)**
Tax attributable to Additional Tier 1 securities	**–**	**–**	**–**	**5.5**	**5.5**
Share based payments – charge for year	**–**	**–**	**–**	**9.9**	**9.9**
Deferred tax on share based payments	**–**	**–**	**–**	**–**	**–**
Total transactions with equity holders	**–**	**–**	**–**	**(4.7)**	**(4.7)**
Balance at 31 December 2017	**1,400.0**	**230.0**	**4.5**	**244.7**	**1,879.2**

	Share capital £m	Other equity instruments £m	Other reserves £m	Retained earnings £m	Total equity £m
Balance at 1 January 2016	1,400.0	–	(0.3)	(71.0)	1,328.7
Comprehensive income					
Profit for the year	–	–	–	115.6	115.6
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	–	–	4.4	–	4.4
Total comprehensive income for the year	–	–	4.4	115.6	120.0
Transactions with equity holders					
Distributions on Additional Tier 1 securities	–	–	–	–	–
Tax attributable to Additional Tier 1 securities	–	–	–	–	–
Issue of Additional Tier 1 securities	–	230.0	–	–	230.0
Share based payments – charge for year	–	–	–	12.8	12.8
Deferred tax on share based payments	–	–	–	(0.3)	(0.3)
Total transactions with equity holders	–	230.0	–	12.5	242.5
Balance at 31 December 2016	1,400.0	230.0	4.1	57.1	1,691.2

Further details of movements in the Company's share capital and reserves are provided in notes 24 to 26.

Virgin Money plc
Cash flow statement

For the year ended 31 December 2017

	Note	2017 £m	2016 £m
Profit before taxation		**263.1**	159.7
Adjustments for:			
Changes in operating assets	31a	**(4,390.9)**	(5,374.4)
Changes in operating liabilities	31b	**5,964.4**	4,557.1
Non-cash and other items	31c	**33.3**	11.3
Tax paid		**(45.1)**	(22.1)
Net cash provided by/(used in) operating activities		**1,824.8**	(668.4)
Cash flows from investing activities			
Purchase of securities		**(541.5)**	(670.0)
Proceeds from sale and redemption of available-for-sale financial assets		**497.1**	1,150.0
Purchase and investment in intangible assets		**(74.3)**	(31.6)
Purchase of tangible fixed assets		**(5.7)**	(8.6)
Disposal of tangible fixed assets		**–**	0.7
Net cash (used in)/provided by investing activities		**(124.4)**	440.5
Cash flows from financing activities			
Issue of Additional Tier 1 securities		**2.3**	227.7
Distributions to Additional Tier 1 security holders		**(20.1)**	–
Net cash (used in)/provided by financing activities		**(17.8)**	227.7
Change in cash and cash equivalents		**1,682.6**	(0.2)
Cash and cash equivalents at beginning of year		**966.3**	966.5
Cash and cash equivalents at end of year	31d	**2,648.9**	966.3

The accompanying notes are an integral part of these financial statements.

Notes to the financial statements

Note 1: Basis of preparation and accounting policies

1.1 Reporting entity

Virgin Money plc (the Company) is a company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-upon-Tyne, NE3 4PL. The Company was incorporated as a private limited company with registered number 06952311 and was re-registered as a public limited company on 10 November 2009.

1.2 Basis of preparation

The Company financial statements, which should be read in conjunction with the Strategic Report and the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Company. The Directors are confident that they show that the Company will have sufficient resources to meet its liabilities as they fall due and to continue to operate for a period of at least 12 months from the date of approval of the financial statements. Accordingly the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

As permitted by section 400 of the Companies Act 2006 the Company has not prepared consolidated financial statements.

1.3 Changes in accounting policy

New standards, amendments to standards or interpretations adopted

In 2017, the Company adopted amendments to existing standards that were endorsed for adoption by the EU and mandatory for annual reporting periods beginning on or after 1 January 2017.

The adoption of the amendments to IAS 12 'Income Taxes' had no impact on these financial statements or the accounting polices applied in their preparation. In adopting the amendments to IAS 7 'Statement of cash flows' reconciliation disclosures have been provided in the 'Debt securities in issue' note to the financial statements to enable reconciliation to related amounts included within 'financing activities' in the cash flow statement.

New accounting standards issued by the IASB that are relevant to the Company and effective in future periods are presented in note 36.

1.4 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments and available-for-sale financial assets held at fair value. A summary of the material accounting policies of the Company are included within note 1.7.

The accounting policies set out in note 1.7 have been applied consistently to all periods presented in these financial statements.

1.5 Foreign currency translation

The Company's financial statements are presented in sterling, which is the functional currency of the Company.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement, except when recognised in other comprehensive income if relating to a qualifying cash flow hedge or available-for-sale assets. Non-monetary items (which are assets or liabilities which do not attach to a right to receive or an obligation to pay currency) measured at historical cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation.

1.6 Operating segments

The Company has issued debt securities which are traded in a public market and therefore falls within the scope of IFRS 8 'Operating Segments'. However, no discrete financial information on the performance of the Company is prepared nor regularly reviewed by the Company's chief operating decision maker (which has been determined to be the Group Executive Committee). The Company has therefore determined that it has no reportable operating segments and is not required to produce additional segmental disclosure.

Segmental performance disclosures of the Group, in which the financial statements of the Company are consolidated, are included in the consolidated financial statements of Virgin Money Holdings (UK) plc.

Note 1: Basis of preparation and accounting policies (continued)

1.7 Accounting policies

The accounting policies of the Company are set out below:

(a) *Interest income and expense*

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

This method calculates the amortised cost of a financial asset or liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or liability. The Company estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Company that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument, loan commitment fees and all other premiums and discounts.

Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised on the written down carrying value using the asset's original effective interest rate, being the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accrual basis in interest receivable or payable. Interest on available-for-sale (AFS) debt securities is recorded in interest receivable using the effective interest rate method.

(b) *Fees and commissions*

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided.

(c) *Other operating income*

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts.

(d) *Operating expenses*

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy (e).

> Staff costs

The Company accounts for the following components of employee costs on the following bases:

> *Short-term employee benefits*

Short-term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate. Cash bonus awards are recognised to the extent that the Company has a present obligation to its employees that can be measured reliably and are recognised over the period that employees are required to provide services.

> Other long-term employee benefits

Other long-term employee benefits include deferred cash bonus awards. Deferred cash bonus awards are recognised at the present value of the obligation at the reporting date. These costs are recognised over the period that employees are required to provide services.

> Retirement benefit obligations

A defined contribution plan is a post-employment benefit plan into which the Company pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in the income statement in the periods during which related employee services are fulfilled. The Company operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Company in independently administered funds.

> Leases

If the lease agreement in which the Company is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

Note 1: Basis of preparation and accounting policies (continued)

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease. Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made

(e) Share based payments

The Group operates a number of equity settled share based payment transactions in respect of services received from certain of its employees. Employees are employed by the Company but receive Virgin Money Holdings (UK) plc Ordinary Shares.

The value of the employee services received in exchange for awards granted under these schemes is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards (the vesting period).

All awards granted under current schemes are conditional shares which have service conditions. The Long Term Incentive Plan awards also have non-market performance conditions. No awards have market performance conditions and no share options have been granted in the current or prior year.

The employee expense is determined by reference to the fair value of the number of Virgin Money Holdings (UK) plc shares that are expected to vest. The fair value of the shares granted is based on market prices at the date of award. The determination of fair values excludes the impact of service conditions and any non-market performance conditions, which are included in the assumptions used to estimate the number of shares that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement, together with a corresponding adjustment to equity.

(f) Impairment losses

The Company assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if and only if there is a loss event (or events) that has occurred after initial recognition, and on or before the balance sheet date, that has an impact on the estimated future cash flows of the financial assets or groups of financial assets that can be reliably measured. Losses that are incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements

> Loans and receivables at amortised cost

The Company assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. Financial assets that are not individually significant are assessed on a collective basis, except for such assets where there are specific circumstances indicating evidence of impairment (for example loans that have entered possession or where fraud has been committed). Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Company about the following loss events:

- there is evidence of the customer or issuer experiencing financial difficulty;
- there is a breach of contract, such as a default or delinquency in repayments;
- the customer is granted a concession that would otherwise not be considered;
- the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - there are adverse changes in the payment status of borrowers in the portfolio; and
  - economic conditions that correlate with defaults on the assets in the portfolio.

If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. In assessing collective impairment for retail assets the Company uses statistical modelling of historic trends to assess the probability of a group of financial assets going into default and the subsequent loss incurred. Regular model monitoring is performed to ensure model assumptions remain appropriate.

Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an impairment allowance and the amount of the loss is recognised in the profit or loss.

Note 1: Basis of preparation and accounting policies (continued)

When a loan or receivable is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in profit or loss.

An allowance is also made in the case of accounts which may not currently be in arrears, where losses may have been incurred but not yet recognised. An increased allowance is held for accounts where an impairment trigger event has occurred which includes accounts benefitting from forbearance and those in arrears. Refer to note 30 for details of the forbearance policy.

> Available-for-sale financial assets

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. The loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit and loss.

(g) Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income. Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Company has adopted the Code of Practice on Taxation for Banks issued by HM Revenue & Customs.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(h) Financial instruments

> Financial assets

Management determines the classification of its financial instruments at initial recognition.

In line with IAS 39 'Financial Instruments: Recognition and Measurement' financial assets can be classified in the following categories:

- loans and receivables;
- available-for-sale;
- held to maturity; or
- financial assets at fair value through profit or loss

Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Company commits to purchase or sell the asset.

> Loans and receivables at amortised cost

The Company's loans and advances to banks and customers, and asset backed securities for which there is no active market, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Company has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

Note 1: Basis of preparation and accounting policies (continued)

> Available-for-sale financial assets

Available-for-sale financial assets are non-derivative assets that are either designated as available-for-sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally, but not exclusively, investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices.

They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models. With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss.

Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

> Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Company has the ability and intention to hold to maturity. No financial assets were classified as held to maturity during either the current or prior year.

> Financial assets at fair value through profit or loss

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in the income statement or other comprehensive income (refer policy (l)).

> Financial liabilities

The Company measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (l)). Borrowings, including deposits, debt securities in issue and amounts due to securitisation special purpose vehicles are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Company does not hold any financial liabilities classified as held for trading.

> Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

> Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in deposits from banks or customer deposits, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest rate method. Securities lent to counterparties are also retained in the financial statements.

> Derecognition of financial assets and liabilities

Derecognition is the point at which the Company ceases to recognise an asset or liability on its balance sheet. The Company's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Company transfers the financial assets to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Company has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Company transferring the right to receive the cash flows of the financial assets, but it does result in the Company assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised.

The Company derecognises financial liabilities only when the obligation specified in the contract is discharged, converted to shares, cancelled or has expired or is transferred to a third party. There were no transactions in the year where the Company transferred financial assets that should have been derecognised in their entirety.

Notes to the financial statements

Note 1: Basis of preparation and accounting policies (continued)

(i) *Loans and advances to banks*

The Company's loans and advances to banks are classified as loans and receivables.

(j) *Loans and advances to customers*

The Company's loans and advances to customers are classified as loans and receivables.

(k) *Available-for-sale financial assets*

The Company's debt securities and equity investments not in subsidiary undertakings are held as available-for-sale assets.

Equity instruments are classified as available-for-sale because they do not meet the definition of loans and receivables, have no defined maturity dates and are not derivatives or assets held at fair value through profit or loss.

(l) *Derivative financial instruments and hedge accounting*

The Company is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

The Company's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates and foreign exchange rates inherent in the Company's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially and subsequently at fair value. Fair values are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Where derivatives are not designated as part of an accounting hedge relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within accounting hedge relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Company documents at the inception of the accounting hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Company also documents its assessment both at inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Company designates certain derivatives as:

> Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

The most frequently used fair value hedges are:

- hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;
- hedging the interest rate risk of a portfolio of fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish micro fair value hedges for fixed rate investments; and
- hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps. This solution is used to establish micro fair value hedges for foreign currency denominated fixed rate investments.

(m) *Investments in subsidiaries*

Investments in subsidiaries are valued at cost less provision for impairment. Investments in subsidiaries are included in the Company's balance sheet, comprising equity investments in subsidiary entities. At each reporting date an assessment is undertaken to determine if there is any indication of impairment. This assessment can include reviewing factors such as the solvency, profitability and cash flows generated by the subsidiary. If there is an indication of impairment, an estimate of the recoverable amount is made. If the carrying value exceeds the recoverable amount then a provision for impairment is made to reduce the carrying value to the recoverable amount.

Note 1: Basis of preparation and accounting policies (continued)

(n) Funding for Lending Scheme

The Company participates in the Bank of England's Funding for Lending Scheme (FLS). The scheme allows the Company to receive Treasury bills in return for eligible collateral, including approved portfolios of loans and advances to customers.

Receipt of Treasury bills under the FLS does not involve the substantial transfer of the risks and rewards on the collateral, or the right to receive its related cash flows, hence the derecognition criteria outlined in policy (h) are not satisfied. Therefore the collateral assets will continue to be recognised in the financial statements and the Treasury bills are not separately recognised.

In the event that Treasury bills are utilised for repo transactions, the related collateral assets are categorised as pledged assets and the associated liability to the counterparty is recognised in the financial statements.

(o) Intangible assets and amortisation

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3- 10 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 13 'Fair Value Measurement'.

Expenditure incurred in relation to scoping, planning and researching the build of an asset as part of a project is expensed as incurred.

Development expenditure incurred on a project is capitalised only if the following criteria are met:

> an asset is created that can be identified;

> it is probable that the asset created will generate future economic benefits; and

> the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

Internally generated intangible assets relate to computer software and core banking platforms.

> Computer software

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Company from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

Costs associated with maintaining software are expensed as they are incurred.

> Banking platforms

Banking platforms primarily represent the construction of operating platforms, which are internally generated. Banking platforms are amortised on a straight line basis over 3 to 10 years.

> Impairment of intangible assets

Intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of intangible assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

Note 1: Basis of preparation and accounting policies (continued)

(p) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50-100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5-30 years
Computer equipment	3-5 years
Office equipment	3-10 years
Motor vehicles	4 years

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated.

> Impairment of tangible fixed assets

Tangible fixed assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amount, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on a fixed asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the fixed asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

(q) Other assets

Other assets include prepayments and other amounts the Company is due to receive from third parties in the normal course of business.

(r) Deposits from banks

Deposits from banks are initially measured at fair value, which is normally the proceeds received net of any directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method.

(s) Customer deposits

Customer deposits are initially measured at fair value, which is normally the proceeds received. Subsequent measurement is at amortised cost, using the effective interest rate method.

(t) Provisions

Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be estimated reliably.

Provisions for levies are recognised when the conditions that trigger the payment of the levy is met.

(u) Other liabilities

Deferred income represents amounts received in advance of the Company providing services, and will be recognised as income in profit or loss when the services have been provided.

Trade creditors and accruals represent amounts the Company is due to pay to third parties in the normal course of business. These include expense accruals, which have been incurred, but not yet billed.

Note 1: Basis of preparation and accounting policies (continued)

(v) Share capital

> Share capital

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

- they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and
- where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

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

> Share issue costs

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

> Dividends

Dividends are recognised in equity in the period in which they are approved by the Company's shareholders or paid.

(w) Other equity instruments

Issued financial instruments are recognised as equity where there is no contractual obligation to deliver either cash or another financial asset. The proceeds are included in equity, net of transaction costs. Distributions and other returns to equity holders are treated as a deduction from equity.

(x) Other reserves

> Revaluation reserve in respect of available-for-sale financial assets

The revaluation reserve in respect of available-for-sale financial assets represents the unrealised change in the fair value of available-for-sale investments since initial recognition.

(y) Contingent liabilities

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(z) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash and non-restricted balances with central banks.

(aa) Fair value of financial assets and liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Company will not fulfil an obligation), including the Company's own credit risk.

For the majority of instruments, fair value is determined with reference to quoted prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Where quoted prices are not available, fair value is based upon cash flow models, which use, wherever possible, independently sourced observable market parameters such as interest rate yield curves, currency rates and option volatilities. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction and is discounted at a risk free rate.

Refer to note 28 for a description of different levels within the fair value hierarchy. Levels are reviewed at each balance sheet date and this determines whether transfers between levels are required.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price - i.e. the fair value of consideration given or received. The Company does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Company's portfolio is fully collateralised. If an asset or a liability measured at fair value has a bid price and an ask price, the Company measures assets at bid price and liabilities at ask price.

Note 1: Basis of preparation and accounting policies (continued)

1.8 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires Management to make estimates and judgements in the application of accounting policies that affect the reported amounts of assets, liabilities, income and expense. Estimates and judgements are based on historical experience and Management's best knowledge of the amount. Due to the inherent uncertainty in making estimates and judgements, actual results in future periods may be based on amounts which differ from those estimates.

(a) Critical assumptions and sources of estimation uncertainty

The following areas are the critical assumptions concerning the future and the key sources of estimation uncertainty in the reporting period. These areas may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

> Effective interest rates

For financial instruments recorded at amortised cost, IAS 39 requires interest to be measured under the effective interest rate (EIR) method. For the Company this includes interest income earned on mortgages and credit cards, as well as interest expense paid on wholesale liabilities. The EIR rate is determined at inception based upon Management's best estimate of the future cash flows of the financial instrument.

In the event that these estimates are revised at a later date, a present value adjustment may be recognised in profit and loss. This adjustment includes an element that adjusts income previously recognised, as well as an element that adjusts for future interest not yet recognised. Such adjustments can introduce significant volatility. As such the EIR method introduces a source of estimation uncertainty. Management consider the most material risk of adjustment to be in relation to the application of EIR to the Company's credit card portfolio.

The Company offers a range of credit card products. Interest income is recorded under the EIR method, which provides a level yield over the life of the card. Management model expected future cash flows over the estimated customer life, restricted to a maximum of seven years, which is supported by observed experience. Income recognition can differ significantly from actual cash receipts over that period. Similarly, the selection of expected life for modelling purposes also has a material bearing on the EIR rate used for each cohort. A shorter modelling period results in a lower rate for revenue recognition. If the modelled period had been restricted to five years at origination, the profit for the year would have been reduced by approximately £25.2 million in 2017 and £15.8 million in 2016.

As at 31 December 2017 the EIR method gave rise to an adjustment of £159.8 million (2016: £81.8 million) to the balance sheet value of unsecured loans. This adjustment represented 5.3% (2016: 3.3%) of the balance sheet carrying value of unsecured loans. The movement in the year of £78.0 million was recognised as interest income.

In the calculation of EIR, Management uses estimates and assumptions of future customer behaviour. These include the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period. Should management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured lending cohorts were all reduced by 0.1%, the present value adjustment to interest income, in relation to the revised future cash flows, would be approximately £(10.2) million as at 31 December 2017.

A significant proportion of the Company's credit card portfolio includes customers within promotional periods. The level of repayment immediately post promotional period is a key sensitivity within the EIR assumptions. There is evidence to support the expected behaviour of customers after the end of promotional periods, however there is inherent risk that this data may not be indicative of actual future behaviour. If the proportion of customers who repay their balance post-promotion differs to Management's estimate it can have a material impact on the revised future cash flows.

To illustrate this, Management have undertaken a sensitivity on post-promotion payment rates for all cohorts which are still within their promotional periods at the end of 2017. For these cohorts, should the payment rate be 10% higher than forecast for the six months following end of promotion, Management estimate this would result in a negative present value adjustment to interest income of approximately £(30.8) million as at 31 December 2017. In such an adjustment, £(11.5) million would relate to write-off of income previously recognised, and £(19.3) million would adjust for future interest not yet recognised.

Note 1: Basis of preparation and accounting policies (continued)

> Impairment of loans and receivables

Management must make a best estimate of losses incurred at the balance sheet date when determining the appropriate allowance for impairment of loans and receivables. Judgement is required when individually assessing loans for impairment and significant estimation is required when using statistical models for collective assessment. The key assumptions used within the statistical models are based on behavioural and arrears status. These variables include measurement of probability of default, probability that default results in charge-off or possession, and any subsequent loss incurred in that event. In relation to measuring incurred loss the estimation of the period over which incurred losses emerge is also an area of estimation uncertainty.

Management consider that the measurement of allowance for impairment for a retail bank is a critical estimate. Whilst the estimates used to determine the appropriate balance sheet allowance are not currently considered to be a source of material uncertainty, it is acknowledged that the Company has observed historically low levels of customer arrears and default. Material change in future customer behaviours and unanticipated changes in the economic environment could result in higher losses being incurred in future periods.

The most significant estimation within the measurement of the secured impairment allowance is considered to be the estimation of house prices. To the extent that house prices differed adversely or positively by 10%, the impairment allowance would be an estimated £1.7 million higher (2016: £1.3 million) or £3.2 million lower (2016: £2.6 million) at 31 December 2017.

In relation to the measurement of the unsecured impairment allowance, the estimation of the period over which incurred losses emerge is considered to be the most significant estimation. To the extent that the emergence period of six months differs by +/-3 months, the impairment allowance would be an estimated £7.1 million higher (2016: £5.9 million) or £7.1 million lower (2016: £5.9 million) respectively.

> Fair value of financial assets and liabilities

Management must use estimation when calculating the fair value of financial instruments categorised as level 2 and level 3 (as defined by IFRS 13). In these instances the necessary valuation inputs are not observable and/or specific factors may need to be considered. Details of the Company's level 2 and level 3 financial instruments are included in note 28.

The most significant area of estimation uncertainty relates to the Company's level 2 derivative financial instruments, where valuations are not derived from quoted prices. The accuracy of fair value calculations would be affected by unexpected market movements and any inaccuracies within the discounted cash flow models used, particularly use of incorrect interest yield curves. For example, to the extent the interest yield curve differed by +/- 10 bps, the net impact on fair values of derivative financial instruments would be an estimated increase of £41.7 million (2016: £33.5 million) or decrease of £41.9 million (2016: £33.7 million) respectively.

(b) Critical judgements in applying accounting policies

The following are the critical judgements that have been made in the process of applying the Company's accounting policies that have the most significant effect on the amount recognised in the financial statements:

> Capitalisation of intangibles and assessment for impairment

Significant judgement is required when assessing whether the conditions of IAS 38 have been met to allow the capitalisation of project development costs as an intangible asset. During the reporting period the Company has incurred significant costs in relation to the development of the Company's digital banking programme. Following a detailed review of the programme and the nature of the costs incurred, Management have determined that the amount of £38.3 million meets the recognition criteria for capitalisation as an intangible asset.

Separately, Management judgement is required in assessing whether capitalised intangible assets or assets not yet in use exhibit any indicators of impairment at the reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made which may indicate the need for an impairment charge to be recognised. Management have assessed and reviewed intangible assets for the existence of impairment indicators. This exercise identified previous software development, with a carrying value of £4.8 million, which was discontinued in the year in light of a strategic decision to consolidate activities within the digital banking programme. An impairment charge of £4.8 million was recognised in the financial statements (2016: £nil).

Notes to the financial statements

Note 2: Net interest income

	2017 £m	2016 £m
Interest and similar income:		
Loans and advances to customers	**951.0**	936.6
– *of which relates to securitisation subordinated loan*	*5.8*	*7.3*
Loans and advances to banks	**0.4**	0.8
Interest receivable on loans and receivables	**951.4**	937.4
Available-for sale financial assets	**5.6**	8.9
Cash and balances at central banks	**6.3**	3.8
Other interest	**1.4**	1.6
Total interest and similar income	**964.7**	951.7
Interest and similar expense:		
Deposits from banks	**(16.5)**	(7.6)
Customer deposits	**(310.8)**	(370.2)
Debt securities in issue	**(4.3)**	(4.9)
Securitisation special purpose vehicles	**(29.3)**	(38.3)
Other	**(9.1)**	(11.4)
Total interest and similar expense	**(370.0)**	(432.4)
Net interest income	**594.7**	519.3

Interest accrued on impaired assets was £7.1 million (2016: £5.8 million).

Note 3: Fee and commission income

	2017 £m	2016 £m
On loans and advances to customers	**21.3**	19.5
Other fee and commission income	**0.3**	1.8
Total fee and commission income	**21.6**	21.3

Note 4: Other operating income

	2017 £m	2016 £m
Gains on sale of available-for-sale financial assets (refer note 13)	**8.4**	6.7
Other	**4.9**	5.2
Total other operating income	**13.3**	11.9

Notes to the financial statements

Note 5: Operating expenses

	2017 £m	2016 £m
Staff costs:		
Wages and salaries	**161.9**	160.6
Social security costs	**15.5**	14.6
Other pension costs	**10.9**	10.7
Employee share schemes	**9.9**	12.8
	198.2	198.7
Premises and equipment:		
Hire of equipment	**4.6**	4.6
Rent and rates	**14.0**	13.9
Other property costs	**11.0**	9.6
	29.6	28.1
Other expenses:		
Marketing costs	**20.8**	21.0
Telecommunications and IT	**18.5**	17.2
Professional fees	**22.1**	19.4
Other	**8.4**	23.4
	69.8	81.0
Depreciation and amortisation:		
Depreciation of tangible fixed assets	**8.0**	7.2
Amortisation of intangible assets	**21.7**	14.0
Impairment of intangible assets	**4.8**	–
	34.5	21.2
Total operating expenses	**332.1**	329.0

Average headcount

The monthly average number of persons (including Directors) employed by the Company during the year was as follows:

	2017	2016
Full time	**2,413**	2,394
Part time	**811**	746
Total	**3,224**	3,140

Retirement benefit obligations

The Company operates a defined contribution pension scheme, the Virgin Money (2011) Pension Scheme, for its Directors and employees. The assets of the schemes are held separately from those of the Company in independently administered funds.

The Company made contributions of £10.9 million (2016: £10.7 million) during the year. There were no contributions overdue at the year end (2016: £nil).

Fees payable to the auditors

During the year the Company obtained the following services from the Company's auditors as detailed below:

	2017 £m	2016 £m
Fees payable for the audit of the Company's Annual Report and Accounts	**0.9**	0.4
Audit-related assurance services	**0.1**	0.1
Total audit and audit-related fees	**1.0**	0.5
Other non-audit fees:		
Other services	**0.1**	–
Total fees payable to the auditors by the Company	**1.1**	0.5

Note 6: Share based payments

All share based payments charges relate to equity settled schemes.

The scheme details are summarised below.

	Award plan	Eligible employees	Nature of award	Vesting conditions[1]	Issue dates[2]
(A)	Long term incentive plan	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances and achievement of performance conditions	2015, 2016 & 2017
(B)	Deferred bonus share plan	Selected senior employees	Deferred bonus-conditional share award	Continuing employment or leavers in certain circumstances	2014, 2015, 2016 & 2017
(C)	Phantom share award	Selected senior employees	Deferred bonus-conditional share award	Continuing employment or leavers in certain circumstances	2012 & 2013
(D)	IPO incentive scheme	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(E)	Recruitment award	Two senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(F)	IPO share award	All employees excluding the Group's Executive Committee	Conditional share award	Continuing employment or leavers in certain circumstances	2014

1 All awards have vesting conditions and therefore some may not vest.

2 Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme. All share awards relate to Ordinary Shares in the Company's parent undertaking, Virgin Money Holdings (UK) plc.

The terms of the equity settled schemes the Group operated during the year are as follows:

(A) Long term incentive plan (LTIP)

The LTIP introduced in 2014 is aimed at delivering shareholder value by linking the receipt of shares to performance measures that are based on delivering the Group's strategic objectives over a 3 year period. Awards are made within limits set by the rules of the plan.

The performance period for the 2015 awards ended on 31 December 2017. Based on performance against the targets set, 65.3 per cent of the 2015 awards will vest.

During 2017 selected senior employees of the Company were granted up to a maximum of 1,382,905 Ordinary Shares under the LTIP scheme. Awards granted under the LTIP have performance and service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2017 was £3.27 based on market prices at the date of grant.

(B) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short term incentive plan for Executive Directors and other senior managers of the Company. Share awards for the deferred element of 2017 bonuses will be granted under this scheme in 2018.

During 2017, selected senior employees of the Company were granted up to a maximum of 1,833,349 Ordinary Shares under the scheme. This number includes awards granted to senior employees who joined the Company in 2017 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Company. Awards granted under the scheme have service conditions, with vesting dates prescribed for each participant. The weighted-average fair value of awards granted during 2017 was £3.26 based on market prices at the date of grant.

(C) – (F) Phantom share award, IPO incentive scheme, Recruitment award and IPO share award

These schemes relate to awards issued in previous years. No awards were granted under these schemes in 2017 (2016: none).

Note 6: Share based payments (continued)

Movement in share options and conditional shares

	Virgin Money Holdings (UK) plc Ordinary Shares				
	Interest in share options[1]	**Long term incentive plan**	**Deferred bonus share plan**	**Phantom share award**	**IPO share award**
Outstanding at 1 January 2017	**625,328**	**2,651,338**	**2,098,649**	**2,044,480**	**68,920**
Granted in year	**–**	**1,382,905**	**1,833,349**	**–**	**–**
Exercised or vested in year	**–**	**(47,021)**	**(1,105,235)**	**(1,480,940)**	**(66,304)**
Forfeited in year	**–**	**(153,464)**	**(124,782)**	**–**	**(2,616)**
Outstanding at 31 December 2017	**625,328**	**3,833,758**	**2,701,981**	**563,540**	**–**
Of which exercisable	**625,328**	**–**	**–**	**–**	**–**

	Virgin Money Holdings (UK) plc Ordinary Shares						
	Interest in share options[1]	Long term incentive plan	Deferred bonus share plan	Phantom share award	IPO incentive scheme	Recruitment award	IPO share award
Outstanding at 1 January 2016	625,328	1,399,453	1,157,800	3,061,820	332,334	175,810	139,041
Granted in year	–	1,572,717	1,695,266	–	–	–	–
Exercised or vested in year	–	(98,349)	(754,417)	(950,550)	(305,676)	(175,810)	(68,885)
Forfeited in year	–	(222,483)	–	(66,790)	(26,658)	–	(1,236)
Outstanding at 31 December 2016	625,328	2,651,338	2,098,649	2,044,480	–	–	68,920
Of which exercisable	625,328	–	–	–	–	–	–

1 This scheme was set up for Sir David Clementi, who was Chairman for the period from October 2011 to May 2015. All share options granted under the scheme had vested prior to 1 January 2016. No share options have been exercised during 2017 or 2016. The weighted-average exercise price for options outstanding at 1 January 2017 and 31 December 2017 was £2.15. The options outstanding will expire 10 years from the date of Virgin Money Holdings (UK) plc's listing if not exercised.

Note 7: Allowance for impairment losses on loans and receivables

	2017			2016		
	On secured loans £m	**On unsecured Loans £m**	**Total £m**	On secured loans £m	On unsecured loans £m	Total £m
At 1 January	**10.6**	**39.5**	**50.1**	8.7	31.2	39.9
Advances written off	**(0.7)**	**(34.2)**	**(34.9)**	(0.8)	(26.6)	(27.4)
Charge to the income statement	**2.2**	**42.0**	**44.2**	2.7	34.9	37.6
As at 31 December	**12.1**	**47.3**	**59.4**	10.6	39.5	50.1

Of the total allowance in respect of loans and advances to customers, £57.5 million (2016: £49.4 million) was assessed on a collective basis.

Notes to the financial statements

Note 8: Taxation

A. Analysis of the tax charge for the year

	2017 £m	2016 £m
UK corporation tax		
Current year corporation tax	**(58.6)**	(33.0)
Group relief payment	**(0.3)**	(0.4)
Adjustments in respect of prior years	**(0.6)**	0.5
Current tax charge	**(59.5)**	(32.9)
Deferred tax (refer note 18)		
Origination and reversal of temporary differences	**(11.8)**	(11.3)
Adjustments in respect of prior years	**0.9**	0.2
Effect of changes in tax rates	**(0.4)**	(0.1)
Deferred tax charge	**(11.3)**	(11.2)
Tax charge	**(70.8)**	(44.1)

Analysis of tax charge recognised in Other Comprehensive Income:

	2017 £m	2016 £m
Deferred tax		
Available-for-sale financial assets	**(0.1)**	(1.7)
Total charge	**(0.1)**	(1.7)

B. Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2017 £m	2016 £m
Profit before tax	**263.1**	159.7
Tax charge at standard tax rate of 19.25% (2016: 20%)	**(50.6)**	(31.9)
Factors affecting (charge) / credit:		
Disallowed items	**(0.9)**	(0.9)
Bank corporation tax surcharge	**(19.2)**	(10.8)
UK corporation tax rate changes	**(0.4)**	(0.1)
Deferred tax charge in respect of share schemes	**–**	(1.1)
Adjustments in respect of prior years	**0.3**	0.7
Total tax charge	**(70.8)**	(44.1)

The main rate of corporation tax reduced from 20% to 19% on 1 April 2017, and will reduce further to 17% on 1 April 2020 in accordance with the Finance Act 2016.

The charge in respect of the corporation tax surcharge for banks which was introduced from 1 January 2016 is £19.2 million in the year ended 31 December 2017. The surcharge imposes an 8% charge on the banking profits of the Company (less a £25 million allowance against those profits).

Notes to the financial statements

Note 9: Analysis of financial assets and financial liabilities by measurement basis

	Held at amortised cost £m	Fair value through profit or loss £m	Loans and receivables £m	Available for sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as Fair value hedges £m	Total £m
2017							
Financial assets							
Cash and balances at central banks	**–**	**–**	**2,579.0**	**–**	**–**	**–**	**2,579.0**
Derivative financial instruments	**–**	**–**	**–**	**–**	**10.5**	**11.5**	**22.0**
Loans and receivables:							
Loans and advances to banks	**–**	**–**	**122.9**	**–**	**–**	**–**	**122.9**
Loans and advances to customers	**–**	**–**	**37,099.9**	**–**	**–**	**–**	**37,099.9**
Debt securities	**–**	**–**	**0.3**	**–**	**–**	**–**	**0.3**
Available-for-sale financial assets	**–**	**–**	**–**	**902.4**	**–**	**–**	**902.4**
Other assets	**–**	**–**	**51.1**	**–**	**–**	**–**	**51.1**
Total financial assets	**–**	**–**	**39,853.2**	**902.4**	**10.5**	**11.5**	**40,777.6**
Non financial assets							**241.3**
Total assets							**41,018.9**
Financial liabilities							
Deposits from banks	**5,377.7**	**–**	**–**	**–**	**–**	**–**	**5,377.7**
Customer deposits	**30,808.4**	**–**	**–**	**–**	**–**	**–**	**30,808.4**
Derivative financial instruments	**–**	**–**	**–**	**–**	**10.5**	**82.6**	**93.1**
Amounts due to securitisation special purpose vehicles	**2,300.4**	**–**	**–**	**–**	**–**	**–**	**2,300.4**
Debt securities in issue	**302.8**	**–**	**–**	**–**	**–**	**–**	**302.8**
Other liabilities	**210.5**	**–**	**–**	**–**	**–**	**–**	**210.5**
Total financial liabilities	**38,999.8**	**–**	**–**	**–**	**10.5**	**82.6**	**39,092.9**
Non financial liabilities							**46.8**
Total liabilities							**39,139.7**
Equity							**1,879.2**
Total liabilities and equity							**41,018.9**

Notes to the financial statements

Note 9: Analysis of financial assets and financial liabilities by measurement basis (continued)

	Held at amortised cost £m	Fair value through profit or loss £m	Loans and receivables £m	Available for sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as Fair value hedges £m	Total £m
2016							
Financial assets							
Cash and balances at central banks	–	–	786.3	–	–	–	786.3
Derivative financial instruments	–	–	–	–	14.1	21.1	35.2
Loans and receivables:							
Loans and advances to banks	–	–	229.7	–	–	–	229.7
Loans and advances to customers	–	–	32,708.9	–	–	–	32,708.9
Debt securities	–	–	0.7	–	–	–	0.7
Available-for-sale financial assets	–	–	–	858.8	–	–	858.8
Other assets	–	–	62.9	–	–	–	62.9
Total financial assets	–	–	33,788.5	858.8	14.1	21.1	34,682.5
Non financial assets							232.7
Total assets							34,915.2
Financial liabilities							
Deposits from banks	2,129.7	–	–	–	–	–	2,129.7
Customer deposits	28,106.3	–	–	–	–	–	28,106.3
Derivative financial instruments	–	–	–	–	18.5	206.8	225.3
Amounts due to securitisation special purpose vehicles	2,143.6	–	–	–	–	–	2,143.6
Debt securities in issue	305.8	–	–	–	–	–	305.8
Other liabilities	185.6	–	–	–	–	–	185.6
Total financial liabilities	32,871.0	–	–	–	18.5	206.8	33,096.3
Non financial liabilities							127.7
Total liabilities							33,224.0
Equity							1,691.2
Total liabilities and equity							34,915.2

Note 10: Derivative financial instruments

The fair values and notional amounts of assets and liabilities recognised within Derivative financial instruments are set out in the following table.

	As at 31 December 2017			As at 31 December 2016		
	Contract/ notional amount £m	**Asset fair value £m**	**Liability fair value £m**	Contract/ notional amount £m	Asset fair value £m	Liability fair value £m
Derivatives in accounting hedge relationships						
Designated as fair value hedges:						
Interest rate derivatives (gross)	**23,314.7**	**61.7**	**(91.1)**	21,584.8	34.8	(219.8)
Less: contracts centrally cleared	**(17,360.6)**	**(50.2)**	**8.5**	(8,194.1)	(13.7)	13.0
Interest rate derivatives (net)	**5,954.1**	**11.5**	**(82.6)**	13,390.7	21.1	(206.8)
Total derivative assets/(liabilities)-in accounting hedge relationships	**5,954.1**	**11.5**	**(82.6)**	13,390.7	21.1	(206.8)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives (gross)	**8,244.5**	**8.1**	**(13.1)**	8,676.6	16.5	(26.1)
Less: contracts centrally cleared	**(4,029.7)**	**(0.8)**	**5.7**	(4,952.2)	(6.0)	11.4
Interest rate derivatives (net)	**4,214.8**	**7.3**	**(7.4)**	3,724.4	10.5	(14.7)
Currency derivatives	**76.0**	**3.2**	**(3.1)**	56.0	3.6	(3.8)
Equity and other options	**3.0**	**–**	**–**	1.2	–	–
Total derivative assets/(liabilities)-in economic hedging relationship but not in accounting hedge relationships	**4,293.8**	**10.5**	**(10.5)**	3,781.6	14.1	(18.5)
Total recognised derivative assets/(liabilities)	**10,247.9**	**22.0**	**(93.1)**	17,172.3	35.2	(225.3)

The notional amount of the contracts does not represent the Company's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Company should the counterparty default. To reduce credit risk the Company uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in note 30.

The fair values and notional amounts shown in the line 'Total recognised derivative assets/(liabilities)' above reflect amounts relating only to contracts that are not centrally cleared. Centrally cleared interest rate derivatives are set off in the balance sheet as they meet the offsetting criteria under IAS 32 (refer note 29).

Fair value gains/(losses) on financial instruments

	2017 £m	2016 £m
Fair value gains/(losses) from derivatives designated as fair value hedges	**104.8**	(70.0)
Fair value (losses)/gains from underlying hedged risk	**(99.4)**	81.8
Fair value gain from fair value hedge accounting[1]	**5.4**	11.8
Fair value gains/(losses) from other derivatives[2]	**4.4**	(38.0)
Fair value gains/(losses) on financial instruments	**9.8**	(26.2)

1 Gains or losses from fair value hedges can arise where there is an IAS 39 hedge accounting relationship in place and either:
- the fair value of the derivative was not exactly offset by the change in fair value attributable to the hedged risk; or
- the derivative was designated in or dedesignated from the IAS 39 hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.

2 Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

Notes to the financial statements

Note 11: Loans and advances to banks

	2017 £m	2016 £m
Cash collateral pledged to banks (refer note 14)	**89.7**	179.1
Other lending to banks	**33.2**	50.6
Total loans and advances to banks	**122.9**	229.7

Note 12: Loans and advances to customers

	2017 £m	2016 £m
Advances secured on residential property not subject to securitisation	**21,878.7**	19,375.2
Advances secured on residential property subject to securitisation	**5,438.5**	4,907.8
	27,317.2	24,283.0
Residential buy-to-let loans not subject to securitisation	**6,367.3**	5,468.4
Total loans and advances to customers secured on residential property	**33,684.5**	29,751.4
Unsecured receivables not subject to securitisation	**3,071.4**	2,486.6
Amounts due from group companies	**359.7**	341.8
Total loans and advances to customers before allowance for impairment losses	**37,115.6**	32,579.8
Allowance for impairment losses on loans and receivables (refer note 7)	**(59.4)**	(50.1)
Total loans and advances to customers excluding portfolio hedging	**37,056.2**	32,529.7
Fair value of portfolio hedging	**43.7**	179.2
Total loans and advances to customers	**37,099.9**	32,708.9

The fair value of portfolio hedging represents an accounting adjustment which offsets the fair value movement on derivatives designated in IAS 39 hedge accounting relationships with the mortgage portfolio. Such relationships are established to protect the Company from interest rate risk on fixed rate products (refer note 10).

For collateral held in respect of the values included in the table above, please refer to note 30.

Securitisation

Securitisation is a means used by the Company to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their carrying value to SPVs and have been funded through the issue of amortising mortgage backed securities to investors with a proportion retained by the Company. The transfers do not meet the criteria for asset derecognition in IAS 39 'Financial Instruments: Recognition and Measurement' as the Company has retained the risks and rewards of the assets.

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. The table also sets out the fair value of financial assets where the counterparty to the associated liabilities has recourse to those financial assets. There were no transactions in the year where the Company transferred financial assets that should have been derecognised in their entirety.

	2017		2016	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Transferred assets	**5,438.5**	**5,512.6**	4,907.8	4,982.7
Associated liabilities	**2,300.4**	**2,300.4**	2,143.6	2,143.6

Notes to the financial statements

Note 13: Available-for-sale financial assets

	2017 £m	2016 £m
At 1 January	**858.8**	1,296.9
Additions	**541.5**	670.0
Disposals (sales and redemptions)	**(483.2)**	(1,111.1)
Exchange differences	**1.2**	0.1
Changes due to amortisation and accrued interest	**(4.9)**	(11.6)
Net (losses)/gains on changes in fair value	**(11.0)**	14.5
At 31 December	**902.4**	858.8

Gains on sale of available-for-sale financial assets amounted to £8.4 million (2016: £6.7 million).

Further analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in note 30. All available-for-sale assets have been individually assessed for impairment and following this assessment no write down of assets was required.

Note 14: Collateral pledged and received

The Company receives and accepts collateral in the form of cash and marketable securities in respect of derivatives, sale and repurchase and reverse sale and repurchase agreements, and secured loans.

Collateral in respect of derivatives is subject to the standard industry terms of International Swaps and Derivatives Association (ISDA) Credit Support Annex. This means that securities received or given as collateral can be pledged or sold during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral.

At 31 December 2017 cash collateral of £98.2 million had been pledged by the Company, comprising £89.7 million recognised within loans and advances to banks and £8.5 million within other assets (2016: £233.0 million, comprising £179.1 million recognised within loans and advances to banks and £53.9 million within other assets) and £52.6 million (2016: £11.1 million) has been received as cash collateral by the Company, of which £11.7 million (2016: £11.1 million) is recognised within deposits from banks and £40.9 million (2016: £nil) within other liabilities.

At 31 December 2017 available-for-sale financial assets of £nil (2016: £10.6 million) had been pledged as collateral in respect of derivative transactions.

At 31 December 2017 loans and advances of £6,219.8 million (2016: £2,302.3 million) are pledged as collateral in respect of secured loans and sale and repurchase agreements under terms that are usual and customary for such activities.

Notes to the financial statements

Note 15: Investments in subsidiary undertakings

The following were subsidiaries of the Company during the year:

Name	Class of share	Holding
Direct holdings		
Eagle Place Covered Bonds LLP[1,2]	N/A[3]	N/A[3]
Northern Rock Limited[1,2]	Ordinary	100%

1 Dormant entities.
2 Registered office: Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.
3 The entity does not have share capital.

The following companies are Special Purpose Vehicles (SPVs) established in connection with the Company's securitisation programme. Judgement has been used to determine whether the Company has control over these entities and should account for them as subsidiaries. Although the Company has no direct or indirect ownership interest in these companies, they are accounted for as subsidiaries, because they are principally engaged in providing a source of long-term funding to the Company. This means the Company is exposed to the rights of variable returns from its involvement in the activities of the SPVs and has the ability to affect those returns through its power over these entities.

Name	Nature of business
Gosforth Funding 2011-1 plc[4]	Issue of securitised notes
Gosforth Funding 2012-1 plc[4]	Issue of securitised notes
Gosforth Funding 2012-2 plc[4]	Issue of securitised notes
Gosforth Funding 2014-1 plc[5]	Issue of securitised notes
Gosforth Funding 2015-1 plc[5]	Issue of securitised notes
Gosforth Funding 2016-1 plc[5]	Issue of securitised notes
Gosforth Funding 2016-2 plc[5]	Issue of securitised notes
Gosforth Funding 2017-1 plc[5]	Issue of securitised notes
Gosforth Mortgages Trustee 2011-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2012-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2012-2 Limited[4]	Trust
Gosforth Mortgages Trustee 2014-1 Limited[5]	Trust
Gosforth Mortgages Trustee 2015-1 Limited[5]	Trust
Gosforth Mortgages Trustee 2016-1 Limited[5]	Trust
Gosforth Mortgages Trustee 2016-2 Limited[5]	Trust
Gosforth Mortgages Trustee 2017-1 Limited[5]	Trust
Gosforth Holdings 2011-1 Limited[4]	Holding company
Gosforth Holdings 2012-1 Limited[4]	Holding company
Gosforth Holdings 2012-2 Limited[4]	Holding company
Gosforth Holdings 2014-1 Limited[5]	Holding company
Gosforth Holdings 2015-1 Limited[5]	Holding company
Gosforth Holdings 2016-1 Limited[5]	Holding company
Gosforth Holdings 2016-2 Limited[5]	Holding company
Gosforth Holdings 2017-1 Limited[5]	Holding company

4 These companies are in the process of liquidation and their registered office is C/O KPMG LLP, 8 Princes Parade, Liverpool, L3 1QH.
5 Registered office: Fifth Floor, 100 Wood Street, London, EC2V 7EX.

Notes to the financial statements

Note 16: Intangible assets

	Software £m	Banking platforms £m	Total £m
Cost:			
At 1 January 2016	95.9	21.6	117.5
Additions	31.6	–	31.6
Disposals	(2.1)	–	(2.1)
At 31 December 2016	125.4	21.6	147.0
Additions	**36.0**	**38.3**	**74.3**
Disposals	**(5.7)**	**–**	**(5.7)**
At 31 December 2017	**155.7**	**59.9**	**215.6**
Accumulated amortisation and impairment:			
At 1 January 2016	51.6	2.9	54.5
Charge for the year	10.4	3.6	14.0
Disposals	(2.1)	–	(2.1)
At 31 December 2016	59.9	6.5	66.4
Charge for the year	**18.1**	**3.6**	**21.7**
Disposals	**(5.7)**	**–**	**(5.7)**
Impairment	**4.8**	**–**	**4.8**
At 31 December 2017	**77.1**	**10.1**	**87.2**
Balance sheet amount at 31 December 2017	**78.6**	**49.8**	**128.4**
Balance sheet amount at 31 December 2016	65.5	15.1	80.6

Within Banking platforms at 31 December 2017 is £38.3 million of expenditure relating to the development of the Company's digital banking programme.

The impairment charge of £4.8 million in the year represents previous software development which has been discontinued in light of a strategic decision to consolidate activities within the digital banking programme.

Note 17: Tangible fixed assets

	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Total £m
Cost:			
At 1 January 2016	60.4	43.7	104.1
Additions	1.8	6.8	8.6
Disposals	(0.6)	(3.0)	(3.6)
At 31 December 2016	61.6	47.5	109.1
Additions	**–**	**5.7**	**5.7**
Disposals	**–**	**(0.1)**	**(0.1)**
At 31 December 2017	**61.6**	**53.1**	**114.7**
Accumulated depreciation and impairment:			
At 1 January 2016	6.6	22.9	29.5
Charge for the year	1.7	5.5	7.2
Disposals	(0.5)	(2.9)	(3.4)
At 31 December 2016	7.8	25.5	33.3
Charge for the year	**1.7**	**6.3**	**8.0**
Disposals	**–**	**(0.1)**	**(0.1)**
At 31 December 2017	**9.5**	**31.7**	**41.2**
Balance sheet amount at 31 December 2017	**52.1**	**21.4**	**73.5**
Balance sheet amount at 31 December 2016	53.8	22.0	75.8

Note 18: Deferred tax

Deferred tax assets / (liabilities)	2017 £m	2016 £m
Accelerated capital allowances	**9.8**	11.7
Tax losses carried forward	**0.8**	12.6
Change in accounting basis on adoption of IFRS	**(3.3)**	(4.1)
Other temporary differences	**5.2**	4.2
Revaluation reserve in respect of available-for-sale financial assets	**(2.1)**	(2.6)
Total deferred tax assets	**10.4**	21.8

The movement in the net deferred tax balance is as follows:

	2017 £m	2016 £m
At 1 January	**21.8**	35.0
Income statement (charge)/credit (refer note 8)		
Accelerated capital allowances	**(1.9)**	(2.0)
Tax losses carried forward	**(11.8)**	(9.3)
Other temporary differences	**2.4**	0.1
	(11.3)	(11.2)
Amounts charged to equity:		
Share based payments	**–**	(0.3)
Revaluation reserve in respect of available-for-sale financial assets	**(0.1)**	(1.7)
	(0.1)	(2.0)
At 31 December	**10.4**	21.8

Note 19: Other assets

	2017 £m	2016 £m
Trade debtors	**2.9**	14.6
Prepayments and accrued income	**39.8**	27.7
Amounts owed from related parties	**4.0**	3.9
Other	**33.4**	71.2
Total other assets	**80.1**	117.4

Included within 'Other' assets are amounts receivable from clearing houses on centrally cleared derivative financial instruments of £8.5 million (2016: £50.7 million) recorded on a net basis.

Note 20: Deposits from banks

	2017 £m	2016 £m
Liabilities in respect of securities sold under repurchase agreements	**1,130.0**	850.0
Secured loans	**4,236.0**	1,268.0
Other deposits from banks	**11.7**	11.7
Total deposits from banks	**5,377.7**	2,129.7

Secured loans relate to the Company's drawings from the Bank of England's Term Funding Scheme.

Notes to the financial statements

Note 21: Customer deposits

	2017 £m	2016 £m
Savings and investment accounts	**30,393.0**	27,762.7
Personal current accounts	**415.4**	343.6
Total customer deposits	**30,808.4**	28,106.3

Note 22: Debt securities in issue

	Medium term notes £m
At 1 January 2016	297.5
Amortisation of issue costs and hedge accounting adjustments	8.3
At 31 December 2016	305.8
Amortisation of issue costs and hedge accounting adjustments	**(3.0)**
At 31 December 2017	**302.8**

The notes have a nominal value of £300 million at a coupon of 2.25% per annum and will be repayable on 21 April 2020. They were issued as part of the Company's £3 billion Global Medium Term Note programme.

Note 23: Other liabilities

	2017 £m	2016 £m
Trade creditors and accruals	**64.3**	57.3
Provisions	**7.4**	8.5
Deferred income	**2.2**	2.9
Accrued interest	**108.4**	124.4
Amounts owed to subsidiary undertakings	**0.1**	0.9
Other liabilities	**51.2**	102.5
Total other liabilities	**233.6**	296.5

Deferred income represents income advanced from partners that will be recognised in future periods.

Accrued interest primarily represents interest which has accrued on savings and investment accounts.

Note 24: Share capital

	2017 £m	2016 £m
Share capital (allotted, called up and fully paid)[1]	**1,400.0**	1,400.0
At 31 December	**1,400.0**	1,400.0

1 Total Ordinary Shares by number 1,400.0 million with a nominal value of £1, amounting to £1,400.0 million.

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Company. All Ordinary Shares in issue in the Company rank equally and carry the same voting rights and the same rights to receive dividends and other distributions declared or paid by the Company.

No dividends were paid in 2017 or 2016.

Note 25: Other equity instruments

The Company issued £230.0 million of Fixed Rate Resettable Additional Tier 1 (AT1) securities to its parent company on 10 November 2016. This issue is treated as an equity instrument in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £nil. Dividends and other returns to equity holders are treated as a deduction from equity. The principal terms of the securities are described below:

> the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;

> the securities bear a fixed rate of interest of 8.75% from the issue date until the first reset date on 10 November 2021;

> interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion at all times, and for any reason, to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;

> the securities are perpetual with no fixed redemption date and are repayable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and

> all AT1 securities are subject to an automatic write-down to £nil, should the Common Equity Tier 1 ratio of the Company, or its parent company, fall below 7.0% as specified in the terms. Following such write-down the securities will convey no rights to repayment of the principal amount or any unpaid interest.

Note 26: Other reserves

Revaluation reserve in respect of available-for-sale financial assets	2017 £m	2016 £m
At 1 January	**4.1**	(0.3)
Net gains from changes in fair value	**2.6**	52.8
Net gains on disposal transferred to income statement	**(13.5)**	(38.3)
Amounts transferred to income statement due to hedge accounting	**11.4**	(8.4)
Taxation	**(0.1)**	(1.7)
At 31 December	**4.5**	4.1

Note 27: Contingent liabilities and commitments

Contingent liabilities

The Board is not aware of any significant contingent liabilities as at 31 December 2017 (2016: £nil). The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

The Board does not expect the ultimate resolution of any other threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Company.

Loan commitments

Contractual amounts to which the Company is committed for extension of credit to customers.

	2017 £m	2016 £m
Not later than 1 year	**5,815.9**	4,854.3
Later than 1 year and not later than 5 years	**97.1**	88.2
Later than 5 years	**280.5**	346.6
Total loan commitments	**6,193.5**	5,289.1

Operating lease commitments – land and buildings

Minimum future lease payments under non-cancellable operating leases.

	2017 £m	2016 £m
Not later than 1 year	**7.0**	6.7
Later than 1 year and not later than 5 years	**24.9**	23.5
Later than 5 years	**18.3**	20.0
Total operating lease commitments – land and buildings	**50.2**	50.2

Operating lease commitments – other operating leases

Minimum future lease payments under non-cancellable operating leases.

	2017 £m	2016 £m
Not later than 1 year	**4.6**	4.6
Later than 1 year and not later than 5 years	**–**	4.6
Later than 5 years	**–**	–
Total operating lease commitments – other operating leases	**4.6**	9.2

Capital commitments

Capital commitments for the acquisition of fixed assets.

	2017 £m	2016 £m
Not later than 1 year	**1.1**	1.0
Later than 1 year and not later than 5 years	**–**	–
Later than 5 years	**–**	–
Total capital commitments	**1.1**	1.0

Notes to the financial statements

Note 28: Fair value of financial assets and financial liabilities

(1) Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Company's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy (h) in note 1 sets out the key principles for estimating the fair values of the financial instruments.

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
2017					
Cash and balances at central banks	**–**	**2,579.0**	**–**	**2,579.0**	**2,579.0**
Loans and advances to banks	**–**	**122.9**	**–**	**122.9**	**122.9**
Loans and advances to customers	**–**	**359.6**	**36,951.6**	**37,311.2**	**37,099.9**
Debt securities classified as loans and receivables	**0.3**	**–**	**–**	**0.3**	**0.3**
Available-for-sale financial assets	**–**	**–**	**0.3**	**0.3**	**0.3**
Other assets	**–**	**51.1**	**–**	**51.1**	**51.1**
Total financial assets	**0.3**	**3,112.6**	**36,951.9**	**40,064.8**	**39,853.5**
Deposits from banks	**–**	**5,377.7**	**–**	**5,377.7**	**5,377.7**
Customer deposits	**–**	**30,800.5**	**–**	**30,800.5**	**30,808.4**
Amounts due to securitisation special purpose vehicles	**–**	**2,300.4**	**–**	**2,300.4**	**2,300.4**
Debt securities in issue	**305.1**	**–**	**–**	**305.1**	**302.8**
Other liabilities	**–**	**210.5**	**–**	**210.5**	**210.5**
Total financial liabilities	**305.1**	**38,689.1**	**–**	**38,994.2**	**38,999.8**

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
2016					
Cash and balances at central banks	–	786.3	–	786.3	786.3
Loans and advances to banks	–	229.7	–	229.7	229.7
Loans and advances to customers	–	341.8	32,514.0	32,855.8	32,708.9
Debt securities classified as loans and receivables	0.7	–	–	0.7	0.7
Available-for-sale financial assets	–	–	0.3	0.3	0.3
Other assets	–	62.9	–	62.9	62.9
Total financial assets	0.7	1,420.7	32,514.3	33,935.7	33,788.8
Deposits from banks	–	2,129.7	–	2,129.7	2,129.7
Customer deposits	–	28,222.7	–	28,222.7	28,106.3
Amounts due to securitisation special purpose vehicles	–	2,143.6	–	2,143.6	2,143.6
Debt securities in issue	310.7	–	–	310.7	305.8
Other liabilities	–	185.6	–	185.6	185.6
Total financial liabilities	310.7	32,681.6	–	32,992.3	32,871.0

Fair value hierarchy

There are three levels to the hierarchy as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

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

Valuation methods for calculations of fair values of financial assets and liabilities recognised at cost are set out on the following page:

Note 28: Fair value of financial assets and financial liabilities (continued)

Cash and balances at central banks

Fair value approximates to carrying value because cash and balances at central banks have minimal credit losses and are either short-term in nature or reprice frequently.

Loans and advances to banks

Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Loans and advances to customers

The Company provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Company. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, the Company's policy is to hedge fixed rate loans in respect of interest rate risk, which limits the Company's exposure to this difference in value to be within the Company's risk appetite.

Loans and advances to customers are categorised as level 3 as unobservable prepayment rates are applied.

Debt securities classified as loans and receivables

Fair values are based on quoted prices where available or estimated by discounting cash flows using market rates.

Available-for-sale financial assets

These are unquoted equity securities held by the Company and relating to participation in banking and credit card operations. They are categorised as level 3 as the fair value of these securities cannot be reliably measured, due to the lack of equivalent instruments with observable prices.

Other assets and liabilities

This includes amounts owed from/to related undertakings (excluding securitisation special purpose vehicles). Fair value is deemed to approximate to the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Company for deposits of similar remaining maturities.

Debt securities in issue

Fair values are based on quoted prices.

Amounts due to securitisation special purpose vehicles

Fair value was estimated by discounting cash flows using market rates where practicable or rates offered by other financial institutions for loans with similar characteristics.

Notes to the financial statements

Note 28: Fair value of financial assets and financial liabilities (continued)

(2) Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy (h) in note 1 sets out the key principles for estimating the fair values of financial instruments.

2017	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Derivative financial instruments	**–**	**22.0**	**–**	**22.0**
Available-for-sale financial assets	**899.3**	**–**	**2.8**	**902.1**
Financial liabilities				
Derivative financial instruments	**–**	**93.1**	**–**	**93.1**

2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	–	35.2	–	35.2
Available-for-sale financial assets	850.9	–	7.6	858.5
Financial liabilities				
Derivative financial instruments	–	225.3	–	225.3

Level 1 Valuations

The fair value of debt securities categorised as available-for-sale financial assets is derived from unadjusted quoted prices in an active market.

Level 2 Valuations

The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

Level 3 Valuations

Level 3 available-for-sale financial assets represent the Company’s best estimates of the value of certain unlisted equity investments including unlisted preferred stock. The valuations take into account relevant information on the individual investments, with discounts applied to reflect their illiquid nature and, in respect of the preferred stock, risks of reduction in conversion rights. The discounts applied are the most significant unobservable valuation inputs.

The Company’s shares in VocaLink Holdings Limited (Vocalink) were included within this category at 31 December 2016. The shares were sold in April 2017 following regulatory approval of Mastercard’s acquisition of Vocalink, resulting in recognition of a gain on disposal of £6.1 million, included within other operating income.

Notes to the financial statements

Note 29: Offsetting of financial assets and financial liabilities

2017	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[2] Subject to master netting agreements £m	Collateral received/ pledged £m	Net amounts £m
Financial assets						
Derivative financial instruments	**73.0**	**(51.0)**	**22.0**	**(11.5)**	**(7.1)**	**3.4**
Loans and advances to banks	**122.9**	**–**	**122.9**	**–**	**(71.3)**	**51.6**
Financial liabilities						
Deposits from banks	**5,377.7**	**–**	**5,377.7**	**–**	**(7.1)**	**5,370.6**
Derivative financial instruments	**107.3**	**(14.2)**	**93.1**	**(11.5)**	**(63.2)**	**18.4**
Other liabilities	**247.3**	**(36.8)**	**210.5**	**–**	**–**	**210.5**

2016	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[2] Subject to master netting agreements £m	Collateral received/ pledged £m	Net amounts £m
Financial assets						
Derivative financial instruments	54.9	(19.7)	35.2	(23.5)	(7.9)	3.8
Loans and advances to banks	229.7	–	229.7	–	(166.1)	63.6
Other assets	66.1	(3.2)	62.9	–	–	62.9
Financial liabilities						
Deposits from banks	2,129.7	–	2,129.7	–	(7.9)	2,121.8
Derivative financial instruments	249.7	(24.4)	225.3	(23.5)	(166.1)	35.7
Other liabilities	184.1	1.5	185.6	–	–	185.6

1 The amounts set off in the balance sheet as shown above represent derivatives and variation margin cash collateral with central clearing houses which meet the criteria for offsetting under IAS 32.

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

The effects of over collateralisation have not been taken into account in the above tables.

Note 30: Financial risk management

The principal risks faced by the Company through the use of financial instruments are: market risk, which includes interest rate risk and foreign currency risk; credit risk; and funding and liquidity risk.

(1) Market risk

The Company does not trade or make markets and transacts foreign exchange for limited operational purposes only. As a result, interest rate risk is the only material market risk for the Company

A. Interest Rate Risk in the Banking Book (IRRBB)

The Company's activities expose it to the risk of adverse movements in interest rates. The Company maintains IRRBB management practice in line with applicable regulatory expectations and measures interest rate risk exposures through Capital at Risk (CaR) and Earnings at Risk (EaR).

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 Company's capital position.

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 change 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), swap spread risk and behavioural volume stresses (pipeline and optionality risk). Both CaR and EaR are controlled by a defined risk appetite limit and supporting metrics.

The Company calculates both CaR and EaR sensitivities on a regulated entity basis, being the consolidated interest rate exposures of the Company and the SPVs detailed in note 15. This aligns to the basis of calculation of the Company's capital resources, as detailed in note 32.

The table below shows CaR measurements, based on a 2% parallel stress over the balance sheet horizon.

Capital at Risk	**2017**		2016	
(unaudited)	**Positive 2% rate shock £m**	**Negative 2% rate shock £m**	Positive 2% rate shock £m	Negative 2% rate shock £m
Interest rate mismatch risk	**2.9**	**(6.2)**	8.8	(1.5)
Basis risk	**(1.5)**	**(1.5)**	–	–
Pipeline risk	**(4.7)**	**(5.5)**	(5.7)	(7.1)
Optionality risk	**(39.7)**	**(18.9)**	(30.1)	(7.7)
Total interest rate risk – capital at risk	**(43.0)**	**(32.1)**	(27.0)	(16.3)

CaR as at 31 December 2017 increased to £32.1 million from £16.3 million at 31 December 2016 in a negative rate shock scenario. In a positive rate shock scenario, it increased to £43.0 million at 31 December 2017 from £27.0 million as at 31 December 2016. In both rate shock scenarios this was due the increase in the balance sheet and the consequential increase in interest rate mismatch risk, and optionality risk arising from the increase in potential mortgage early repayments and savings redemptions.

Note 30: Financial risk management (continued)

Earnings at Risk	2017		2016	
	Positive 1% rate shock	**Negative 1% rate shock**	Positive 1% rate shock	Negative 1% rate shock
(unaudited)	**£m**	**£m**	£m	£m
Interest rate mismatch risk	**23.1**	**0.4**	1.4	(1.8)
Basis risk	**(0.1)**	**(9.2)**	(10.6)	(18.0)
Pipeline risk	**(2.5)**	**(1.3)**	(3.0)	(2.3)
Optionality risk	**(6.3)**	**(1.6)**	(8.6)	(0.3)
Total interest rate risk – earnings at risk	**14.2**	**(11.7)**	(20.8)	(22.4)

EaR has decreased over the year by £35.0 million in a positive rate shock scenario and by £10.7 million in a negative rate shock scenario. These improvements are due to the Company's savings pricing strategy and changes in customer terms and conditions, which has benefitted interest rate mismatch risk. Additionally, the further utilisation of basis swapped positions has reduced the level of basis risk arising in these rate shock scenarios.

Due to reductions in the structural mismatches of assets and liabilities on the balance sheet across the year, net interest income at 31 December 2017 is significantly less likely to suffer from a large, sudden shock to interest rates than it was at 31 December 2016.

2017 Interest rate repricing of assets and liabilities[1]	**Within 3 months £m**	**After 3 months and within 6 months £m**	**After 6 months and within 1 year £m**	**After 1 year and within 5 years £m**	**After 5 years £m**	**Non-interest bearing instruments £m**	**Total £m**
Assets							
Cash and balances at central banks	**2,521.4**	**–**	**–**	**–**	**–**	**57.6**	**2,579.0**
Loans and receivables:							
Loans and advances to banks	**115.5**	**–**	**–**	**–**	**–**	**7.4**	**122.9**
Loans and advances to customers	**7,495.6**	**2,137.5**	**4,843.8**	**21,650.2**	**532.8**	**440.0**	**37,099.9**
Debt securities	**0.3**	**–**	**–**	**–**	**–**	**–**	**0.3**
Available-for-sale financial assets	**257.4**	**13.1**	**5.0**	**122.8**	**444.8**	**59.3**	**902.4**
Other assets	**(32.5)**	**–**	**–**	**–**	**–**	**346.9**	**314.4**
Total assets	**10,357.7**	**2,150.6**	**4,848.8**	**21,773.0**	**977.6**	**911.2**	**41,018.9**
Liabilities							
Deposits from banks	**5,377.7**	**–**	**–**	**–**	**–**	**–**	**5,377.7**
Customer deposits	**17,022.1**	**2,256.0**	**5,275.7**	**6,245.5**	**0.6**	**8.5**	**30,808.4**
Amounts due to securitisation special purpose vehicles	**2,391.0**	**–**	**–**	**–**	**–**	**(90.6)**	**2,300.4**
Debt Securities in issue	**–**	**–**	**–**	**300.0**	**–**	**2.8**	**302.8**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**350.4**	**350.4**
Equity	**–**	**–**	**–**	**230.0**	**–**	**1,649.2**	**1,879.2**
Total liabilities and equity	**24,790.8**	**2,256.0**	**5,275.7**	**6,775.5**	**0.6**	**1,920.3**	**41,018.9**
Notional values of derivatives affecting interest rate sensitivity	**12,901.2**	**676.0**	**674.7**	**(12,909.6)**	**(1,343.6)**	**1.3**	**–**
Total interest rate sensitivity gap	**(1,531.9)**	**570.6**	**247.8**	**2,087.9**	**(366.6)**	**(1,007.8)**	**–**
Cumulative interest rate sensitivity gap	**(1,531.9)**	**(961.3)**	**(713.5)**	**1,374.4**	**1,007.8**	**–**	**–**

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate repricing date and the residual maturity date.

Note 30: Financial risk management (continued)

2016 Interest rate repricing of assets and liabilities[1]	Within 3 months £m	After 3 months and within 6 months £m	After 6 months and within 1 year £m	After 1 year and within 5 years £m	After 5 years £m	Non-interest bearing instruments £m	Total £m
Assets							
Cash and balances at central banks	732.0	–	–	–	–	54.3	786.3
Loans and receivables:							
Loans and advances to banks	224.2	–	–	–	–	5.5	229.7
Loans and advances to customers	8,289.3	1,871.1	3,425.2	18,365.2	298.5	459.6	32,708.9
Debt securities	0.7	–	–	–	–	–	0.7
Available-for-sale financial assets	212.9	–	–	154.5	426.0	65.4	858.8
Other assets	53.9	–	–	–	–	276.9	330.8
Total assets	9,513.0	1,871.1	3,425.2	18,519.7	724.5	861.7	34,915.2
Liabilities							
Deposits from banks	2,129.7	–	–	–	–	–	2,129.7
Customer deposits	18,027.5	1,157.1	4,081.4	4,810.2	–	30.1	28,106.3
Amounts due to securitisation special purpose vehicles	2,203.7	–	–	–	–	(60.1)	2,143.6
Debt Securities in issue	–	–	–	300.0	–	5.8	305.8
Other liabilities	–	–	–	–	–	538.6	538.6
Equity	–	–	–	230.0	–	1,461.2	1,691.2
Total liabilities and equity	22,360.9	1,157.1	4,081.4	5,340.2	–	1,975.6	34,915.2
Notional values of derivatives affecting interest rate sensitivity	10,956.3	(548.2)	1,388.0	(10,555.5)	(1,240.6)	–	–
Total interest rate sensitivity gap	(1,891.6)	165.8	731.8	2,624.0	(516.1)	(1,113.9)	–
Cumulative interest rate sensitivity gap	(1,891.6)	(1,725.8)	(994.0)	1,630.0	1,113.9	–	–

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate repricing date and the residual maturity date.

The interest rate re-pricing tables shown above reflect the re-pricing of assets and liabilities without adjustments to the re-pricing profile that reflect future pricing assumptions. Therefore, the gap profile shown above does not directly translate to the CaR and EaR term mismatch quantification.

B. Foreign currency risk

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. The Company has minimal exposure to foreign currency risk.

Exposures to adverse changes in exchange rates have been reduced by using cross currency swaps, resulting in a minimal net exposure. The table below shows assets and liabilities in foreign currency at Sterling carrying values.

Assets and liabilities in foreign currency at sterling carrying values	**2017**		2016	
	US$ in £m	**€ in £m**	US$ in £m	€ in £m
Assets				
Loans and advances to banks	**0.7**	**0.9**	0.7	0.9
Available-for-sale financial assets	**1.4**	**54.0**	1.5	–
Intangible assets	**0.1**	**0.1**	0.1	0.1
Other assets	–	**0.6**	–	0.4
Total assets	**2.2**	**55.6**	2.3	1.4
Liabilities				
Other liabilities	**0.3**	**0.4**	0.1	0.4
Total liabilities	**0.3**	**0.4**	0.1	0.4
Notional value of derivatives affecting currency exposures	**1.6**	**54.1**	1.5	–
Net position	**0.3**	**1.1**	0.7	1.0

Note 30: Financial risk management (continued)

(2) Credit risk

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

The Company has appetite for high-quality credit exposures including retail lending and liquid wholesale investments. The Company uses a range of approaches to mitigate credit risk, using risk appetite to set out the credit policy for each type of credit risk.

Loans and advances to customers comprise:

Loans and advances to customers	**2017 £m**	2016 £m
Advances secured on residential property not subject to securitisation	**21,878.7**	19,375.2
Advances secured on residential property subject to securitisation	**5,438.5**	4,907.8
	27,317.2	24,283.0
Residential buy to let loans not subject to securitisation	**6,367.3**	5,468.4
Total loans and advances secured on residential property	**33,684.5**	29,751.4
Allowance for impairment – secured	**(12.1)**	(10.6)
Loans and advances – secured	**33,672.4**	29,740.8
Credit cards not subject to securitisation	**3,071.3**	2,486.5
Overdrafts not subject to securitisation	**0.1**	0.1
Total unsecured receivables not subject to securitisation	**3,071.4**	2,486.6
Allowance for impairment – unsecured	**(47.3)**	(39.5)
Loans and advances – unsecured	**3,024.1**	2,447.1
Amounts due from group companies	**359.7**	341.8
Total loans and advances to customers excluding fair value of portfolio hedging	**37,056.2**	32,529.7

A. Credit risk portfolio and maximum credit exposure

The tables below show the total credit risk exposure for the Company's retail and wholesale portfolios. All of the Company's wholesale exposures are categorised as low risk.

In addition, the maximum credit risk exposure of the Company includes off-balance sheet items.

These items relate to applications that have been approved and have not yet been drawn by the customer and undrawn loan commitments. These commitments represent agreements to lend in the future and may be decreased or removed by the Company, subject to product notice requirements. No account is taken of any collateral held, other credit enhancements or provisions for impairment. As at 31 December 2017, off-balance sheet items totalled £6,193.5 million (2016: £5,289.1 million) and were all classified as low risk.

2017 Credit risk portfolio	**Secured**		**Unsecured**		**Wholesale**		
	Residential mortgage loans £m	**Residential buy-to-let mortgage loans £m**	**Credit cards £m**	**Overdrafts £m**	**Treasury assets £m**	**Derivative exposures £m**	**Total £m**
Total gross retail loans and advances to customers	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**–**	**–**	**36,755.9**
of which are low risk	*26,770.5*	*6,322.5*	*3,025.2*	*0.1*	*–*	*–*	*36,118.3*
of which are medium risk	*220.0*	*11.7*	*3.5*	*–*	*–*	*–*	*235.2*
of which are high risk	*326.7*	*33.1*	*42.6*	*–*	*–*	*–*	*402.4*
Loans and advances to banks	**–**	**–**	**–**	**–**	**122.9**	**–**	**122.9**
Cash and balances at central banks	**–**	**–**	**–**	**–**	**2,579.0**	**–**	**2,579.0**
Debt securities classified as loans and receivables	**–**	**–**	**–**	**–**	**0.3**	**–**	**0.3**
Available-for-sale financial assets	**–**	**–**	**–**	**–**	**902.4**	**–**	**902.4**
Derivative financial instrument assets	**–**	**–**	**–**	**–**	**–**	**22.0**	**22.0**
Loans and advances to customers – amounts due from group companies	**–**	**–**	**–**	**–**	**359.7**	**–**	**359.7**
Total	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**3,964.3**	**22.0**	**40,742.2**

Note 30: Financial risk management (continued)

2016 Credit risk portfolio	Secured Residential mortgage loans £m	 Residential buy-to-let mortgage loans £m	Unsecured Credit cards £m	 Overdrafts £m	Wholesale Treasury assets £m	 Derivative exposures £m	Total £m
Total gross retail loans and advances to customers	24,283.0	5,468.4	2,486.5	0.1	–	–	32,238.0
of which are low risk	*21,565.5*	*5,256.8*	*2,451.2*	*0.1*	–	–	*29,273.6*
of which are medium risk	*1,699.5*	*172.1*	*2.9*	–	–	–	*1,874.5*
of which are high risk	*1,018.0*	*39.5*	*32.4*	–	–	–	*1,089.9*
Loans and advances to banks	–	–	–	–	229.7	–	229.7
Cash and balances at central banks	–	–	–	–	786.3	–	786.3
Debt securities classified as loans and receivables	–	–	–	–	0.7	–	0.7
Available-for-sale financial assets	–	–	–	–	858.8	–	858.8
Derivative financial instrument assets	–	–	–	–	–	35.2	35.2
Loans and advances to customers – amounts due from group companies	–	–	–	–	341.8	–	341.8
Total	24,283.0	5,468.4	2,486.5	0.1	2,217.3	35.2	34,490.5

B. Retail secured credit risk concentration

The table below shows the geographical concentration of the mortgage portfolio.

Geographical concentration	**2017** **£m**	 **%**	2016 £m	 %
East Anglia	**862.4**	**2.6**	726.0	2.6
East Midlands	**1,784.3**	**5.3**	1,556.4	5.2
North	**1,118.2**	**3.3**	1,025.3	3.4
Yorkshire & Humberside	**1,881.5**	**5.6**	1,640.3	5.5
North West	**2,512.2**	**7.5**	2,209.3	7.4
West Midlands	**1,785.5**	**5.3**	1,560.9	5.2
South West	**2,676.6**	**7.9**	2,320.6	7.8
South East	**8,447.1**	**25.1**	7,365.7	24.8
Greater London	**9,297.2**	**27.6**	8,365.9	28.1
Wales	**753.7**	**2.2**	673.9	2.3
Scotland	**2,030.3**	**6.0**	1,828.0	6.1
Northern Ireland	**534.0**	**1.6**	478.3	1.6
Other	**1.5**	**–**	0.8	–
Total	**33,684.5**	**100.0**	29,751.4	100.0

The geographic split of the portfolio remains broadly unchanged.

The table below shows retail secured credit concentrations by loan size.

Retail secured credit concentrations by loan size	**2017** **£m**	 **%**	2016 £m	 %
0-£100k	**5,324.4**	**15.8**	5,169.8	17.5
£100k-£250k	**16,023.6**	**47.6**	13,989.6	47.0
£250k-£500k	**9,569.0**	**28.4**	7,835.2	26.3
£500k-£1m	**2,542.0**	**7.5**	2,536.2	8.5
£1m-£2.5m	**215.5**	**0.6**	207.4	0.7
>£2.5m	**10.0**	**0.1**	13.2	–
Total	**33,684.5**	**100.0**	29,751.4	100.0

As at 31 December 2017, 0.7% (2016: 0.7%) of mortgage balances consisted of loans in excess of £1.0 million.

The value of loans with balances of up to £250,000 increased by £2,188.6 million during 2017. This represents 55.6% of the total secured loans portfolio growth of £3,933.1 million.

Note 30: Financial risk management (continued)

The tables below show retail secured credit concentrations by loan type.

2017 Retail secured credit concentrations by loan type	**Residential mortgage loans**		**Buy-to-let mortgage loans**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**
Capital repayment	**22,963.2**	**84.0**	**1,040.0**	**16.4**	**24,003.2**	**71.3**
Part-and-part	**1,007.1**	**3.7**	**46.8**	**0.7**	**1,053.9**	**3.1**
Interest only	**3,346.9**	**12.3**	**5,280.5**	**82.9**	**8,627.4**	**25.6**
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**33,684.5**	**100.0**

2016 Retail secured credit concentrations by loan type	Residential mortgage loans		Buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	19,521.7	80.4	913.0	16.7	20,434.7	68.7
Part-and-part	1,115.6	4.6	37.3	0.7	1,152.9	3.9
Interest only	3,645.7	15.0	4,518.1	82.6	8,163.8	27.4
Total	24,283.0	100.0	5,468.4	100.0	29,751.4	100.0

The tables below show the distribution of retail secured loans by loan-to-value (LTV) banding.

2017 Retail secured loan to value LTV – indexed value at financial year end	**Residential mortgage loans**		**Residential buy-to-let mortgage loans**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**
<50%	**10,249.6**	**37.6**	**2,293.5**	**36.1**	**12,543.1**	**37.2**
50%-<60%	**5,362.9**	**19.6**	**1,851.5**	**29.1**	**7,214.4**	**21.4**
60%-<70%	**4,508.4**	**16.5**	**1,441.4**	**22.6**	**5,949.8**	**17.7**
70%-<80%	**4,022.9**	**14.7**	**778.1**	**12.2**	**4,801.0**	**14.3**
80%-<90%	**2,725.7**	**10.0**	**1.9**	**–**	**2,727.6**	**8.1**
90%-<100%	**444.6**	**1.6**	**0.6**	**–**	**445.2**	**1.3**
>100%	**3.1**	**–**	**0.3**	**–**	**3.4**	**–**
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**33,684.5**	**100.0**
Average LTV of stock - indexed[1]		**56.1**		**54.1**		**55.8**
Average LTV of new business		**70.0**		**59.7**		**68.1**

2016 Retail secured loan to value LTV – indexed value at financial year end	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	9,476.6	39.1	1,922.8	35.2	11,399.4	38.3
50%-<60%	4,958.1	20.4	1,454.8	26.6	6,412.9	21.6
60%-<70%	3,918.9	16.1	1,271.8	23.3	5,190.7	17.4
70%-<80%	3,162.8	13.0	796.4	14.6	3,959.2	13.3
80%-<90%	2,307.7	9.5	19.0	0.3	2,326.7	7.8
90%-<100%	445.1	1.8	2.2	–	447.3	1.5
>100%	13.8	0.1	1.4	–	15.2	0.1
Total	24,283.0	100.0	5,468.4	100.0	29,751.4	100.0
Average LTV of stock - indexed[1]		55.6		54.8		55.4
Average LTV of new business		69.8		60.5		68.0

1 The average LTV of stock and new business is balance weighted.

The average indexed LTVs of the overall mortgage portfolio increased by 0.4 percentage points as at 31 December 2017. The average LTV for new business remained broadly flat at 68.1% as at 31 December 2017.

Note 30: Financial risk management (continued)

C. Credit quality of assets

Loans and receivables

The Company defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures.

Secured credit exposures are segmented according to the credit quality classification and a point-in-time probability of default (PD). The point-in-time PD is an internal parameter used within the Company's Advanced Internal Ratings Based (AIRB) capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where a borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. Exposures are categorised as:

> higher risk where assets are past due or have a point in time PD greater than 2%;

> medium risk where assets are not past due and have a PD greater than 0.8% but less than or equal to 2%; and

> low risk where assets are not past due and have a PD less than or equal to 0.8%.

Unsecured exposures are categorised as:

> higher risk where assets are past due;

> medium risk where assets are currently not past due and benefitting from a forbearance solution; and

> low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. The Company's wholesale exposures, excluding certain derivative financial instruments between the Company and Gosforth Funding securitisation special purpose vehicles, are investment grade and therefore classified as low risk.

No wholesale loans and receivables credit exposures are past due or impaired as at 31 December 2017 or 31 December 2016.

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

Credit risk categorisation	Description
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.
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. Further information on forbearance solutions can be found on page 70.
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.
Impaired assets	Loans that are in arrears and where the carrying amount of the loan exceeds the expected recoverable amount. All mortgage expired terms, fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due.

Note 30: Financial risk management (continued)

The overall credit quality of retail assets has remained stable and is detailed in the tables below.

2017 Gross loans and advances to customers by credit quality	**Secured**				**Unsecured**					
	Residential mortgage loans		**Residential buy-to-let mortgage loans**		**Credit cards**		**Overdrafts**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Neither past due nor impaired	**27,026.2**	**99.0**	**6,336.5**	**99.5**	**3,028.7**	**98.6**	**0.1**	**100.0**	**36,391.5**	**99.0**
– *of which in receipt of forbearance*[1]	*133.8*	*0.5*	*15.8*	*0.2*	*3.5*	*0.1*	*–*	*–*	*153.1*	*0.4*
Past due and not impaired	**168.2**	**0.6**	**18.7**	**0.3**	**–**	**–**	**–**	**–**	**186.9**	**0.5**
Impaired	**122.8**	**0.4**	**12.1**	**0.2**	**42.6**	**1.4**	**–**	**–**	**177.5**	**0.5**
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**3,071.3**	**100.0**	**0.1**	**100.0**	**36,755.9**	**100.0**

2016 Gross loans and advances to customers by credit quality	Secured				Unsecured					
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	24,047.8	99.1	5,441.8	99.5	2,454.0	98.7	0.1	100.0	31,943.7	99.1
– *of which in receipt of forbearance*[1]	*108.6*	*0.4*	*12.2*	*0.2*	*2.9*	*0.1*	-	-	*123.7*	*0.4*
Past due and not impaired	151.3	0.6	17.6	0.3	-	-	-	-	168.9	0.5
Impaired	83.9	0.3	9.0	0.2	32.5	1.3	-	-	125.4	0.4
Total	24,283.0	100.0	5,468.4	100.0	2,486.5	100.0	0.1	100.0	32,238.0	100.0

1 This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Forbearance disclosures for 2016 have been restated to remove term extensions captured as part of the mortgage review process.

The criteria that the Company uses to determine that there is objective evidence of an impairment loss are disclosed in accounting policy (f) in note 1. All loans where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

Loans and advances which are neither past due nor impaired

Loans which were neither past due nor impaired represent 99.0% (2016: 99.1%) of total secured loans. The segmentation for low, medium and higher risk categories for the unsecured portfolio can be found on pages 58 to 59. The tables below show the details of the credit quality for neither past due nor impaired secured loans.

2017 Credit quality for neither past due nor impaired loans	**Residential mortgage loans £m**	**%**	**Residential buy-to-let mortgage loans £m**	**%**	**Total £m**	**%**
PD by internal ratings						
Low risk	**26,770.5**	**99.1**	**6,322.5**	**99.8**	**33,093.0**	**99.2**
Medium risk	**220.0**	**0.8**	**11.7**	**0.2**	**231.7**	**0.7**
Higher risk	**35.7**	**0.1**	**2.3**	**–**	**38.0**	**0.1**
Total neither past due nor impaired	**27,026.2**	**100.0**	**6,336.5**	**100.0**	**33,362.7**	**100.0**

2016 Credit quality for neither past due nor impaired loans	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
PD by internal ratings						
Low risk	21,565.5	89.7	5,256.8	96.6	26,822.3	91.0
Medium risk	1,699.5	7.1	172.1	3.2	1,871.6	6.3
Higher risk	782.8	3.2	12.9	0.2	795.7	2.7
Total neither past due nor impaired	24,047.8	100.0	5,441.8	100.0	29,489.6	100.0

Note 30: Financial risk management (continued)

Loans and advances which are past due and not impaired

The balance of mortgages which are past due and not impaired totalled £186.9 million at 31 December 2017. These assets represented 0.6% of secured loans at 31 December 2017 (31 December 2016: 0.6%). All unsecured assets which are past due are treated as impaired. All loans and advances which are past due and not impaired are classified as 'higher risk'.

The tables below show loans and advances which are past due and not impaired by overdue term.

2017	**Residential mortgage loans**		**Residential buy-to-let mortgage loans**		**Total**	
Past due and not impaired loans	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to one month	**70.1**	**41.7**	**6.4**	**34.3**	**76.5**	**40.8**
One to three months	**74.3**	**44.2**	**9.9**	**52.9**	**84.2**	**45.1**
Three to six months	**16.5**	**9.8**	**2.1**	**11.2**	**18.6**	**10.0**
Over six months	**7.3**	**4.3**	**0.3**	**1.6**	**7.6**	**4.1**
Total past due and not impaired	**168.2**	**100.0**	**18.7**	**100.0**	**186.9**	**100.0**

2016	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
Past due and not impaired loans	£m	%	£m	%	£m	%
Up to one month	57.1	37.8	4.3	24.4	61.4	36.4
One to three months	63.9	42.2	10.8	61.4	74.7	44.2
Three to six months	21.4	14.1	2.1	11.9	23.5	13.9
Over six months	8.9	5.9	0.4	2.3	9.3	5.5
Total past due and not impaired	151.3	100.0	17.6	100.0	168.9	100.0

Impaired assets

The tables below show the movement of impaired loan balances during 2017 and 2016.

	Secured		**Unsecured**	
2017	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Credit cards**	**Total**
Reconciliation of impaired loans	**£m**	**£m**	**£m**	**£m**
As at 1 January 2017	**83.9**	**9.0**	**32.5**	**125.4**
Classified as impaired during the year	**229.9**	**26.4**	**95.6**	**351.9**
Transferred from impaired to unimpaired	**(141.9)**	**(20.4)**	**(35.0)**	**(197.3)**
Amounts written off	**(0.6)**	**(0.1)**	**(43.4)**	**(44.1)**
Repayments	**(48.5)**	**(2.8)**	**(7.1)**	**(58.4)**
As at 31 December 2017	**122.8**	**12.1**	**42.6**	**177.5**

	Secured		Unsecured	
2016	Residential mortgage loans	Residential buy-to-let mortgage loans	Credit cards	Total
Reconciliation of impaired loans	£m	£m	£m	£m
As at 1 January 2016	77.6	7.0	27.4	112.0
Classified as impaired during the year	132.3	20.4	83.3	236.0
Transferred from impaired to unimpaired	(112.9)	(17.7)	(38.3)	(168.9)
Amounts written off	(0.6)	(0.2)	(32.3)	(33.1)
Repayments	(12.5)	(0.5)	(7.6)	(20.6)
As at 31 December 2016	83.9	9.0	32.5	125.4

Note 30: Financial risk management (continued)

Total impaired assets as a proportion of total assets has remained stable at 0.4% (2016: 0.4%). The Group's definition of impaired assets includes accounts that are in arrears and accounts that may not be in arrears but are showing non-delinquency impairment indicators such as expired contractual terms or fraud. Balances with these indicators are categorised as impaired irrespective of arrears status or expected recoverable amount.

Unsecured impaired assets increased by 31.1% to £42.6 million, representing 1.4% of total unsecured loans. This is driven by an increase in arrears balances, consistent with book growth, and by the expected seasoning of older assets on the portfolio.

Further details of the Company's impaired assets and provisions are provided in the tables below.

2017 Impaired assets and impairment provisions	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
Residential mortgage loans	**27,317.2**	**122.8**	**0.4**	**10.8**	**8.8**
Residential buy-to-let mortgage loans	**6,367.3**	**12.1**	**0.2**	**1.3**	**10.7**
Total secured	**33,684.5**	**134.9**	**0.4**	**12.1**	**9.0**
Credit cards	**3,071.3**	**42.6**	**1.4**	**47.2**	**110.8**
Overdrafts	**0.1**	**–**	**–**	**0.1**	**–**
Total unsecured	**3,071.4**	**42.6**	**1.4**	**47.3**	**111.0**
Wholesale treasury assets	**3,964.3**	**–**	**–**	**–**	**–**
Derivative financial instruments	**22.0**	**–**	**–**	**–**	**–**
Total	**40,742.2**	**177.5**	**0.4**	**59.4**	**33.5**

2016 Impaired assets and impairment provisions	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
Residential mortgage loans	24,283.0	83.9	0.3	9.4	11.2
Residential buy-to-let mortgage loans	5,468.4	9.0	0.2	1.2	13.3
Total secured	29,751.4	92.9	0.3	10.6	11.4
Credit cards	2,486.5	32.5	1.3	39.4	121.2
Overdrafts	0.1	–	–	0.1	–
Total unsecured	2,486.6	32.5	1.3	39.5	121.5
Wholesale treasury assets	2,217.3	–	–	–	–
Derivative financial instruments	35.2	–	–	–	–
Total	34,490.5	125.4	0.4	50.1	40.0

An analysis of impaired assets by overdue term and secured loan assets where the borrower's property was in possession is provided in the tables below. All impaired loans are classified as higher risk.

2017 Impaired assets by overdue term and possession status – secured	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
Up to date	**80.3**	**65.5**	**7.9**	**65.3**	**88.2**	**65.4**
Up to one month	**17.6**	**14.3**	**0.8**	**6.6**	**18.4**	**13.7**
One to three months	**20.4**	**16.6**	**2.7**	**22.3**	**23.1**	**17.1**
Three to six months	**2.5**	**2.0**	**0.3**	**2.5**	**2.8**	**2.1**
Over six months	**1.5**	**1.2**	**0.3**	**2.5**	**1.8**	**1.3**
Possession	**0.5**	**0.4**	**0.1**	**0.8**	**0.6**	**0.4**
Total impaired assets	**122.8**	**100.0**	**12.1**	**100.0**	**134.9**	**100.0**

Note 30: Financial risk management (continued)

2016 Impaired assets by overdue term and possession status – secured	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
Up to date	45.7	54.5	4.9	54.5	50.6	54.5
Up to one month	10.0	11.9	1.3	14.5	11.3	12.2
One to three months	19.9	23.7	2.2	24.4	22.1	23.8
Three to six months	4.1	4.9	0.3	3.3	4.4	4.7
Over six months	3.9	4.6	0.2	2.2	4.1	4.4
Possession	0.3	0.4	0.1	1.1	0.4	0.4
Total impaired assets	83.9	100.0	9.0	100.0	92.9	100.0

2017 **Impaired assets by overdue term – unsecured**	**£m**	**%**
Credit cards		
Up to date	**0.3**	**0.7**
Up to one month	**15.5**	**36.3**
One to three months	**13.4**	**31.5**
Three to six months	**13.1**	**30.8**
Over six months	**0.3**	**0.7**
Total	**42.6**	**100.0**

2016 Impaired assets by overdue term – unsecured	£m	%
Credit cards		
Up to date	0.1	0.3
Up to one month	13.0	40.1
One to three months	9.3	28.6
Three to six months	9.7	29.8
Over six months	0.4	1.2
Total	32.5	100.0

The table below shows the movement of impairment provisions during the year.

	Secured		**Unsecured**		
Impairment provisions on loans and advances	**Residential mortgage loans**	**Residential buy-to-let property**	**Credit cards**	**Overdrafts**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
As at 1 January 2016	7.7	1.0	31.1	0.1	39.9
Advances written off	(0.6)	(0.2)	(26.6)	–	(27.4)
Charge to the income statement	2.3	0.4	34.9	–	37.6
As at 31 December 2016	**9.4**	**1.2**	**39.4**	**0.1**	**50.1**
Advances written off	**(0.6)**	**(0.1)**	**(34.2)**	**–**	**(34.9)**
Charge to the income statement	**2.0**	**0.2**	**42.0**	**–**	**44.2**
As at 31 December 2017	**10.8**	**1.3**	**47.2**	**0.1**	**59.4**

Of the total allowance in respect of loans and advances to customers, £57.5 million (2016: £49.4 million) was assessed on a collective basis.

Note 30: Financial risk management (continued)

D. Wholesale credit risk and concentration

Wholesale credit risk exposures increased by £1,738.6 million during the year to £3,983.2 million at 31 December 2017. This partly reflects the replacement of off-balance sheet liquidity from the Bank of England's Funding for Lending Scheme (FLS) with on-balance sheet liquidity. The table below shows the wholesale credit exposures of the Company. Reserves placed with the Bank of England are included as wholesale credit exposures within the table.

Wholesale credit exposures	**2017 £m**	2016 £m
Loans and advances to banks	**122.9**	229.7
Cash and balances at central banks	**2,579.0**	786.3
Debt securities classified as loans and receivables	**0.3**	0.7
Debt securities classified as available-for-sale financial assets	**899.3**	850.9
Gross positive fair value of derivative contracts	**22.0**	35.2
Loans and advances to customers – amounts due from group companies	**359.7**	341.8
Total	**3,983.2**	2,244.6

At 31 December 2017 the single largest exposure to any single counterparty which is not a sovereign, a supranational or a Gosforth Funding securitisation vehicle was £94.6 million (2016: £85.8 million).

The table below shows the credit ratings of loans and advances to banks. Cash and balances with central banks represents reserves placed with, or currency backed by, the Bank of England which has a credit rating of AA (2016: AA).

Loans and advances to banks	**2017 £m**	2016 £m
AA-	**38.1**	70.6
A+	**7.4**	18.7
A	**46.5**	77.4
A-	**14.8**	35.0
BBB+	**16.1**	28.0
Total	**122.9**	229.7

The tables below show the composition of debt securities and their credit ratings.

	2017		2016	
	Debt securities classified as loans and receivables £m	**Debt securities classified as available-for-sale financial assets £m**	Debt securities classified as loans and receivables £m	Debt securities classified as available-for-sale financial assets £m
UK sovereign exposures	**–**	**207.3**	–	317.3
Supranational	**–**	**234.1**	–	129.3
Residential mortgage-backed securities	**0.3**	**61.4**	0.7	52.2
Covered bonds	**–**	**396.5**	–	327.1
Debt securities issued by banks	**–**	**–**	–	25.0
Total	**0.3**	**899.3**	0.7	850.9

Credit rating on debt securities	**2017 £m**	2016 £m
AAA	**692.0**	508.6
AA	**207.3**	317.3
AA-	**–**	25.0
A	**0.3**	0.7
Total	**899.6**	851.6

Note 30: Financial risk management (continued)

The credit ratings of the debt securities remains high, with 100.0% rated AA or higher at 31 December 2017 (2016: 97.0%).

Concentration risk is managed for both individual counterparties and for country of exposure. The Company does not set a limit to exposures to the Bank of England and the UK sovereign.

The table below shows wholesale credit risk exposures by country.

Wholesale credit exposures by country	**2017 £m**	2016 £m
Australia	**8.5**	19.3
Canada	**–**	25.0
France	**24.5**	36.4
UK	**3,707.1**	2,022.0
USA	**9.0**	12.6
Supranational	**234.1**	129.3
Total	**3,983.2**	2,244.6

E. Derivative financial instruments

The Company reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions, as detailed in notes 10 and 29. For derivatives not eligible for central clearing, exposure is reduced by use of master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Company's maximum credit risk relating to derivative assets of £22.0 million (2016: £35.2 million), cash collateral of £7.1 million (2016: £7.9 million) was held.

The Company measures exposure in derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, they are represented on the balance sheet on a gross basis unless the IAS 32 offsetting rules are met. Derivative contracts which do not meet the IAS 32 offsetting rules, and have positive fair values are disclosed as assets in the balance sheet under 'derivative financial instruments', those with negative fair values are disclosed as liabilities.

Cash collateral received is classified as deposits from banks, and cash collateral posted classified as loans and advances to banks (refer note 14).

The table below details derivative exposures, excluding those that are centrally cleared.

Derivative exposures	**2017 £m**	2016 £m
Gross positive fair value of derivative contracts	**22.0**	35.2
Netting with gross negative fair value of derivative contracts[1]	**(11.5)**	(23.5)
Potential future incremental exposure	**13.8**	24.7
Collateral received (deposits from banks)	**(7.1)**	(7.9)
Net derivative exposures	**17.2**	28.5

Derivative liabilities	**2017 £m**	2016 £m
Gross negative fair value of derivative contracts	**(83.8)**	(218.0)
Netting with gross positive fair value of derivative contracts[1]	**11.5**	23.5
Collateral pledged (loans and advances to banks)	**71.3**	166.1
Net derivative liability	**(1.0)**	(28.4)

1 The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

Note 30: Financial risk management (continued)

The only netting agreements in place are in relation to derivative financial instruments. In respect of repurchase transactions, only the difference between the asset pledged and deposit received is classed as an exposure given the balance sheet maintains the exposure to the underlying obligor.

The table below provides credit quality analysis of the gross derivative exposures, excluding those that are centrally cleared, by credit rating of the counterparties.

	2017		2016	
Gross derivative exposures by credit rating	**£m**	**%**	£m	%
AA-	**1.6**	**7.3**	3.9	11.1
A+	**6.5**	**29.5**	0.6	1.7
A	**10.3**	**46.8**	13.6	38.6
A-	**0.3**	**1.4**	12.7	36.1
BBB+	**0.2**	**0.9**	0.8	2.3
Not rated	**3.1**	**14.1**	3.6	10.2
Total	**22.0**	**100.0**	35.2	100.0

Gross derivative exposures reported as 'Not rated' relate to currency derivative transactions between Gosforth Funding securitisation special purpose vehicles and the Company.

F. Collateral held as security for financial assets

The Company holds collateral against loans and receivables on the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral below.

Loans and receivables to customers

The Company holds collateral in respect of secured loans as set out below. No collateral is held in respect of retail credit cards or overdrafts. The Company does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

Collateral held in relation to secured loans is capped to 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.

2017 **Fair value of collateral against secured loans – capped at loan value[1]**	**Collateral value of residential mortgage loans**		**Collateral value of residential buy-to-let mortgage loans**		**Total collateral value**	
	£m	**%**	**£m**	**%**	**£m**	**%**
Neither past due nor impaired	**27,025.9**	**100.0**	**6,336.5**	**100.0**	**33,362.4**	**100.0**
– *of which in receipt of forbearance*	*133.8*	*100.0*	*15.8*	*100.0*	*149.6*	*100.0*
Past due and not impaired	**168.2**	**100.0**	**18.7**	**100.0**	**186.9**	**100.0**
Impaired	**122.8**	**100.0**	**12.1**	**100.0**	**134.9**	**100.0**
– *of which in possession*	*0.5*	*100.0*	*0.1*	*100.0*	*0.6*	*100.0*
Total	**27,316.9**	**100.0**	**6,367.3**	**100.0**	**33,684.2**	**100.0**

1 Some segments may look fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

Note 30: Financial risk management (continued)

2016 Fair value of collateral against secured loans – capped at loan value[1]	Collateral value of residential mortgage loans		Collateral value of residential buy-to-let mortgage loans		Total collateral value	
	£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[2]*	*108.6*	*100.0*	*12.2*	*100.0*	*120.8*	*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

1 Some segments may look fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

2 Forbearance disclosures have been restated to exclude term extensions captured as part of the mortgage review process.

As at 31 December 2017, there was £0.3 million (2016: £1.4 million) excess between the balance of residential mortgages with a LTV of greater than 100% and the collateral held against them. All of these mortgage balances were classified as neither past due nor impaired. The recoverable amount used for impairment provision purposes reflects this level of collateral.

Loans and advances to banks

All new eligible derivative transactions with wholesale counterparties are centrally cleared with cash posted as collateral to further mitigate credit risk. Residual and non-eligible trades are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement.

The Company's derivative exposures to Gosforth Funding securitisation special purpose vehicles are an exception to collateral requirements.

Other wholesale exposures

Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by a portfolio of financial assets.

G. Collateral repossessed

The Company works with customers who have difficulty paying their mortgages, and will repossess a property only when all other possibilities have been exhausted. Where properties have been repossessed, the Company will obtain the best price, taking into account factors such as property and market conditions.

The Company uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

The Company held 10 repossessed properties as at 31 December 2017 compared to 6 as at 31 December 2016. The total number of properties taken into possession during the year reduced to 12, from 36 in 2016.

Note 30: Financial risk management (continued)

H. Debt management for customers in financial difficulty

The Company's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Company by discharging the Company's responsibilities to support customers and act in their best long-term interests. This allows customer credit facilities to be brought back into a sustainable position.

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.

Forbearance and provisioning

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

Impaired assets are reviewed on an ongoing basis. Regular detailed analysis of impairment provisions is undertaken recognising the impact of forbearance activities.

The Company operates a number of treatments to assist borrowers who are experiencing financial distress. In defining these treatments, the Company distinguishes between the following categories for secured assets:

> Payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example, short-term arrangements to pay less than the contractual payment;

> Transfers to interest only: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears of capital repayment existing at the commencement of the arrangement remain outstanding;

> Term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and

> Discretionary payment holidays: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment.

Loans which are subject to forbearance are grouped with other assets with similar risk characteristics and assessed collectively for impairment. Loans are not considered as impaired loans unless they meet the Company's definition of an impaired asset.

The value of forbearance stock totalled £176.4 million at 31 December 2017 (2016: £141.3 million). £161.2 million (31 December 2016: £128.6 million) of retail secured loans and advances were subject to forbearance, representing 0.48% of total secured loans and advances (2016: 0.43%). This increase in forbearance is consistent with portfolio growth and reflects the Company's focus on proactive debt management due to the low level of arrears emergence.

During 2017, the Company amended its secured forbearance capture to exclude routine term extensions processed as part of the mortgage review process, where there is no forbearance. Such cases had been captured prudently as forborne in prior reporting periods. The 2016 comparative has been restated to reflect this change.

The tables overleaf show analysis by forbearance category.

Notes to the financial statements

Note 30: Financial risk management (continued)

2017	**Neither past due nor impaired**		**Past due not impaired**		**Impaired**		**Total**	
Forbearance stock	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Secured								
Payment arrangement	**0.6**	**0.5**	**1.4**	**15.7**	**–**	**–**	**2.0**	**1.2**
Transfer to interest only	**29.2**	**19.5**	**1.4**	**15.7**	**0.3**	**11.1**	**30.9**	**19.2**
Term extension	**59.0**	**39.4**	**3.2**	**36.0**	**2.1**	**77.8**	**64.3**	**39.9**
Payment holiday	**60.8**	**40.6**	**2.9**	**32.6**	**0.3**	**11.1**	**64.0**	**39.7**
Total secured forbearance	**149.6**	**100.0**	**8.9**	**100.0**	**2.7**	**100.0**	**161.2**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	**3.5**	**100.0**	**–**	**–**	**11.7**	**100.0**	**15.2**	**100.0**
Total unsecured forbearance	**3.5**	**100.0**	**–**	**–**	**11.7**	**100.0**	**15.2**	**100.0**
Total forbearance	**153.1**	**100.0**	**8.9**	**100.0**	**14.4**	**100.0**	**176.4**	**100.0**

2016	Neither past due nor impaired		Past due not impaired		Impaired		Total	
Forbearance stock	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	0.1	0.2	0.6	11.0	0.2	8.7	0.9	0.7
Transfer to interest only	21.8	18.0	1.8	32.7	0.6	26.1	24.2	18.8
Term extension	44.5	36.8	1.9	34.5	0.8	34.8	47.2	36.7
Payment holiday	54.4	45.0	1.2	21.8	0.7	30.4	56.3	43.8
Total secured forbearance	120.8	100.0	5.5	100.0	2.3	100.0	128.6	100.0
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	–	–	9.8	100.0	12.7	100.0
Total unsecured forbearance	2.9	100.0	–	–	9.8	100.0	12.7	100.0
Total forbearance	123.7	100.0	5.5	100.0	12.1	100.0	141.3	100.0

Note 30: Financial risk management (continued)

(3) Funding and Liquidity risk

Funding risk is defined as the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

Liquidity risk is defined as the inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations to make payments as they fall due.

Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

Liquid asset portfolio

The Company maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or supranational institutions and deposits with the Bank of England. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to cover more extreme stress events and provide flexibility for liquidity management.

The table below shows the composition of the liquidity portfolio.

Composition of the liquidity portfolio	**2017 £m**	**2017 Average £m**	2016 £m	2016 Average £m
Level 1				
Cash and balances at central banks	**2,525.9**	**1,923.0**	737.2	819.6
UK Government securities	**207.3**	**221.8**	306.7	339.3
Other HQLA level 1 eligible	**–**	**–**	–	33.8
Supranational securities	**234.1**	**178.0**	129.3	222.0
Treasury bills raised through FLS	**1,850.6**	**2,219.7**	2,683.7	2,528.2
Covered bonds (Level 1 eligible)	**374.7**	**378.8**	304.9	434.4
Total level 1	**5,192.6**	**4,921.3**	4,161.8	4,377.3
Level 2a				
Covered bonds (Level 2a eligible)	**21.7**	**22.2**	22.2	22.4
Total level 2a	**21.7**	**22.2**	22.2	22.4
Level 2b				
Eligible RMBS	**50.1**	**52.6**	38.6	49.1
Total level 2b	**50.1**	**52.6**	38.6	49.1
High Quality Liquid Assets (Level 1 + 2a + 2b)	**5,264.4**	**4,996.1**	4,222.6	4,448.8
Other liquidity resources				
Covered Bonds	**–**	**–**	–	1.2
Non-eligible RMBS	**11.4**	**8.6**	13.6	11.6
Certificates of deposit	**–**	**37.6**	–	44.5
Floating rate notes	**–**	**7.7**	25.0	9.6
Total other liquidity resources	**11.4**	**53.9**	38.6	66.9
Self-issued RMBS	**601.7**	**958.2**	1,306.4	550.8
Total liquidity	**5,877.5**	**6,008.2**	5,567.6	5,066.5

The Company holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

Notes to the financial statements

Note 30: Financial risk management (continued)

The following tables analyse assets and liabilities of the Company into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Company's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms.

In particular, the majority of customer deposits are contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity.

2017 **Assets and liabilities by maturity profile**	**Within 3 months £m**	**3-12 months £m**	**1-5 years £m**	**After 5 years £m**	**Total £m**
Assets					
Cash and balances at central banks	**2,526.0**	**–**	**–**	**53.0**	**2,579.0**
Derivative financial instruments	**0.5**	**1.4**	**20.0**	**0.1**	**22.0**
Loans and receivables:					
Loans and advances to banks	**122.9**	**–**	**–**	**–**	**122.9**
Loans and advances to customers	**3,560.7**	**794.2**	**4,429.2**	**28,315.8**	**37,099.9**
Debt securities	**–**	**–**	**–**	**0.3**	**0.3**
Available-for-sale financial assets	**10.0**	**18.9**	**314.9**	**558.6**	**902.4**
Other assets	**71.4**	**8.2**	**58.7**	**154.1**	**292.4**
Total assets	**6,291.5**	**822.7**	**4,822.8**	**29,081.9**	**41,018.9**
Liabilities					
Deposits from banks	**16.7**	**850.0**	**4,511.0**	**–**	**5,377.7**
Customer deposits	**27,268.6**	**2,144.2**	**1,395.0**	**0.6**	**30,808.4**
Derivative financial instruments	**9.4**	**4.4**	**63.9**	**15.4**	**93.1**
Amounts due to securitisation special purpose vehicles	**218.7**	**142.1**	**767.6**	**1,172.0**	**2,300.4**
Debt securities in issue	**–**	**–**	**302.8**	**–**	**302.8**
Other liabilities	**178.0**	**70.2**	**5.7**	**3.4**	**257.3**
Total liabilities	**27,691.4**	**3,210.9**	**7,046.0**	**1,191.4**	**39,139.7**
Net liquidity (gap)/surplus	**(21,399.9)**	**(2,388.2)**	**(2,223.2)**	**27,890.5**	**1,879.2**

2016 Assets and liabilities by maturity profile	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Assets					
Cash and balances at central banks	737.2	–	–	49.1	786.3
Derivative financial instruments	1.4	1.1	31.2	1.5	35.2
Loans and receivables:					
Loans and advances to banks	229.7	–	–	–	229.7
Loans and advances to customers	2,901.9	720.1	3,910.6	25,176.3	32,708.9
Debt securities	–	–	–	0.7	0.7
Available-for-sale financial assets	–	25.0	283.2	550.6	858.8
Other assets	94.0	26.1	9.5	166.0	295.6
Total assets	3,964.2	772.3	4,234.5	25,944.2	34,915.2
Liabilities					
Deposits from banks	511.7	75.0	1,543.0	–	2,129.7
Customer deposits	24,540.2	1,883.6	1,682.5	–	28,106.3
Derivative financial instruments	8.3	6.2	183.6	27.2	225.3
Amounts due to securitisation special purpose vehicles	161.5	125.2	685.6	1,171.3	2,143.6
Debt securities in issue	–	–	305.8	–	305.8
Other liabilities	241.7	62.8	5.0	3.8	313.3
Total liabilities	25,463.4	2,152.8	4,405.5	1,202.3	33,224.0
Net liquidity (gap)/surplus	(21,499.2)	(1,380.5)	(171.0)	24,741.9	1,691.2

Note 30: Financial risk management (continued)

Funding sources

The table below shows the Company's sources of wholesale funding.

Source of wholesale funding	**2017 £m**	2016 £m
Amounts due to securitisation special purpose vehicles	**2,300.4**	2,143.6
Debt securities in issue	**302.8**	305.8
Liabilities in respect of securities sold under repurchase agreements	**1,130.0**	850.0
Secured loans	**4,236.0**	1,268.0
Total on-balance sheet sources of funds	**7,969.2**	4,567.4
Treasury bills raised through FLS	**2,033.5**	2,683.7
Total	**10,002.7**	7,251.1

Secured loans relate to the Company's drawings from the Bank of England's Term Funding Scheme (TFS). The increase is due to further TFS drawings that were made during the year.

The tables below show the residual maturity of the wholesale funding book.

2017 **Residual maturity of the wholesale funding book**	**Within 3 months £m**	**3-12 months £m**	**1-5 years £m**	**After 5 years £m**	**Total £m**
Amounts due to securitisation special purpose vehicles	**218.7**	**142.1**	**767.6**	**1,172.0**	**2,300.4**
Debt securities in issue	**–**	**–**	**302.8**	**–**	**302.8**
Liabilities in respect of securities sold under repurchase agreements	**5.0**	**850.0**	**275.0**	**–**	**1,130.0**
Secured loans	**–**	**–**	**4,236.0**	**–**	**4,236.0**
Total on-balance sheet sources of funds	**223.7**	**992.1**	**5,581.4**	**1,172.0**	**7,969.2**
Treasury bills raised through FLS	**–**	**1,098.5**	**935.0**	**–**	**2,033.5**
Total	**223.7**	**2,090.6**	**6,516.4**	**1,172.0**	**10,002.7**

2016 Residual maturity of the wholesale funding book	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Amounts due to securitisation special purpose vehicles	161.5	125.2	685.6	1,171.3	2,143.6
Debt securities in issue	–	–	305.8	–	305.8
Liabilities in respect of securities sold under repurchase agreements	500.0	75.0	275.0	–	850.0
Secured loans	–	–	1,268.0	–	1,268.0
Total on-balance sheet sources of funds	661.5	200.2	2,534.4	1,171.3	4,567.4
Treasury bills raised through FLS	–	649.2	2,034.5	–	2,683.7
Total	661.5	849.4	4,568.9	1,171.3	7,251.1

An increase in average tenor of wholesale funding during 2017 is driven by the drawings of TFS, which are categorised as 1-5 years maturity.

Note 30: Financial risk management (continued)

Encumbered assets

The Company's assets can be used to support funding collateral requirements for central bank operations or third party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes. The tables below show the total asset encumbrance position of the Company for 2017 and 2016.

2017	**Encumbered assets**		**Unencumbered assets**		**Total**
Asset encumbrance	**Pledged as collateral[1] £m**	**Other[2] £m**	**Available as collateral[3] £m**	**Other[4] £m**	**£m**
Cash balances at central banks	**–**	**215.7**	**–**	**2,363.3**	**2,579.0**
Debt securities classified as loans and receivables	**–**	**–**	**0.3**	**–**	**0.3**
Available-for-sale financial assets	**–**	**–**	**899.3**	**3.1**	**902.4**
Derivative financial assets	**–**	**–**	**–**	**22.0**	**22.0**
Loans and advances to banks	**89.7**	**–**	**–**	**33.2**	**122.9**
Loans and advances to customers	**13,109.4**	**–**	**4,670.3**	**19,320.2**	**37,099.9**
Other assets	**8.5**	**–**	**–**	**283.9**	**292.4**
Total assets	**13,207.6**	**215.7**	**5,569.9**	**22,025.7**	**41,018.9**
Treasury bills raised through FLS held off balance sheet[5]	**182.9**	**–**	**1,850.6**	**–**	**2,033.5**
Total assets plus off balance sheet treasury bills raised through FLS	**13,390.5**	**215.7**	**7,420.5**	**22,025.7**	**43,052.4**

2016	Encumbered assets		Unencumbered assets		Total
Asset encumbrance	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	£m
Cash balances at central banks	–	168.1	–	618.2	786.3
Debt securities classified as loans and receivables	–	–	0.7	–	0.7
Available-for-sale financial assets	10.6	–	840.3	7.9	858.8
Derivative financial assets	–	–	–	35.2	35.2
Loans and advances to banks	179.1	–	–	50.6	229.7
Loans and advances to customers	9,425.6	–	2,932.9	20,350.4	32,708.9
Other assets	53.9	–	–	241.7	295.6
Total assets	9,669.2	168.1	3,773.9	21,304.0	34,915.2
Treasury bills raised through FLS held off balance sheet[5]	–	–	2,683.7	–	2,683.7
Total assets plus off balance sheet treasury bills raised through FLS	9,669.2	168.1	6,457.6	21,304.0	37,598.9

1 Encumbered assets pledged as collateral include amounts to derivative counterparties of £89.7 million (2016: £179.1 million) and amounts in respect of centrally cleared derivatives of £8.5 million (2016: £53.9 million). Encumbered loans and advances to customers of £13,109.4 million (2016: £9,425.6 million) consist of securitised mortgages and other loan pools positioned with the Bank of England that have been pledged as collateral for funding and liquidity transactions. At 31 December 2017, £6,219.8 million (2016: £2,302.3 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements (refer note 14).

2 Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These comprise the mandatory reserve and the minimum requirement for the BACS payment system.

3 Unencumbered assets which are classified as 'available for collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'available for collateral' only if they are already in such a form that they can be used immediately to raise funding.

4 Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

5 These amounts represent Treasury Bills received by the Company through FLS which are not recognised on the balance sheet. The Company is permitted to re-pledge these securities to generate on-balance sheet financial assets, such as cash or to fund lending. These items are classified as encumbered where the Company has used them in repurchase transactions or unencumbered where it has not.

The Company's total level of asset encumbrance increased by £3,768.9 million to 31.6% (2016: 26.2%) This was primarily due to using the TFS to support increased lending, which took total drawings to date to £4,236.0 million. The Company manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Note 30: Financial risk management (continued)

Cash flow profile

The tables below allocate the Company's non-derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

2017 Maturity groupings for non-derivative cash outflows	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits from banks	**21.9**	**858.9**	**12.4**	**4,567.9**	**–**	**5,461.1**
Customer deposits	**27,338.1**	**847.3**	**1,495.7**	**1,571.6**	**0.6**	**31,253.3**
Amounts due to securitisation special purpose vehicles	**602.6**	**355.8**	**750.4**	**763.7**	**–**	**2,472.5**
Debt securities in issue	**–**	**6.8**	**–**	**313.5**	**–**	**320.3**
Total	**27,962.6**	**2,068.8**	**2,258.5**	**7,216.7**	**0.6**	**39,507.2**

2016 Maturity groupings for non-derivative cash outflows	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	513.5	76.7	3.1	1,556.8	–	2,150.1
Customer deposits	24,628.0	680.8	1,371.3	1,835.9	–	28,516.0
Amounts due to securitisation special purpose vehicles	507.2	386.3	632.7	807.5	–	2,333.7
Debt securities in issue	–	6.8	–	320.3	–	327.1
Total	25,648.7	1,150.6	2,007.1	4,520.5	–	33,326.9

The following tables display future derivative cash flows in the relevant maturity groupings in which they fall due. Cash flows for the floating legs of derivative transactions are calculated using the forward interest rate curve. These cash flows are not discounted in the same way that derivative valuations are, and totals will therefore not be identical to those reported on derivatives in other notes to the financial statements.

2017 Maturity groupings for derivative cash outflows	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.5)**	**(0.1)**	**(1.5)**	**(4.4)**	**–**	**(7.5)**
Derivatives in accounting hedge relationships	**(12.9)**	**(8.1)**	**(14.1)**	**(32.3)**	**(7.6)**	**(75.0)**
	(14.4)	**(8.2)**	**(15.6)**	**(36.7)**	**(7.6)**	**(82.5)**
Settled on a gross basis						
Outflows	**2.5**	**2.5**	**4.7**	**28.5**	**–**	**38.2**
Inflows	**(2.7)**	**(2.6)**	**(4.9)**	**(31.6)**	**–**	**(41.8)**
Total	**(14.6)**	**(8.3)**	**(15.8)**	**(39.8)**	**(7.6)**	**(86.1)**

Note 30: Financial risk management (continued)

2016 Maturity groupings for derivative cash outflows	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(1.7)	(0.5)	(2.2)	(10.2)	(0.2)	(14.8)
Derivatives in accounting hedge relationships	(26.1)	(21.2)	(37.6)	(110.0)	(6.2)	(201.1)
	(27.8)	(21.7)	(39.8)	(120.2)	(6.4)	(215.9)
Settled on a gross basis						
Outflows	1.4	2.6	2.5	23.3	–	29.8
Inflows	(1.5)	(3.0)	(2.8)	(26.6)	–	(33.9)
Total	(27.9)	(22.1)	(40.1)	(123.5)	(6.4)	(220.0)

External credit ratings

The Company's short and long-term credit ratings as at 31 December 2017 are as follows.

	Long Term	**Short Term**	**Outlook**	**Date of last rating action**	**Rating action type**
Fitch	BBB+	F2	Stable	7 September 2017	Affirmed
Moody's	Baa2	P2	Stable	26 June 2017	Assigned

In September 2017, the rating agency Fitch maintained the Company's outlook as Stable and affirmed its long-term rating at BBB+. On 26 June 2017, the rating agency Moody's assigned the Company's outlook as Stable and its long-term rating as Baa2.

The table below sets out the amount of additional collateral the Company would need to provide in the event of a one and two notch downgrade by external credit ratings agencies.

	Cumulative adjustment for a one-notch downgrade £m	**Cumulative adjustment for a two-notch downgrade £m**
31 December 2017	–	–
31 December 2016	–	10.0

Notes to the financial statements

Note 31: Cash flow statements

(a) Change in operating assets

	2017 £m	2016 £m
Change in loans and advances to customers	**(4,435.2)**	(5,355.1)
Change in derivative financial assets	**13.2**	45.5
Change in other operating assets	**31.1**	(64.8)
Change in operating assets	**(4,390.9)**	(5,374.4)

(b) Change in operating liabilities

	2017 £m	2016 £m
Change in deposits from banks	**3,248.6**	845.3
Changes in customer deposits	**2,702.1**	2,961.0
Change in derivative financial liabilities	**(132.2)**	70.0
Change in other operating liabilities	**145.9**	680.8
Change in operating liabilities	**5,964.4**	4,557.1

(c) Non-cash and other items

	2017 £m	2016 £m
Depreciation and amortisation	**29.7**	21.2
Other non-cash items	**3.6**	(9.9)
Total non-cash and other items	**33.3**	11.3

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2017 £m	2016 £m
Cash and balances at central banks	**2,579.0**	786.3
Less: mandatory reserve deposits[1]	**(53.0)**	(49.1)
	2,526.0	737.2
Loans and advances to banks	**122.9**	229.7
Deposits from banks	**(5,377.7)**	(2,129.7)
Less: amounts not repayable on demand	**5,377.7**	2,129.1
	–	(0.6)
Total cash and cash equivalents	**2,648.9**	966.3

1 Mandatory reserves with central banks are not available for use in day to day operations.

Notes to the financial statements

Note 32: Capital resources

Capital is a regulatory measure held by the Company to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support its business strategy against losses, inherent risks and stress events. In assessing the adequacy of its capital resources, the Company considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks.

The Company manages capital in accordance with prudential rules issued by the PRA, in line with the EU Capital Requirements Directive (referred to as CRD IV) which implements Basel III in Europe. CRD IV legislation became effective from 1 January 2014.

The Company is committed to maintaining a strong capital base and has complied with all capital requirements set by the regulators throughout the year.

The tables below analyse the composition of the regulatory capital resources of the Company on a CRD IV basis in both 2017 and 2016.

For regulatory capital purposes, the special purpose vehicles detailed in note 15 form part of the Virgin Money plc regulated entity. As such, these companies have been consolidated within these capital disclosures.

Own funds

	2017 £m	2016 £m
Ordinary share capital	**1,400.0**	1,400.0
Other equity instruments	**230.0**	230.0
Other reserves	**4.5**	4.1
Retained earnings	**244.7**	57.1
Total equity	**1,879.2**	1,691.2
Regulatory capital adjustments (unaudited)		
Net assets of special purpose vehicles	**19.1**	28.6
Foreseeable distribution on AT1 securities	**(2.1)**	(2.8)
Other equity instruments	**(230.0)**	(230.0)
Intangible assets	**(128.4)**	(80.6)
Excess of expected loss over impairment	**(46.9)**	(41.1)
Deferred tax on tax losses carried forward[1]	**(0.6)**	(7.3)
Additional valuation adjustment	**(1.2)**	(1.2)
Common Equity Tier 1 capital (unaudited)	**1,489.1**	1,356.8
Additional Tier securities	**230.0**	230.0
Tier 1 capital (unaudited)	**1,719.1**	1,586.8
Tier 2 capital (unaudited)		
General credit risk adjustments	**14.3**	11.9
Tier 2 capital	**14.3**	11.9
Total own funds (unaudited)	**1,733.4**	1,598.7

1 After consolidation of special purpose vehicles

Movements in Common Equity Tier 1 capital are summarised below.

(unaudited)	**2017 £m**	2016 £m
Common Equity Tier 1 capital at 1 January	**1,356.8**	1,227.6
Movement in retained earnings	**187.6**	128.1
Movement in revaluation reserve in respect of available-for-sale financial assets	**0.4**	4.4
Movement in foreseeable distribution on AT1 securities	**0.7**	(2.8)
Movement in net assets of special purpose vehicles	**(9.5)**	13.3
Movement in intangible assets	**(47.8)**	(17.6)
Movement in excess of expected loss over impairment	**(5.8)**	(5.7)
Movement in deferred tax on tax losses carried forward	**6.7**	10.7
Movement in additional valuation adjustment	**–**	(1.2)
Common Equity Tier 1 capital at 31 December	**1,489.1**	1,356.8

Note 32: Capital resources (continued)

Risk-weighted assets – Pillar 1

(unaudited)	**2017 £m**	2016 £m
AIRB mortgages	**5,790.5**	4,764.5
Other standardised lending	**2,282.9**	1,847.4
Other standardised assets	**322.6**	374.3
Credit valuation adjustments	**9.9**	21.7
Operational risks	**687.5**	595.1
Total risk-weighted assets	**9,093.4**	7,603.0

The Company calculates its capital requirement for mortgages on an Internal Ratings Based approach, and on the Standardised Basis for credit cards and other assets.

Capital ratios

Capital ratios are calculated as the capital measure shown divided by the total risk-weighted assets of the Company.

(unaudited)	**2017 %**	2016 %
Common Equity Tier 1 ratio	**16.4**	17.8
Tier 1 ratio	**18.9**	20.9
Total capital ratio	**19.1**	21.0

Note 33: Related party transactions

(a) Key Management personnel

Key Management personnel refer to the Executive Committee and Non-Executive Directors of the Company and its parent undertaking.

Compensation	**2017 £m**	2016 £m
Salaries and other short-term benefits	**5.7**	6.7
Share based payments	**5.6**	6.8
Pension contributions	**0.8**	0.8
Total compensation	**12.1**	14.3

Aggregate contributions in respect of Key Management personnel to defined contribution pension schemes £0.8 million (2016: £0.8 million).

Deposits	**2017 £m**	2016 £m
At 1 January	**1.2**	2.0
Placed (includes deposits of appointed Key Management Personnel)	**0.6**	1.4
Withdrawn (includes deposits of former Key Management Personnel)	**(1.1)**	(2.2)
Deposits outstanding at 31 December	**0.7**	1.2

Deposits placed by Key Management personnel attracted interest rates of up to 3.0% (2016: 3.0%). At 31 December 2017, the Company did not provide any guarantees in respect of Key Management personnel (2016: none).

At 31 December 2017, transactions, arrangements and agreements entered into with Key Management personnel included amounts outstanding in respect of loans and credit card transactions of £0.4 million with 6 Key Management personnel (2016: £0.7 million with 5 Key Management personnel).

Note 33: Related party transactions (continued)

(b) Directors' emoluments

Aggregate compensation in respect of the Company's directors were £6.8 million (2016: £4.7 million) comprising salary and other short-term benefits of £2.9 million (2016: £2.1 million), share-based payments of £3.5 million (2016: £2.3 million) and contributions to defined contribution pensions schemes £0.4 million (2016: £0.3 million).

The total compensation of the highest paid director was £2.9 million (2016: £3.0 million) comprising salaries and other short-term benefits of £1.1 million (2016: £1.1 million), share-based payments of £1.6 million (2016: £1.7 million) and contributions to defined contribution pensions schemes £0.2 million (2016: £0.2 million).

(c) Group Companies and other transactions

Details of subsidiaries are presented in note 15.

Transaction value for the year ended:

	2017 £m	2016 £m
Amounts owed by parent company	**5.5**	5.4
Amounts owed by fellow Group Companies	**10.2**	11.1
Amounts owed to fellow Group Companies	**(1.2)**	(1.4)
Trademark licence fees to Virgin Enterprises Limited	**(7.5)**	(6.6)
Commissions received and charges paid to Virgin Atlantic Airways Limited	**(0.5)**	(0.4)
Donations to The Virgin Money Foundation	**(1.4)**	(1.4)
Other costs to Virgin Management Group Companies	**(0.3)**	(0.2)

Balance outstanding at year end:

	2017 £m	2016 £m
Amounts owed by parent company	**88.0**	78.0
Amounts owed by fellow Group Companies	**3.4**	0.4
Amounts owed to parent company	**(0.3)**	(0.5)
Amounts owed to fellow Group Companies	**(0.1)**	(0.9)
Trademark licence fees to Virgin Enterprises Limited	**(0.6)**	(0.5)
Commissions received and charges paid to Virgin Atlantic Airways Limited	**0.1**	0.1
Asset recognised in relation to Virgin Atlantic Airways Limited agreement	**10.0**	–
Liability recognised in relation to Virgin Atlantic Airways Limited agreement	**(10.0)**	–
Donations to The Virgin Money Foundation	**–**	(0.2)
Other balances with Virgin Management Group Companies	**–**	(0.1)

A. Amounts owed by parent company and by fellow Group Companies

Interest is accrued on monies loaned to the parent company and fellow Group Companies at a margin of 1.5% over 3 Month Sterling LIBOR.

B. Trademark licence fees paid to Virgin Enterprises Limited

The Company paid licence fees to Virgin Enterprises Limited for use of the Virgin Money brand and trademark.

C. Virgin Atlantic Airways Limited

The Company receives credit card commissions and incurs air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties.

In June 2017 an agreement was signed with VAA which will give rise to related party transactions in future periods. An asset and liability has been recognised during the year in relation to a committed payment under this agreement.

Note 33: Related party transactions (continued)

D. Donations to The Virgin Money Foundation (the Foundation)

The Company has made donations to the Foundation in both the current and prior year to enable the Foundation to pursue its charitable objectives.

The Company has also provided a number of support services to the Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.4 million (2016: £0.3 million).

E. Other costs to Virgin Management Group Companies

These relate to transactions with other companies in the Virgin Group.

(d) Securitisation special purpose vehicles

The following transactions were carried out with the securitisation special purpose vehicles established in connection with the Company's securitisation programme:

2017	**Interest income £m**	**Interest expense £m**	**Amounts due from SPVs £m**	**Amounts due to SPVs £m**
Gosforth Funding 2014-1 plc	**0.9**	**6.2**	**58.4**	**420.0**
Gosforth Funding 2015-1 plc	**0.7**	**4.8**	**24.1**	**366.3**
Gosforth Funding 2016-1 plc	**2.2**	**10.1**	**84.5**	**510.4**
Gosforth Funding 2016-2 plc	**1.7**	**6.0**	**84.0**	**276.2**
Gosforth Funding 2017-1 plc	**0.3**	**2.2**	**21.3**	**727.5**
Total	**5.8**	**29.3**	**272.3**	**2,300.4**

2016	Interest income £m	Interest expense £m	Amounts due from SPVs £m	Amounts due to SPVs £m
Gosforth Funding 2011-1 plc	0.2	1.1	–	–
Gosforth Funding 2012-1 plc	0.6	1.0	–	–
Gosforth Funding 2012-2 plc	–	0.3	–	–
Gosforth Funding 2014-1 plc	1.3	9.3	68.9	572.5
Gosforth Funding 2015-1 plc	1.5	7.7	32.7	507.5
Gosforth Funding 2016-1 plc	2.5	12.8	107.1	687.1
Gosforth Funding 2016-2 plc	1.2	6.1	58.9	376.5
Total	7.3	38.3	267.6	2,143.6

Note 34: Events after balance sheet date

There have been no significant events between 31 December 2017 and the date of approval of the financial statements which would require a change or additional disclosure in the financial statements.

Note 35: Parent undertaking

The Company is a subsidiary of Virgin Money Holdings (UK) plc, a company registered in England and Wales.

Virgin Money Holdings (UK) plc is the largest and smallest group in which the financial statements of the Company are consolidated. The consolidated financial statements of Virgin Money Holdings (UK) plc may be obtained from Jubilee House, Gosforth, Newcastle-upon-Tyne, NE3 4PL.

The Company's direct and ultimate controlling party is Virgin Money Holdings (UK) plc.

Note 36: Future accounting developments

A number of new accounting standards and amendments to accounting standards have been issued by the IASB, however are not yet effective and have not been early adopted by the Company. Those which may be relevant to the Company are set out below.

(a) IFRS 9 *'Financial instruments'* (Effective 1 January 2018, EU endorsed on 22 November 2016)

Background

In July 2014, the IASB issued the final version of IFRS 9 *'Financial Instruments'* which replaces IAS 39 '*Financial Instruments: Recognition and Measurement'*. This new accounting standard is effective from 1 January 2018 and has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Company are from the changes to impairment.

Classification and Measurement

The Classification and Measurement requirements of IFRS 9 require financial assets to be classified into one of three measurement categories, fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) and amortised cost. For financial assets classification is based on the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. IFRS 9 retains most of the existing classification requirements for financial liabilities.

In relation to Classification and Measurement, IFRS 9 will not result in a significant change to current asset and liability measurement bases. The Company's debt security investment portfolio, which is classified as Available-for-Sale under IAS 39, will be reclassified into the FVOCI category on 1 January 2018, with no change in measurement basis and no impact to the Company's financial position. The Company's small number of equity investments, which are classified as Available-for-Sale under IAS 39, will be reclassified to either FVOCI or FVTPL on a case by case basis, with no change in measurement basis.

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach. IFRS 9 includes an accounting policy choice to maintain existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. The Company has decided to apply this accounting policy choice and will continue applying IAS 39 hedge accounting.

Impairment (Expected Credit Loss)

The impairment requirements of IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss approach, resulting in earlier recognition of credit losses. The IFRS 9 impairment model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2).

Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope for impairment. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology. It involves quantitative and qualitative measures and therefore requires considerable Management judgement. In addition IFRS 9 also requires the use of more forward-looking information including reasonable and supportable forecasts of future economic conditions.

Key accounting judgements

The Company undertook a full technical assessment of IFRS 9 which highlighted certain significant accounting policies and judgements. These areas include the selection of quantitative and qualitative criteria for the determination of significant increase in credit risk and the application of forward-looking data into the expected credit loss calculations, including multiple economic scenarios. The following summarises the key accounting judgements the Company will apply on adoption of IFRS 9:

Measurement of Expected Credit Loss

Expected credit loss is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether the asset meets the definition of default. Expected credit loss is the product of the probability of default (PD), exposure at default (EAD) and loss given default (LGD), discounted at the effective interest rate.

Note 36: Future accounting developments (continued)

Significant Increase in Credit Risk (movement from stage 1 to stage 2)

The Company has identified a series of quantitative, qualitative and backstop criteria that will be used to determine if an account has demonstrated a significant increase in credit risk, and therefore should move from stage 1 to stage 2:

- Quantitative measures consider the increase in an account's remaining lifetime PD compared to the expected residual lifetime PD when the account was originated. The Company will segment its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency.
- Qualitative measures include the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms.
- IFRS 9 includes a rebuttable presumption that 30 days past due is an indicator of a significant increase in credit risk. The Company considers 30 days past due to be an appropriate backstop measure and will not rebut this presumption.

Definition of default (movement to stage 3)

The Company has identified a series of quantitative and qualitative criteria that will be used to determine if an account meets the definition of default, and therefore should move to stage 3:

- IFRS 9 includes a rebuttable presumption that 90 days past due is an indicator of default. The Company considers 90 days past due to be an appropriate measure of default and will not rebut this presumption.
- Qualitative measures include the observation of specific events such as insolvency or enforcement activity.

Forward-looking information and multiple economic scenarios

The assessment of significant increase in credit risk and the calculation of expected credit loss both incorporate forward-looking information. The Company has identified the most significant macroeconomic factors including house price inflation, unemployment rate and Bank Base Rate. These variables and their associated impact on PD, EAD and LGD have been factored into the credit loss models.

The Company has determined an approach to the selection and application of multiple scenarios. The Company does not have an in-house economics function and will therefore source economic scenarios from a third party source to form the basis of the economic scenarios used. The Company will consider a minimum of three scenarios on a probability-weighted approach. These scenarios include a base, an upside and a downside scenario.

IFRS 9 implementation programme and governance

The Company has managed the transition to IFRS 9 through an IFRS 9 delivery programme to ensure a high-quality implementation in compliance with the accounting and regulatory guidance. The Audit Committee has had oversight responsibility for the implementation of IFRS 9.

The Company has developed and built new expected credit loss models for the key retail portfolios (secured and unsecured). The Company has run these models during the second half of 2017 in a period of parallel run to ensure full readiness in advance of implementation from 1 January 2018. The Company is in the process of completing the refinement and validation of these models. The Company's auditors have undertaken extensive audit procedures during the course of 2017 to provide proactive assurance over the new expected credit loss models and the Company's IFRS 9 accounting policies. The Company continues to monitor the wider market developments in relation to IFRS 9, including evolving disclosure requirements and regulatory developments such as potential capital transitionary rules.

Impact of transition to IFRS 9

The Company will record an adjustment to its opening 1 January 2018 retained earnings to reflect the application of the new requirements of IFRS 9 and will not restate comparative periods.

The Company estimates the transition to IFRS 9 will reduce shareholders' equity by approximately £35 million after deferred tax as at 1 January 2018. The impact on the Company's CET1 ratio will reflect the recently published capital transitional arrangements. This adjustment arises from the increase in the Company's balance sheet loan loss allowances as a result of the application of IFRS 9 requirements, with the Company's retail credit card portfolio being the most significantly impacted. The Company continues to refine, monitor and validate certain elements of the impairment models and related controls ahead of full reporting of IFRS 9 impacts later in 2018.

Note 36: Future accounting developments (continued)

(b) IFRS 15 'Revenue from Contracts with Customers' (Effective 1 January 2018, EU endorsed on 22 September 2016)

IFRS 15 replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' as a comprehensive standard to address current inconsistencies in accounting practice for revenue recognition. Financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of this standard.

The Company has reviewed the requirements of the new standard and it is not expected to have a significant impact, as a substantial proportion of the Company's income is generated from financial instruments.

(c) IFRS 16 'Leases (Effective 1 January 2019, EU endorsed on 31 October 2017)

This standard replaces IAS 17 'Leases' and will result in most leases for lessees being brought on to the Balance Sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged.

This will mainly impact properties the Company currently accounts for as operating leases. A project is in place and the Company is currently undertaking a review of its lease agreements. No decisions have been made yet in relation to transition options.

Note 37: Country by country reporting

The Capital Requirements (country by country reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV.

Refer to Virgin Money Holdings (UK) plc Group's annual report and accounts for country by country reporting disclosures.