2018 HALF-YEAR RESULTS

News release

BASIS OF PRESENTATION

This report covers the results of Virgin Money Holdings (UK) plc together with its subsidiaries ('Virgin Money', 'Virgin Money Group' or 'the Group') for the half-year ended 30 June 2018.

Statutory basis

Statutory information is set out in the condensed consolidated half-year financial statements section of this announcement.

Underlying basis

In order to present a more meaningful view of business performance for 2018, the results of the Group are presented on an underlying basis, which excludes:

- Strategic items; and
- Fair value gains/losses on financial instruments.

Reconciliations of the Group's statutory and underlying results are reported on pages 3 and 9 and in note 2 to the condensed consolidated half-year financial statements.

Alternative performance measures

A number of alternative performance measures (APMs), in addition to underlying profit, are used in the analysis and discussion of the Group's financial performance and position. APMs do not have standardised definitions and may not be directly comparable to any measures defined within International Financial Reporting Standards (IFRS). Details of all APMs, including the rationale for their use and their bases of calculation, are set out on page 66.

Forward looking statements

This document contains certain forward looking statements with respect to the business, strategy and plans of Virgin Money Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Virgin Money Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to Virgin Money's credit ratings; the ability to derive cost savings; changing demographic developments, including mortality, and changing customer behaviour, including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, the exit by the UK from the European Union (EU) and the potential for one or more other countries to exit the Eurozone or EU, and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to cyber security; natural and other disasters, adverse weather and similar contingencies outside Virgin Money's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices, including as a result of the exit by the UK from the EU, regulatory capital or liquidity requirements and similar contingencies outside Virgin Money's control; the policies and actions of governmental or regulatory authorities in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write–downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; market relating trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non–bank financial services and lending companies; and the success of Virgin Money in managing the risks of the foregoing.

Any forward looking statements made in this document speak only as of the date they are made and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange plc or applicable law, Virgin Money expressly disclaims any obligation or undertaking to release publicly any updates of revisions to any forward looking statements contained in this document to reflect any change in Virgin Money's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Note: The information in this announcement relates to Virgin Money as a standalone business and does not take into account the impact of the offer for Virgin Money from CYBG PLC which was announced on 18 June 2018.

Virgin Money Holdings (UK) plc - Registered in England and Wales (Company No. 03087587). Registered Office: Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL.

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VIRGIN MONEY GROUP: RESULTS FOR THE HALF-YEAR TO 30 JUNE 2018

Financial highlights

- Underlying profit before tax increased by 10 per cent to £141.6 million, from £128.6 million in H1 2017
- Statutory profit before tax increased to £127.2 million, compared to £123.8 million in H1 2017
- Underlying total income increased by 5 per cent to £343.0 million, from £327.2 million in H1 2017
- Return on tangible equity of 14.2 per cent
- Banking net interest margin of 164 basis points
- Cost:income ratio of 49.9 per cent
- Continued low cost of risk at 0.16 per cent under IFRS 9
- Common equity tier 1 ratio of 16.3 per cent and leverage ratio of 3.8 per cent
- Interim dividend of 2.3 pence per ordinary share to be paid in September 2018

Business update

- Disciplined approach to growth across our core markets
- SME savings franchise on track to deliver £500 million of new SME deposits by the end of 2018
- Virgin Atlantic partnership off to an excellent start with applications significantly ahead of expectations
- Joint venture with Aberdeen Standard Investments announced in March 2018 – new investment proposition planned for 2019
- Development of digital banking platform progressing well
- Strong customer satisfaction maintained with an overall Net Promoter Score (NPS) of +37
- Further improvement in our mean gender pay gap, with a 9 per cent reduction between April 2017 and April 2018 to 29.7 per cent

Jayne-Anne Gadhia, Chief Executive said:

“I am delighted to report that our customer-focused strategy of growth, quality and returns continued to drive strong financial and operational performance during the first half of the year. We also made good progress in delivering on our strategic initiatives.

“As a result of our disciplined approach to growth across our core markets and rigorous management of our cost base, underlying profit before tax was up 10 per cent to £141.6 million, our cost:income ratio improved to 49.9 per cent and our return on tangible equity was strong at 14.2 per cent.

“We continue to maintain a strong balance sheet, as shown in our common equity tier 1 ratio of 16.3 per cent. This benefited from recent changes to our capital models to ensure they fully reflected the excellent credit quality of our lending portfolios.

“Our SME savings franchise gathered real momentum and is on track to deliver £500 million of new deposits by the end of 2018. Our partnership with Virgin Atlantic has got off to a flying start and the development of our digital banking platform is progressing well.

“We remain focused on providing our customers with good value, straightforward products and an overall Net Promoter Score (NPS) of +37 continues to make Virgin Money one of the best-rated UK retail banks for customer satisfaction.

“I am delighted that we have continued to improve our gender pay gap, which reduced by a further 9 per cent over the last year. We remain committed to achieving 50:50 gender balance throughout the company by the end of 2020.

“The recommended offer made by CYBG for Virgin Money in June reflects confidence in our strategy, our track record of delivery and the complementary models of the two businesses and will accelerate the delivery of our strategic objectives.”

SUMMARY INCOME STATEMENT

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change %**	Half-year to 31 Dec 2017 £ million	**Change %**
Net interest income	**303.1**	288.5	**5.1**	306.1	**(1.0)**
Other income	**39.9**	38.7	**3.1**	32.7	**22.0**
Total income	**343.0**	327.2	**4.8**	338.8	**1.2**
Costs	**(171.0)**	(176.4)	**(3.1)**	(172.1)	**(0.6)**
Impairment[1]	**(30.4)**	(22.2)	**36.9**	(22.0)	**38.2**
Underlying profit before tax	**141.6**	128.6	**10.1**	144.7	**(2.1)**
Reconciling items between underlying and statutory profit before tax	**(14.4)**	(4.8)	**200.0**	(5.9)	**144.1**
Statutory profit before tax	**127.2**	123.8	**2.7**	138.8	**(8.4)**
Taxation	**(33.7)**	(33.3)	**1.2**	(37.2)	**(9.4)**
Statutory profit after tax	**93.5**	90.5	**3.3**	101.6	**(8.0)**
Distributions to Additional Tier 1 security holders (net of tax)	**(12.5)**	(12.4)	**0.8**	(12.4)	**0.8**
Profit attributable to equity shareholders	**81.0**	78.1	**3.7**	89.2	**(9.2)**
Basic earnings per share – statutory (pence)	**18.3**	17.7	**3.4**	20.2	**(9.4)**

1 The impairment charge in the half-year to 30 June 2018 reflects impairment charges on an expected credit loss basis in accordance with IFRS 9. The comparative figures reflect impairment charges on an incurred credit loss basis, as previously reported under IAS 39.

CONSOLIDATED BALANCE SHEET

	At 30 Jun 2018 £ million	At 30 Jun 2017 £ million	**Change %**	At 31 Dec 2017 £ million	**Change %**
Assets					
Cash and balances at central banks	**4,164.2**	3,677.0	**13.2**	2,579.0	**61.5**
Loans and advances to banks	**309.0**	522.3	**(40.8)**	359.4	**(14.0)**
Loans and advances to customers	**37,176.0**	34,683.9	**7.2**	36,740.2	**1.2**
- of which secured	**34,035.6**	31,927.5	**6.6**	33,716.1	**0.9**
- of which unsecured	**3,140.4**	2,756.4	**13.9**	3,024.1	**3.8**
Financial instruments at fair value through other comprehensive income	**1,638.3**	–	–	–	–
Available-for-sale financial assets	**–**	1,046.7	**(100.0)**	1,051.8	**(100.0)**
Disposal group assets held for sale	**19.7**	–	–	–	–
Other	**388.9**	386.5	**0.6**	377.4	**3.0**
Total assets	**43,696.1**	40,316.4	**8.4**	41,107.8	**6.3**
Liabilities and equity					
Deposits from banks	**7,083.4**	6,124.7	**15.7**	5,379.0	**31.7**
Customer deposits	**31,445.6**	29,564.2	**6.4**	30,808.4	**2.1**
Debt securities in issue	**2,939.2**	2,298.8	**27.9**	2,736.9	**7.4**
Disposal group liabilities held for sale	**3.0**	–	–	–	–
Other	**363.7**	590.7	**(38.4)**	358.6	**1.4**
Total liabilities	**41,834.9**	38,578.4	**8.4**	39,282.9	**6.5**
Total equity	**1,861.2**	1,738.0	**7.1**	1,824.9	**2.0**
Total liabilities and equity	**43,696.1**	40,316.4	**8.4**	41,107.8	**6.3**

KEY METRICS

		Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	**Change**	Half-year to 31 Dec 2017	**Change**
Banking net interest margin	%	**1.64**	1.72	**(8)bps**	1.72	**(8)bps**
Cost:income ratio	%	**49.9**	53.9	**(4.0)pp**	50.8	**(0.9)pp**
Cost of risk[1]	%	**0.16**	0.13	**3bps**	0.12	**4bps**
Statutory basic earnings per share	p	**18.3**	17.7	**0.6p**	20.2	**(1.9)p**
Tangible net asset value per share	£	**2.97**	2.84	**13p**	2.97	**-**
Total capital ratio	%	**21.1**	18.4	**2.7pp**	18.1	**3.0pp**
Common equity tier 1 ratio	%	**16.3**	13.8	**2.5pp**	13.8	**2.5pp**
Leverage ratio	%	**3.8**	3.9	**(0.1)pp**	3.9	**(0.1)pp**
Return on tangible equity	%	**14.2**	13.3	**0.9pp**	14.7	**(0.5)pp**

1 The cost of risk in the half-year to 30 June 2018 reflects impairment charges on an expected credit loss basis in accordance with IFRS 9. The comparative figures reflect impairment charges on an incurred credit loss basis under IAS 39, as previously reported in 2017.

Key ratios are presented on an underlying basis except where stated. Capital ratios include verified profit for H1 2018.

RECONCILIATION TO STATUTORY PROFIT

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change %**	Half-year to 31 Dec 2017 £ million	**Change %**
Underlying profit before tax	**141.6**	128.6	**10.1**	144.7	**(2.1)**
Strategic items	**(11.6)**	(5.5)		(1.0)	
Fair value gains/(losses) on financial instruments	**(2.8)**	1.3		(4.6)	
IPO share based payments	**-**	(0.6)		(0.3)	
Statutory profit before tax	**127.2**	123.8	**2.7**	138.8	**(8.4)**

CHIEF EXECUTIVE'S STATEMENT

Executive summary

I am delighted to report that our customer-focused strategy of growth, quality and returns continued to drive strong financial and operational performance during the first half of the year. We also made good progress in delivering on our strategic initiatives.

As a result of our disciplined approach to growth across our core markets and rigorous management of our cost base, underlying profit before tax was up 10.1 per cent to £141.6 million. Our cost:income ratio improved to 49.9 per cent, from 53.9 per cent, and our cost of risk remained low at 0.16 per cent. Taken together this delivered a return on tangible equity of 14.2 per cent.

Our SME savings franchise gathered real momentum and is on track to deliver £500 million of new deposits by the end of 2018. Our partnership with Virgin Atlantic has got off to an excellent start with a better than expected customer response to the launch of our new frequent flyer cards. We announced our joint venture with Aberdeen Standard Investments (ASI) in March 2018 with the intention to grow funds under management from 2019 and the development of our digital banking platform is progressing well.

During the period we repaid our remaining Funding for Lending Scheme (FLS) balances in full, using our final drawing from the Term Funding Scheme (TFS). Our inaugural MREL[1] eligible Medium Term Note issuance in April demonstrated the strength of our franchise. Over £900 million of investor demand resulted in a better than expected price for the £350 million of notes which we issued.

In March we submitted an application for a reduction in our mortgage risk-weights to the Prudential Regulation Authority (PRA), reflecting the excellent credit quality of our mortgage portfolio. The PRA have approved these model changes and the reduction in risk-weights resulted in a material increase in our common equity tier 1 (CET1) ratio to 16.3 per cent. Our total capital ratio was 21.1 per cent and our leverage ratio was 3.8 per cent at the end of the first half.

As a result of our strong performance, the Board has declared an interim dividend of 2.3 pence per ordinary share in respect of the half-year, which is up 21 per cent from the first half of 2017.

After considering the interests of shareholders and other stakeholders, in June the Board agreed a recommended all-share offer to be made by CYBG PLC for Virgin Money. The recommended offer reflects confidence in our strategy and the complementary strengths of the two businesses, and will accelerate the delivery of our strategic objectives.

Operating environment

According to the Office for National Statistics (ONS), UK gross domestic product (GDP) grew by 0.2 per cent in the three months to May, continuing the recent pattern of modest growth. The UK unemployment rate improved to 4.2 per cent, the lowest since 1975, and a 2.7 per cent increase in wage growth meant pay growth started to exceed inflation after a period of falling below it.

The strength of the UK labour market, wage growth and ongoing low mortgage rates continued to underpin mortgage approvals and the UK housing market, all of which are positive for our business and consumers. The Bank Base Rate is expected to rise over the coming years but increases are expected to be at a gradual pace and to a limited extent.

Although the economic environment, including the impact of the UK leaving the European Union, remains uncertain, the strength of our franchise, our customer-focused strategy and our commercial agility give us the flexibility to adapt to possible changes in the operating environment.

Business performance

Our customer-focused strategy of growth, quality and returns continued to drive strong business performance and our overall Net Promoter Score (NPS) of +37 maintained our position as one of the best-rated UK retail banks for customer satisfaction.

The ongoing competition in the mortgage market and differential between front and back book margins has, as expected, impacted our banking net interest margin. As a result of this, we have managed growth with a focus on maintaining the right margin and asset quality. To mitigate some of the competitive pressures we continued to invest in our franchise to deliver new products, support our intermediary partners and further develop our customer proposition. We achieved a gross lending market share of 2.2 per cent to the end of May and mortgage balances grew by 1.2 per cent to £34.1 billion, compared to market growth of 0.6 per cent. Asset quality continued to be a real strength with only 0.12 per cent of all mortgage assets three or more months in arrears.

1 Minimum Requirements for Own Funds and Eligible Liabilities

Our credit card book continued to perform strongly. A full and in depth analysis of customer behaviours as at 30 June was undertaken, which included the 49,000 customers who have come off their zero per cent promotion period during the first half of the year. This analysis resulted in a net adjustment to reduce total income by £7.8 million across the whole portfolio to reflect those behaviours over the seven year modelling period. £5.4 million of the total represents income previously recognised and £2.4 million represents the present value of income not yet earned.

Our partnership with Virgin Atlantic has got off to an excellent start with a better than expected customer response driving high quality new customer acquisition and increased levels of retail spend. Balance growth in the market was broadly flat during the first half of the year while we grew balances to £3.1 billion, up by 3.8 per cent since the end of 2017. On an IFRS 9 basis, our credit card book had a cost of risk of 187 basis points and arrears emergence remained low.

Customers continued to recognise the value of our savings proposition as demonstrated by growth of deposit balances to £31.4 billion in the first half of the year. We attracted £1.5 billion of net ISA flows, which represented a 19 per cent market share of new ISA inflows to the end of May, surpassing net ISA flows for both 2016 and 2017. The strength of our savings franchise was recognised by winning Best Bank Savings Provider at the 2018 Moneyfacts Awards and we were able to deliver competitive pricing for customers' savings while further reducing our weighted average cost of funds.

We opened a new Lounge in Cardiff in June and welcomed 441,000 visitors across our eight Lounges in the first six months of the year, up 18 per cent compared to first half of 2017. The Lounges complement our Stores, which continue to attract around a quarter of overall deposits.

Our Financial Services business line contributed £21.4 million of total income in the first half of 2018, an increase of 20 per cent supported by growth in funds under management to £3.7 billion. In our insurance business we continued to focus on profitable segments of the aggregator market. Insurance income increased by 70 per cent to £3.4 million as a result of a significant increases in sales of travel and life insurance, which both benefitted from renegotiated agreements with our commercial partners.

Differentiated business model continues to drive our ambition to make 'everyone better off'

The contribution to the communities in which we work is a fundamental part of Virgin Money's business model and strategy. Over 14,500 charities have registered with Virgin Money Giving, our not-for-profit online donation service, and more than £660 million has been donated to charities through the service since its launch in 2009, including almost £57 million in the first half of 2018.

The Virgin Money Foundation, which tackles social and economic disadvantage in the North East and beyond, has now provided over £5.5 million of awards to benefit good causes since launching in 2015. The Foundation launched its first grants programme to support charitable organisations across Norfolk with £500,000 in new funding in the first half of the year. This funding is aimed at developing new initiatives and enterprises focused on regenerating deprived communities in the area.

Gender Pay Gap

We are very supportive of the UK government initiative to improve equality through collecting and reporting gender pay data. At April 2018, our mean gender pay gap had reduced by 9 per cent compared with 2017, to 29.7 per cent. We remain committed to achieving 50:50 gender balance (within a 10 per cent tolerance) throughout the company by the end of 2020 and as we make further progress towards this our gender pay gap will continue to reduce.

Outlook

Our central planning scenario for the rest of the year assumes a continuation of resilient economic conditions. We expect to deliver continued strong performance for the full year including a CET1 ratio of around 15.5 per cent, before the benefit, estimated at around 40 basis points, expected to arise from the proposed joint venture with Aberdeen Standard Investments. We continue to deliver on our 2018 guidance and now anticipate a banking net interest margin for the full year 2018 of around 162 basis points, recognising continued pressure on mortgage spreads and our card income adjustment. All other guidance for 2018 remains unchanged and we look forward to the second half of the year with confidence, as we continue to drive strong returns for our shareholders.

Jayne-Anne Gadhia CBE
Chief Executive
25 July 2018

FINANCIAL REVIEW

Overview: Stable asset quality, continued focus on costs and disciplined growth delivered a further increase in profitability

In the first half of 2018 we experienced strong credit performance and continued to maintain a high quality balance sheet.

We managed asset growth to protect returns in a competitive environment. The robust performance of our savings franchise underpinned our growth and helped us to deliver a banking net interest margin of 164 basis points and net interest income growth of 5.1 per cent. Total income increased by 4.8 per cent on H1 2017 as we delivered positive momentum in other income.

Further improvements in operating leverage and effective cost management resulted in a 3.1 per cent reduction in costs. This reduction in costs resulted in the cost:income ratio reducing by 4.0 percentage points on H1 2017, to 49.9 per cent. The cost of risk of 0.16 per cent continued to evidence our commitment to prime lending segments.

Taken together, we delivered an underlying profit before tax of £141.6 million, 10.1 per cent higher than H1 2017. As a result, return on tangible equity improved to 14.2 per cent, from 13.3 per cent in the first half of 2017.

Balance sheet growth

	At 30 Jun 2018 £ million	At 31 Dec 2017 £ million	**Change**
Loans and advances to customers	**37,176.0**	36,740.2	**1.2%**
Customer deposits	**31,445.6**	30,808.4	**2.1%**
Wholesale funding (including government funding)	**10,013.2**	8,102.9	**23.6%**
Wholesale funding <1 year maturity	**687.0**	855.0	**(19.6)%**
Loan-to-deposit ratio	**118.3%**	119.1%	**(0.8)pp**
High quality liquid assets[1]	**5,338.1**	5,264.4	**1.4%**

1 At 31 December 2017 these included Funding for Lending Scheme (FLS) drawings of £1.9 billion which were held off balance sheet, but were available for repo and hence counted towards liquidity resources. FLS drawings were repaid in full during February 2018.

Lending was carefully managed to protect returns in the first half of 2018, with growth in loans and advances to customers of 1.2 per cent since year end.

Mortgage balances grew to £34.1 billion as we balanced our share of gross lending with our focus on returns. Volumes accelerated in the second quarter as we broadened our mortgage product offering. As a result, we entered the second half with a mortgage pipeline of £2.2 billion compared to £1.4 billion at year end.

Credit card balances grew to £3.1 billion during the half, including diversification of our portfolio with the successful launch of our new Virgin Atlantic credit cards.

Lending was funded by continued growth in our retail deposit franchise. Total customer deposits grew to £31.4 billion at 30 June 2018, with particularly strong performance in cash ISAs.

We took further steps to diversify our funding base with the launch of our new SME deposit accounts in the first half of 2018. Balances stood at over £160 million as at 30 June 2018, and we are on track to reach £500 million of new balances by the end of the year.

We repriced £1.5 billion of existing deposits in the first half of 2018, following on from significant repricing activity in 2017. This enabled us to reduce our cost of funds further and helped to offset margin pressure from lower asset spreads.

As a result of our strong performance in retail deposits, the loan-to-deposit ratio reduced to 118.3 per cent at 30 June 2018, down from 119.1 per cent the end of 2017. This is in line with our guidance for a gradual reduction to below 115 per cent in the medium term.

We continued to optimise the mix and duration of our funding base in the first half of 2018. TFS drawings totalled £6.4 billion at the closure of the scheme at the end of February 2018. TFS drawings in the first two months of the year were used to repay outstanding FLS balances in full.

In wholesale funding, having secured investment grade credit ratings for Virgin Money Holdings from Fitch and Moody's, in April we completed our inaugural MREL eligible Medium Term Note issuance of £350 million. The strength of investor demand enabled us to achieve a better price than our initial expectations.

Our regulated covered bonds programme is now established alongside our existing RMBS franchise, enabling further diversification of our funding in the future.

The Group maintained its strong liquidity position throughout the first half of 2018. At the balance sheet date high quality liquid assets stood at £5.3 billion. The repayment in full of off-balance sheet FLS drawings with our final TFS drawing, which is held on balance sheet, resulted in an increase of £2.0 billion in on balance sheet liquidity. At 176 per cent, our liquidity coverage ratio (LCR) remained significantly above the regulatory minimum of 100 per cent.

Income benefitted from growth in asset balances and optimisation of funding costs

	Half-year to 30 Jun 2018 £ million[1]	Half-year to 30 Jun 2017 £ million[1]	**Change**	Half-year to 31 Dec 2017 £ million[1]	**Change**
Net interest income	**303.1**	288.5	**5.1%**	306.1	**(1.0)%**
Other income	**39.9**	38.7	**3.1%**	32.7	**22.0%**
Total income	**343.0**	327.2	**4.8%**	338.8	**1.2%**
Banking net interest margin	**1.64%**	1.72%	**(8)bps**	1.72%	**(8)bps**
Average interest earning banking assets	**36,892**	33,303	**10.8%**	35,769	**3.1%**
Net interest margin	**1.41%**	1.59%	**(18)bps**	1.54%	**(13)bps**
Average interest earning assets	**42,818**	36,141	**18.5%**	39,840	**7.5%**

1 On an underlying basis.

Net interest income increased by 5.1 per cent to £303.1 million. This was driven by growth in loans and advances to customers of 7.2 per cent over the past year which more than offset the reduction in banking net interest margin.

The pressure on banking net interest margin from lower mortgage spreads was partially offset by further optimisation of our funding base, through both improved deposit spreads and the benefit from TFS funding, and by our decision to moderate mortgage balance growth in the competitive market environment.

Our credit card book continued to perform strongly. A full and in depth analysis of all customer behaviours as at 30 June was undertaken, which included the 49,000 customers who have come off their zero per cent promotion period in the first half of the year. This analysis resulted in a net adjustment to reduce total income by £7.8 million across the whole portfolio to reflect those behaviours over the seven year modelling period. £5.4 million of the total represents income previously recognised and £2.4 million represents the present value of income not yet earned.

As a result, banking net interest margin was 164 basis points in the first half of 2018.

Other income increased 3.1 per cent compared to the prior period, largely due to stronger trading in our fee generating Financial Services business lines.

Operational efficiency improved with tightly controlled costs and increased investment

	Half-year to 30 Jun 2018 £ million[1]	Half-year to 30 Jun 2017 £ million[1]	**Change**	Half-year to 31 Dec 2017 £ million[1]	**Change**
Costs	**171.0**	176.4	**(3.1)%**	172.1	**(0.6)%**
Cost:income ratio	**49.9%**	53.9%	**(4.0)pp**	50.8%	**(0.9)pp**

1 On an underlying basis.

Total costs remained tightly controlled, reducing by 3.1 per cent. Set against total income growth of 4.8 per cent this produced positive JAWS of 7.9 per cent and reduced the cost:income ratio by 4.0 percentage points, to 49.9 per cent.

This performance reflected the continued benefit of our scalable platform and disciplined cost management across the business.

In addition to our revenue expenditure, we continued to invest in the business with £44.1 million (H1 2017: £36.3 million) of capital expenditure. This supported the customer proposition, systems and processes in the core bank as well our strategic initiatives which included the continued build of the digital bank.

Impairments reflected a benign environment and rigorous credit risk management

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change**	Half-year to 31 Dec 2017 £ million	**Change**
Mortgages					
Impairment charge	**0.9**	1.4	**(35.7)%**	0.8	**12.5%**
Cost of risk[1]	**<0.01%**	0.01%	**(1)bp**	0.01%	**(1)bp**
Cards					
Impairment charge	**29.5**	20.8	**41.8%**	21.2	**39.2%**
Cost of risk[1]	**1.87%**	1.58%	**29bps**	1.44%	**43bps**
Group					
Impairment charge	**30.4**	22.2	**36.9%**	22.0	**38.2%**
Cost of risk[1]	**0.16%**	0.13%	**3bps**	0.12%	**4bps**
Provisions as a % of arrears balances[2 3]	**63.4%**			58.6%	**4.8pp**
% of loans classified as Stage 2[2]	**5.4%**			4.9%	**0.5pp**
% of Stage 2 loans not past due[2]	**90.6%**			88.6%	**2.0pp**

1 The cost of risk figures for the half-year to 30 June 2018 reflect impairment charges on an expected credit loss basis in accordance with IFRS 9. The comparative figures reflect impairment charges on an incurred credit loss basis under IAS 39.
2 The figures for 31 December 2017 are as at 1 January 2018 to reflect IFRS 9; please see note 19 of the condensed consolidated half-year financial statements for further detail.
3 Secured lending is classified as in arrears where the customer's payment shortfall exceeds 1 per cent of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.

Credit performance remained strong in the first half of 2018, reflecting our established risk appetite framework, ongoing focus on underwriting rigour and the origination of high credit quality customers and prime assets.

The cost of risk for mortgages on an IFRS 9 basis reduced to less than 0.01 per cent. This performance reflected our robust underwriting standards and the benign economic environment, leading to a continued low level of defaults. The percentage of mortgages over three months in arrears was 0.12 per cent at 30 June 2018 (31 December 2017: 0.12 per cent).

The impairment charge for credit cards grew from £20.8 million in the first half of 2017 to £29.5 million in the first half of 2018. £4.7 million of the £8.7 million increase was as a result of the change to reporting under IFRS 9 with the balance reflecting growth in the portfolio.

Provisions as a percentage of balances in arrears increased to 63.4 per cent (1 January 2018: 58.6 per cent) as we retained appropriate coverage of balances at risk of loss.

The proportion of loans classified as stage 2 under IFRS 9 has increased slightly over the half, reflecting the seasoning of our portfolios as the rate of asset growth slowed compared to prior periods. 90.6 per cent of stage 2 loans are up to date. IFRS 9 transitional disclosures are available in note 19 to the condensed consolidated half-year financial statements.

The proportion of credit-impaired assets as a percentage of total loans and advances remained low at 0.6 per cent as at 30 June 2018 (1 January 2018: 0.5 per cent).

Underlying profit before tax to statutory profit before tax reconciliation

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	Half-year to 31 Dec 2017 £ million
Underlying profit before tax	**141.6**	128.6	144.7
Strategic items	**(11.6)**	(5.5)	(1.0)
Fair value gains/(losses) on financial instruments	**(2.8)**	1.3	(4.6)
IPO share based payments	**-**	(0.6)	(0.3)
Reconciling items between underlying and statutory profit before tax	**(14.4)**	(4.8)	(5.9)
Statutory profit before tax	**127.2**	123.8	138.8

Note: The reconciliation of the Group's statutory and underlying results are reported above and in note 2 to the condensed consolidated half-year financial statements.

In 2018 the items affecting underlying performance relate to two categories: costs incurred as a result of strategic developments and the non-cash movement in the fair value of financial instruments. Further detail is given below:

> Strategic items

We incurred strategic investment costs of £11.6 million in the first half of 2018. This included a £10.0 million non-recurring cost to support the launch of Virgin Atlantic financial services products. The remainder related to the development of our digital banking platform.

> 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 underlying profit better represents the underlying performance of the Group. Where derivatives are terminated prior to maturity, this may give rise to fair value movements that do not reverse.

> IPO share based payments

These costs related to share based payment charges triggered by our successful IPO in 2014. 2017 was the last year in which such charges were incurred.

Taxation

In the first half of 2018, the Group recognised a corporation tax charge of £33.7 million. The effective tax rate was 26.5 per cent.

Continued strong progression in returns

		Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	**Change**	Half-year to 31 Dec 2017	**Change**
Return on tangible equity	**%**	**14.2**	13.3	**0.9pp**	14.7	**(0.5)pp**
Return on assets[1]	**%**	**0.43**	0.43	**-**	0.46	**(3)bps**
Tangible net asset value per share	**p**	**297**	284	**13p**	297	**-**

1 Return on assets on a statutory basis, excluding AT1 coupons and other exceptional items, was 0.43 per cent in the first half of 2018, compared to 0.45 per cent in in the first half of 2017.

Income growth and continued operational leverage, combined with our rigorous approach to underwriting and asset quality, have enabled us to deliver attractive returns in the first half of 2018.

Return on tangible equity increased to 14.2 per cent in the first half of 2018 from 13.3 per cent in the first half of 2017. Return on assets was stable at 0.43 per cent in H1 2018.

Tangible net asset value per share was 297 pence, 13 pence higher than as at 30 June 2017. This figure includes the day one impact from IFRS 9. Transitional disclosures upon adoption of IFRS 9 are available in note 19 to the condensed consolidated half-year financial statements. Without that impact, tangible net asset value per share would have been a further 8 pence per share higher at 305 pence as at 30 June 2018.

Capital strength whilst investing in the future

		At 30 Jun 2018	At 31 Dec 2017	Change
Common Equity Tier 1 capital (CET1)	£ million	**1,314.3**	1,264.2	**4.0%**
Risk-weighted assets (RWAs)	£ million	**8,059.3**	9,178.6	**(12.2)%**
> of which mortgage credit risk RWAs	£ million	**4,394.3**	5,790.5	**(24.1)%**
> of which credit card credit risk RWAs	£ million	**2,389.4**	2,282.9	**4.7%**
> of which all other RWAs	£ million	**1,275.6**	1,105.2	**15.4%**
Common Equity Tier 1 ratio	%	**16.3**	13.8	**2.5pp**
Tier 1 ratio	%	**21.1**	18.0	**3.1pp**
Total capital ratio	%	**21.1**	18.1	**3.0pp**
Leverage ratio	%	**3.8**	3.9	**(0.1)pp**

Capital ratios

Our capital ratios improved significantly during the first half of 2018 as a result of continued growth in capital resources set against a reduction in risk-weighted assets (RWAs). This led to a 2.5 percentage point increase in our CET1 ratio to 16.3 per cent, and a 3.0 percentage point increase in our total capital ratio to 21.1 per cent.

The leverage ratio at 30 June 2018 was 3.8 per cent which reflected the growth in our lending portfolios and higher levels of on balance sheet liquidity as FLS was repaid in full.

Capital resources

During the first half of 2018 we generated profit attributable to equity shareholders of £81.0 million, an increase of 3.7 per cent when compared to the same period in 2017.

This profit flowed into capital resources and after allowing for investment, dividends and movements in regulatory items this generated a net increase in CET1 capital in the first half of £50.1 million which was in turn used to support customer lending.

Risk-weighted assets

We received approval for improvements to our AIRB models which reduced mortgage risk-weight density at 30 June 2018 to 12.9 per cent from 17.7 per cent. These improvements, after taking into account growth in balances, resulted in mortgage RWAs at 30 June 2018 of £4.4 billion, a £1.4 billion reduction compared to £5.8 billion at 31 December 2017.

Credit card credit risk RWAs increased to £2.4 billion, principally in line with balance growth as our credit card RWAs are calculated using the standardised approach.

Other RWAs increased to £1.3 billion, driven by increased operational risk RWAs which were recalibrated during the first half of the year to reflect the growth in average income over the past three years, in line with the standardised approach.

Total RWAs at 30 June 2018, after mortgage risk-weight model improvements, were 12.2 per cent lower than at 31 December 2017 at £8.1 billion.

Capital requirements

Our 2018 Supervisory Review and Evaluation Process (“SREP”) took effect from 5 July 2018 (see page 31 for further details). If this outcome had been effective at 30 June 2018 our minimum regulatory requirements for CET1 and total capital would have been 9.9 per cent and 15.8 per cent respectively. The minimum applicable leverage requirement recommended by the EBA remains at 3.0 per cent.

We therefore have significant headroom at 30 June 2018 against our minimum regulatory requirements (6.4 percentage points above minimum CET1 ratio; 5.3 percentage points above minimum total capital and 0.8 percentage points above expected minimum leverage ratio at 30 June 2018) to support investment in our strategic objectives and future growth.

Dividend

The Board has recommended a 21.1 per cent increase in the interim dividend to 2.3 pence per ordinary share, reflecting the performance of the business and our confidence in our future plans.

Conclusion

In the first half of 2018 we delivered continued strong financial performance. Our focus on maintaining a high quality balance sheet and strong credit quality, along with further cost improvement has resulted in improved returns for our shareholders across RoTE, earnings per share and tangible net asset value. This has been achieved with further diversification of our funding base and deposit franchise, and with continued focus on investment in our strategic initiatives. The PRA's agreement to a reduction in mortgage risk-weight density creates significant headroom to redeploy capital in support of further growth.

Peter Bole
Chief Financial Officer
25 July 2018

BUSINESS LINE HIGHLIGHTS

MORTGAGES AND SAVINGS

We provide mortgages, savings and current accounts to almost 1.8 million customers. Mortgages are sold primarily through our intermediary partners and retail deposits are largely originated through our direct to consumer digital channel and store network.

Our Mortgage and Savings business line is an important revenue driver for the Group, contributing 66.0 per cent of total income in the first half of 2018.

Half-year highlights

- net interest income increased by 8.6 per cent to £224.9 million largely driven by growth in mortgage balances over the past year;
- we continued to invest in the mortgage franchise to deliver new products, support our intermediary partners and develop our customer proposition, all within our existing portfolio risk appetite. This enabled us to optimise margins and mitigate some of the competitive pressures in the mortgage market;
- lower funding costs partially offset the pressure on spreads in the mortgage market. As a result we delivered a NIM of 1.32 per cent in the Mortgage and Savings business, compared to 1.34 per cent in H1 2017;
- mortgage balances grew by £0.4 billion in the half as we moderated gross lending to £2.8 billion (H1 2017: £4.3 billion), focusing on growing assets at the right margin and quality;
- we successfully retained 72 per cent of customers with maturing fixed rate or tracker mortgage products, consistent with prior periods;
- credit quality remained strong, with the cost of risk below 0.01 per cent (H1 2017: 0.01 per cent);
- three month plus arrears are 0.12 per cent compared to the latest industry average of 0.81 per cent;
- mortgage risk-weight model changes were implemented resulting in risk-weights that better reflect the excellent credit quality of our mortgage portfolio. The average risk-weight reduction of 27 per cent arising from these changes more than offset an underlying increase in mortgage risk-weights; and
- deposit balances increased to £31.4 billion and we continued to retain 86 per cent of maturing fixed rate deposit balances.

Mortgages key developments

We offer customers a range of residential and buy-to-let mortgages in the prime secured lending market supported by excellent customer service. Mortgages are sold predominantly through our intermediary partners, supplemented by direct distribution.

In the first half we have:

- expanded our reach into new customer segments with the launch of a portfolio landlord proposition, new 7 and 10 year fixed rate products and the extension of Shared Ownership lending nationwide;
- increased the proportion of new mortgage applications from direct customers to 13.3 per cent, from 10.4 per cent in the first half of 2017;
- increased our mortgage NPS in the first half of 2018 to +49, 7 points higher than our mortgage NPS for 2017, driven by positive service experiences;
- achieved a 4.5 out of 5 rating for our service in real-time feedback on our website from intermediary partners; and
- maintained our high quality mortgage book, with an average portfolio LTV of 57.1 per cent (31 December 2017: 55.8 per cent).

Savings key developments

We offer retail customers a range of competitively-priced instant access and fixed term savings products. These are also available as ISAs and distributed primarily through our digital channels supplemented by our stores and contact centres. We attract and retain customers with enduring good value offers and excellent service.

During the first half we enhanced our proposition and broadened our reach with the launch of SME deposit products and the introduction of new savings options for retail customers while making improvements to our customer journeys:

- stores accounted for 23.3 per cent of new inflows in the first half (H1 2017: 20.8 per cent) supported by new technology, additional marketing and training;
- we repriced £1.5 billion of existing deposits in the first half of 2018, following the repricing of £15 billion of deposits in 2017;
- we surpassed net ISA flows for 2016 and 2017, achieving £1.5 billion of net flows which represented a 19 per cent share of ISA inflows to the end of May;
- our ISA proposition was recognised by winning Best Cash ISA provider at both the Moneyfacts and Savings Champion Awards;
- we have seen a strong response to our new variable and fixed rate SME deposit proposition. SME balances ended the half at over £160 million;
- in June we expanded our partnership with Virgin Atlantic by launching an innovative savings account where customers earn Flying Club miles in place of interest, the first and only savings account in the UK to offer such a feature; and
- the strength of our overall savings franchise was recognised by winning Best Bank Savings Provider at the Moneyfacts Awards.

Performance summary – Mortgages and Savings

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change**	Half-year to 31 Dec 2017 £ million	**Change**
Net interest income	**224.9**	207.0	**8.6%**	223.2	**0.8%**
Other income	**1.5**	1.6	**(6.3)%**	1.5	**-**
Total underlying income	**226.4**	208.6	**8.5%**	224.7	**0.8%**
Impairment charge	**(0.9)**	(1.4)	**(35.7)%**	(0.8)	**12.5%**
Mortgages and savings net interest margin	**1.32%**	1.34%	**(2)bps**	1.37%	**(5)bps**
Cost of risk	**<0.01%**	0.01%	**(1)bp**	0.01%	**(1)bp**

Key balance sheet items

	At 30 Jun 2018 £ million	At 31 Dec 2017 £ million	**Change**
Loans and advances to customers[1]	**34,068.7**	33,672.4	**1.2%**
– of which prime residential	**27,443.1**	27,306.4	**0.5%**
– of which buy-to-let	**6,625.6**	6,366.0	**4.1%**
Customer deposits	**31,445.6**	30,808.4	**2.1%**
Total customer balances	**65,514.3**	64,480.8	**1.6%**
Risk-weighted assets	**4,980.2**	6,308.1	**(21.1)%**

1 Excluding fair value of portfolio hedging

CREDIT CARDS

We provide credit card products, predominantly online, to 1.3 million customers. Our portfolio is a mix of balance transfer and retail credit cards, and our offering continues to develop with the launch of our Virgin Atlantic affinity products in the first half of 2018.

Our Credit Cards business line contributed 26.1 per cent of total income in the first half of 2018.

Half-year highlights

- credit card balances increased to £3.1 billion at 30 June 2018, an increase of 3.8 per cent since the end of 2017 benefitting from the diversification of our portfolio through our new Virgin Atlantic proposition. Excluding the day one IFRS 9 adjustment of £44.8 million the growth was 5.4 per cent;
- net interest income stood at £78.2 million after an adjustment to the portfolio effective interest rate of £7.8 million reflecting the latest behavioural information (see page 7 in the Financial Review and note 1 to the condensed consolidated half-year financial statements for further details). Prior to that adjustment, net interest income had grown by 5.5 per cent reflecting balance growth;
- other income increased by 16.5 per cent to £11.3 million, driven by higher interchange and foreign exchange income, reflecting increased retail volumes and a higher mix of retail accounts;
- impairments increased reflecting growth in balances combined with the impact of earlier recognition of losses under IFRS 9. There was no underlying deterioration in performance, reflecting the strong credit quality of the book as unsecured 2 month plus arrears levels remained low at 0.93 per cent (31 December 2017: 0.88 per cent). The reported cost of risk was 1.87 per cent under IFRS 9; and
- our customer indebtedness scores remained better than the market average, driven by strong affordability and affluence established at the point of underwriting. The profile of newly acquired customers was unchanged.

Key developments

- we successfully launched a range of Virgin Atlantic credit cards, with a stronger than expected customer response driving high quality new customer acquisition and increased levels of retail spend;
- we issued over 37,000 new Virgin Atlantic cards, reflecting strong customer demand. A significant proportion of Virgin Atlantic customers are choosing a card with an annual fee, supporting other income;
- as expected, the credit quality of the new Virgin Atlantic card customers is superior to that of the existing portfolio, reflecting the more affluent nature of the customer base; and
- 193,000 new accounts were opened in total in H1 2018 (H1 2017: 150,000), of which 64 per cent were retail-led (H1 2017: 42 per cent), with spend per active account 10 per cent higher than H1 2017.

Performance summary – Credit Cards

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change**	Half-year to 31 Dec 2017 £ million	**Change**
Net interest income	**78.2**	81.5	**(4.0)%**	82.9	**(5.7)%**
Other income	**11.3**	9.7	**16.5%**	9.7	**16.5%**
Total underlying income	**89.5**	91.2	**(1.9)%**	92.6	**(3.3)%**
Impairment charge	**(29.5)**	(20.8)	**41.8%**	(21.2)	**39.2%**
Credit cards net interest margin	**5.17%**	6.19%	**(102) bps**	5.72%	**(55) bps**
Cost of risk	**1.87%**	1.58%	**29 bps**	1.44%	**43 bps**

Key balance sheet items

	At 30 Jun 2018 £ million	At 31 Dec 2017 £ million	**Change**
Loans and advances to customers	**3,140.4**	3,024.1	**3.8%**
Total customer balances	**3,140.4**	3,024.1	**3.8%**
Risk-weighted assets	**2,615.3**	2,467.6	**6.0%**

FINANCIAL SERVICES

The Financial Services business line offers customers investments and pensions, insurance and currency products and services. We work in partnership with a number of specialist organisations to deliver these products, which generate attractive returns and consume low levels of capital.

Our Financial Services business line contributed 6.2 per cent of total income in the first half of 2018.

In the first half we continued to enhance our propositions in this business line and announced our forthcoming joint venture with Aberdeen Standard Investments.

Half-year highlights

- total funds under management at 30 June 2018 were £3.7 billion, 6.2 per cent higher than 30 June 2017;
- investments and pensions income increased by 13.9 per cent on the same period in 2017 to £18.0 million;
- insurance and other income increased by 70.0 per cent on the same period in 2017 to £3.4 million due to significant increases in sales of travel and life insurance, which both benefitted from renegotiated agreements with our commercial partners;
- new travel insurance policy sales were up 27 per cent on H1 2017 reflecting our ability to offer more competitive, value-accretive pricing under a revised agreement with our partner MAPFRE; and
- we achieved 6,500 life insurance sales in the first half, compared to 4,000 sales in H2 2017, an increase of over 60 per cent following the launch of our new proposition during H1 2017.

Key developments

- in March we announced a new partnership with Aberdeen Standard Investments for investments and pensions, which we expect will deliver growth in assets under management; and
- the first new products under this partnership are expected to be offered to customers in 2019.

Performance summary – Financial Services

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change**	Half-year to 31 Dec 2017 £ million	**Change**
Investments and pensions	**18.0**	15.8	**13.9%**	16.2	**11.1%**
Insurance and other	**3.4**	2.0	**70.0%**	3.2	**6.2%**
Total underlying income	**21.4**	17.8	**20.2%**	19.4	**10.3%**

Key balance sheet items

	At 30 Jun 2018 £ million	At 31 Dec 2017 £ million	**Change**
Risk-weighted assets	**55.5**	53.4	**3.9%**

CENTRAL FUNCTIONS

Our Central Functions provide shared support services to each of our business lines. These services include Information Technology and Property, together with functions such as Risk, Finance, Treasury, Human Resources and the Group's Executive. It is not our policy to allocate operating costs to each business line, as we manage operating costs across the business as a whole. This has the benefit of more effective cost management.

This part of our business contributed 1.7 per cent of total income in the first half of 2018 from the sale of treasury assets and debt securities sold by our Treasury function.

Half-year highlights

- other income in the first half of 2018 decreased by £3.9 million compared to the first half of 2017. H1 2017 included a gain of £6.1 million from the sale of Vocalink shares. Excluding this gain, other income increased by £2.2 million, largely due to higher income from sales of treasury assets; and
- total costs remained tightly controlled, reducing by 3.1 per cent as we continued to focus on the realisation of benefits through our scalable platform and disciplined cost management across the business. The increase in staff costs was due to project related activity, including investment in the digital bank.

Key developments

- risk-weights in this business line have increased by 16.8 per cent predominantly due to an increase in the liquidity portfolio following replacement of off-balance sheet FLS treasury bills with on-balance sheet liquidity.

Performance summary – Central Functions

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	**Change**	Half-year to 31 Dec 2017 £ million	**Change**
Other income	**5.7**	9.6	**(40.6)%**	2.1	**171.4%**
Total underlying income	**5.7**	9.6	**(40.6)%**	2.1	**171.4%**
Total underlying costs	**(171.0)**	(176.4)	**(3.1)%**	(172.1)	**(0.6)%**

Key balance sheet items

	At 30 Jun 2018 £ million	At 31 Dec 2017 £ million	**Change**
Risk-weighted assets	**408.3**	349.5	**16.8%**

Operating costs

	Half-year to 30 Jun 2018 £ million[1]	Half-year to 30 Jun 2017 £ million[1]	**Change**	Half-year to 31 Dec 2017 £ million[1]	**Change**
Staff costs	**99.4**	89.9	**10.6%**	100.8	**(1.4)%**
Premises and equipment	**15.9**	15.5	**2.6%**	14.5	**9.7%**
Other expenses	**40.2**	56.0	**(28.2)%**	41.4	**(2.9)%**
Depreciation, amortisation and impairment	**15.5**	15.0	**3.3%**	15.4	**0.6%**
Total costs	**171.0**	176.4	**(3.1)%**	172.1	**(0.6%)**

1 On an underlying basis.

RISK MANAGEMENT REPORT

As a UK retail bank we are focused on serving domestic customers. We are subject to risks arising from macro-economic conditions in the UK, geopolitical uncertainty, market conditions and new structural and regulatory changes which will come into force over the next few years. Our ongoing focus on maintaining a strong retail deposit franchise, building an SME deposit offering, and growing high-quality lending portfolios is supported by clearly defined risk appetite and a robust approach to both financial and non-financial risk management.

The Board-approved risk appetite reflects our tolerance for risk in pursuit of our strategic objectives. It is designed to achieve an appropriate balance between risk and reward. Risk appetite is embedded in the business through delegation of authority from the Board to the Executive. Our risk management approach is fully aligned with Board risk appetite, regulatory requirements and industry good practice.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks faced by the Group are summarised below. Except where noted, there has been no significant change to the description of these risks or key mitigating actions disclosed in the Group's 2017 Annual Report and Accounts (pages 36 to 39), with any quantitative disclosures updated below.

Credit risk

Credit risk is the risk of loss resulting from a borrower or counterparty failing to pay amounts due. We provide 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 operational exposures, our liquid asset portfolio and the use of derivative instruments to manage interest rate risk.

Market risk

Market risk is the risk that unfavourable market movements lead to a reduction in earnings or value. We do not trade or make markets. Interest rate risk is the only material category of market risk for the Group.

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, cybercrime and information security remains a key focus for the Group. During 2018, the Group will become a direct member of all relevant UK inter-bank payment systems.

Conduct risk and compliance

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

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 credit concentration risk, which is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels.

Financial performance can be impacted by adverse changes in customer behaviour. Customer behaviour is monitored monthly and reviewed quarterly at cohort, product and portfolio levels.

Funding and liquidity risk

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

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.

Capital risk

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

CREDIT RISK MANAGEMENT

Overview

The Group’s credit risk exposures are categorised as retail (secured and unsecured) and wholesale. As at 30 June 2018, the total credit risk exposures of the Group totalled £43.5 billion, comprising secured loans and advances to customers of £34.1 billion (78.3%), unsecured loans and advances to customers of £3.2 billion (7.4%) and wholesale exposures of £6.2 billion (14.3%).

Adoption of IFRS 9

The Group adopted IFRS 9 ‘*Financial Instruments*’ on 1 January 2018, which supersedes IAS 39 *‘Financial Instruments: Recognition and Measurement’*. This new accounting standard has three key areas of change: impairment, classification and measurement, and hedge accounting.

Impairment

The impairment requirements of IFRS 9 affect the Group’s retail and wholesale portfolios and introduce an expected credit loss (ECL) assessment, resulting in earlier recognition of credit losses.

ECL is calculated as the product of Probability of Default, Exposure at Default and Loss Given Default for each account, which are defined as:

- Probability of Default (PD) is an estimate of the likelihood of the account defaulting over either 12 months or the lifetime of the account.
- Exposure at Default (EAD) is the amount the Group expects the customer account to represent at the point of default.
- Loss Given Default (LGD) is the amount of loss that will be incurred in the event of default.

IFRS 9 also requires that multiple forward-looking macro-economic scenarios are incorporated into the ECL calculation.

A three stage categorisation is used for assessing impairment under IFRS 9. This is outlined in the table below.

Credit risk categorisation	Expected credit loss calculation period	Description
Stage 1	12 months	A loan that is not credit-impaired on initial recognition and has not experienced a significant increase in credit risk.
Stage 2	Lifetime	If a significant increase in credit risk has occurred since initial recognition, the loan is moved to stage 2, but is not yet deemed to be credit-impaired.
Stage 3	Lifetime	If the loan is credit-impaired it is moved to stage 3. All expired term, fraud and operational risk loans are treated as credit-impaired.

Further information regarding IFRS 9, including transition disclosures, can be found in note 19 to the condensed consolidated half-year financial statements.

The illustrative reconciliation of the IAS 39 retail impairment allowance at 31 December 2017 to the IFRS 9 retail ECL at 1 January 2018 is shown in the table below.

	£m
At 31 December 2017 – IAS 39 incurred loss provision	59.4
Removal of latent risk and other calibration differences	(14.0)
12 month ECL	3.9
Lifetime ECL	42.1
Undrawn balances	11.6
Multiple economic scenarios	1.2
At 1 January 2018 – IFRS 9 expected credit loss	**104.2**

The reconciling items in the table above represent:

Latent risk and other calibration differences: Under IFRS 9, an ECL is recognised for every financial asset, on either a 12 month or lifetime basis. This reconciling item removes the provision held under IAS 39 for losses which had been incurred, but not specifically identified at the reporting date, and adjustments arising from other calibration differences under IFRS 9.

12 month ECL: IFRS 9 recognises a 12 month ECL on all performing loans classified as stage 1. Under IAS 39, an impairment provision would only have been recognised against these accounts to the extent there were observable indicators of impairment.

Lifetime ECL: IFRS 9 recognises a lifetime ECL on all loans that have experienced a significant increase in credit risk. Under IAS 39, an impairment provision would only have been recognised against these accounts to the extent there were observable indicators of impairment.

Undrawn balances: IFRS 9 requires an impairment allowance to be recognised on undrawn balances, where IAS 39 did not. For credit cards, the impact of undrawn exposure on ECL is captured as part of the EAD estimate, and recognised within the ECL calculation.

Multiple economic scenarios: IFRS 9 requires that multiple forward-looking macro-economic scenarios are incorporated into the ECL calculation. Details of the macro-economic scenarios used at 1 January 2018 and 30 June 2018 can be found in note 19 to the condensed consolidated half-year financial statements.

The following table explains the changes in the loss allowance between 1 January 2018 and 30 June 2018.

	£m
At 1 January 2018	104.2
Advances written off	(21.5)
Charge to the income statement	30.4
At 30 June 2018	**113.1**

Further information can be found in note 6 to the condensed consolidated half-year financial statements on page 49.

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 other comprehensive income, fair value through profit or loss and amortised cost. Classification is based on the objectives of the entity’s underlying business model for managing its financial assets and the contractual cash flow characteristics of the instrument.

Unless otherwise stated, the comparatives presented are the balance sheet position under IFRS 9 at 1 January 2018, and under IAS 39 at 31 December 2017.

Loans and advances to customers

The Group's mortgage portfolio is secured on residential and buy-to-let properties and represented 91.3% of total loans and advances to customers at 30 June 2018. Residential lending grew by 0.5% (£137.4 million) during the first half of 2018 and credit quality remained strong. Buy-to-let loans grew by 4.1% (£259.6 million) to £6.6 billion. This is a contained section of the portfolio that represents 19.4% of total secured loans (1 January 2018 and 31 December 2017: 18.9%).

The Group's credit card portfolio represented 8.7% of total loans and advances to customers at 30 June 2018 (1 January 2018 and 31 December 2017: 8.4%). Unsecured credit card lending increased by £169.3 million during the first six months of 2018 to £3.2 billion and the quality of new business remained strong. New lending was well within the approved policy, lending and concentration limits.

	At 30 Jun 2018 £m	At 1 Jan 2018 £m	At 31 Dec 2017 £m
Secured residential loans and advances not subject to securitisation	**22,342.1**	21,878.7	21,878.7
Secured residential loans and advances subject to securitisation	**5,112.5**	5,438.5	5,438.5
	27,454.6	27,317.2	27,317.2
Secured residential buy-to-let loans and advances not subject to securitisation	**6,626.9**	6,367.3	6,367.3
Total loans and advances secured on residential property	**34,081.5**	33,684.5	33,684.5
Impairment allowance – secured	**(12.8)**	(12.1)	(12.1)
Total loans and advances – secured	**34,068.7**	33,672.4	33,672.4
Credit cards	**3,240.6**	3,071.3	3,071.3
Overdrafts	**0.1**	0.1	0.1
Unsecured loans and advances not subject to securitisation	**3,240.7**	3,071.4	3,071.4
Impairment allowance – unsecured	**(100.3)**	(92.1)	(47.3)
Total loans and advances – unsecured	**3,140.4**	2,979.3	3,024.1
Total loans and advances excluding portfolio hedging	**37,209.1**	36,651.7	36,696.5

Gross retail credit risk exposures by IFRS 9 stage allocation

Information regarding the Group's retail credit risk exposures at 30 June 2018 and 1 January 2018, including corresponding impairment allowances and coverage ratios, can be found in the tables below. Information regarding the 31 December 2017 position on an IAS 39 basis can be found in the 2017 Annual Report and Accounts which is available on the Group's website.

At 30 Jun 2018	Stage 1	Stage 2	Stage 3	Total
Gross exposure (£m)				
Residential mortgage loans	**25,798.8**	**1,484.9**	**170.9**	**27,454.6**
Residential buy-to-let mortgage loans	**6,415.9**	**194.4**	**16.6**	**6,626.9**
Total secured	**32,214.7**	**1,679.3**	**187.5**	**34,081.5**
Credit cards	**2,869.5**	**337.2**	**33.9**	**3,240.6**
Overdrafts	**-**	**0.1**	**-**	**0.1**
Total unsecured	**2,869.5**	**337.3**	**33.9**	**3,240.7**
Total	**35,084.2**	**2,016.6**	**221.4**	**37,322.2**
Impairment allowance (£m)				
Residential mortgage loans	**2.8**	**5.2**	**3.6**	**11.6**
Residential buy-to-let mortgage loans	**0.1**	**0.4**	**0.7**	**1.2**
Total secured	**2.9**	**5.6**	**4.3**	**12.8**
Credit cards	**24.8**	**56.0**	**19.4**	**100.2**
Overdrafts	**-**	**0.1**	**-**	**0.1**
Total unsecured	**24.8**	**56.1**	**19.4**	**100.3**
Total	**27.7**	**61.7**	**23.7**	**113.1**
Coverage ratio (%)				
Residential mortgage loans	**<0.1%**	**0.4%**	**2.1%**	**<0.1%**
Residential buy-to-let mortgage loans	**<0.1%**	**0.2%**	**4.2%**	**<0.1%**
Total secured	**<0.1%**	**0.3%**	**2.3%**	**<0.1%**
Credit cards	**0.9%**	**16.6%**	**57.2%**	**3.1%**
Overdrafts	**-**	**100.0%**	**-**	**100.0%**
Total unsecured	**0.9%**	**16.6%**	**57.2%**	**3.1%**
Total	**<0.1%**	**3.1%**	**10.7%**	**0.3%**

At 1 Jan 2018	Stage 1	Stage 2	Stage 3	Total
Gross exposure (£m)				
Residential mortgage loans	25,869.6	1,300.1	147.5	27,317.2
Residential buy-to-let mortgage loans	6,167.8	183.4	16.1	6,367.3
Total secured	32,037.4	1,483.5	163.6	33,684.5
Credit cards	2,741.6	300.3	29.4	3,071.3
Overdrafts	-	0.1	-	0.1
Total unsecured	2,741.6	300.4	29.4	3,071.4
Total	34,779.0	1,783.9	193.0	36,755.9
Impairment allowance (£m)				
Residential mortgage loans	3.2	4.5	3.2	10.9
Residential buy-to-let mortgage loans	0.1	0.3	0.8	1.2
Total secured	3.3	4.8	4.0	12.1
Credit cards	23.3	51.5	17.2	92.0
Overdrafts	-	0.1	-	0.1
Total unsecured	23.3	51.6	17.2	92.1
Total	26.6	56.4	21.2	104.2
Coverage ratio (%)				
Residential mortgage loans	<0.1%	0.3%	2.2%	<0.1%
Residential buy-to-let mortgage loans	<0.1%	0.2%	5.0%	<0.1%
Total secured	<0.1%	0.3%	2.4%	<0.1%
Credit cards	0.8%	17.1%	58.5%	3.0%
Overdrafts	-	100.0%	-	100.0%
Total unsecured	0.8%	17.2%	58.5%	3.0%
Total	<0.1%	3.2%	11.0%	0.3%

Credit-impaired assets and impairment allowances

Total credit-impaired assets increased by £28.4 million in the first half of 2018, and the proportion of credit-impaired assets as a percentage of total loans and advances to customers remained low at 0.6% as at 30 June 2018 (1 January 2018: 0.5%).

Secured credit-impaired loans as a proportion of total secured loans have increased marginally to 0.6% (1 January 2018: 0.5%), with balances increasing by £23.9 million to £187.5 million as at 30 June 2018. This is due to a reduction in interest only expired terms being offset by an increase in fraud balances. The fraud balances account for less than 0.2% of the portfolio, have an average LTV of 64.4%, and are managed at an account level. Provisioning for fraud reflects the expected credit loss associated with each individual account.

Secured impairment allowances increased from £12.1 million to £12.8 million during the first six months of 2018. House Price Index (HPI) reductions in some regions of the UK and book growth were partially offset by favourable arrears performance.

Unsecured credit-impaired loans as a proportion of total unsecured loans has remained stable at 1.0% (1 January 2018: 1.0%), with balances increasing by £4.5 million to £33.9 million as at 30 June 2018. This is primarily due to expected seasoning of the portfolio.

In line with the growth in new lending, unsecured impairment allowances increased by £8.2 million during the first six months of the year.

Assets classified as stage 2

The tables below present stage 2 loans and advances to customers by number of days past due at 30 June 2018 and 1 January 2018.

At 30 Jun 2018	**Not past due**	**1-30 days past due**	**Over 30 days past due**	**Total**
	£m	**£m**	**£m**	**£m**
Residential mortgage loans	**1,319.3**	**110.3**	**55.3**	**1,484.9**
Residential buy-to-let mortgage loans	**178.0**	**9.9**	**6.5**	**194.4**
Total secured	**1,497.3**	**120.2**	**61.8**	**1,679.3**
Credit cards	**329.3**	**4.5**	**3.4**	**337.2**
Overdrafts	**0.1**	**-**	**-**	**0.1**
Total unsecured	**329.4**	**4.5**	**3.4**	**337.3**
Total	**1,826.7**	**124.7**	**65.2**	**2,016.6**

At 1 Jan 2018	Not past due	1-30 days past due	Over 30 days past due	Total
	£m	£m	£m	£m
Residential mortgage loans	1,119.0	121.5	59.6	1,300.1
Residential buy-to-let mortgage loans	167.7	9.1	6.6	183.4
Total secured	1,286.7	130.6	66.2	1,483.5
Credit cards	292.9	4.5	2.9	300.3
Overdrafts	0.1	-	-	0.1
Total unsecured	293.0	4.5	2.9	300.4
Total	1,579.7	135.1	69.1	1,783.9

Stage 2 loans as a proportion of total loans and advances to customers have increased to 5.4% (1 January 2018: 4.9%), with balances increasing by £232.7 million to £2,016.6 million as at 30 June 2018. In assessing whether an account is classified as stage 2, the Group considers a series of quantitative, qualitative and backstop criteria. As a consequence, certain fully performing loans will be captured in stage 2 through the Group's internal debt management processes. These accounts are closely monitored.

In relation to mortgages, the movement is primarily due to an increase in accounts that, while fully performing, have experienced PD deterioration since origination. The majority of these accounts are mature interest only accounts. As the remaining term of the mortgage reduces, the PD increases, irrespective of credit quality, due to increased likelihood of default. The average LTV of these accounts is 45.3% and the resultant expected credit loss is low. The average lifetime PD for secured accounts classified as stage 2 is 7.0%.

In relation to credit cards, the movement is primarily due to an increase in accounts subject to internal account management activity, which is reflective of expected seasoning of the portfolio.

The Group held 15 repossessed properties as at 30 June 2018 (31 December 2017: ten).

Collateral held as security

Period end and weighted average LTVs across the retail mortgage portfolios are shown in the table below.

	Residential mortgage loans		**Residential buy-to-let mortgage loans**		**Total**	
At 30 Jun 2018	**£m**	**%**	**£m**	**%**	**£m**	**%**
<50%	**9,635.4**	**35.1**	**2,200.8**	**33.2**	**11,836.2**	**34.8**
50%-<60%	**5,179.2**	**18.9**	**1,926.6**	**29.1**	**7,105.8**	**20.9**
60%-<70%	**4,635.7**	**16.9**	**1,548.4**	**23.4**	**6,184.1**	**18.1**
70%-<80%	**4,211.1**	**15.3**	**942.9**	**14.2**	**5,154.0**	**15.1**
80%-<90%	**3,008.2**	**11.0**	**6.5**	**0.1**	**3,014.7**	**8.8**
90%-<100%	**778.3**	**2.8**	**1.3**	**-**	**779.6**	**2.3**
>100%	**6.7**	**-**	**0.4**	**-**	**7.1**	**-**
Total	**27,454.6**	**100.0**	**6,626.9**	**100.0**	**34,081.5**	**100.0**
Average loan-to-value[1] of stock – indexed		**57.6%**		**55.1%**		**57.1%**
Average loan-to-value of new business[2]		**71.9%**		**56.2%**		**68.8%**

1 The average loan-to-value of stock and new business is balance weighted.
2 New business includes lending since 1 January 2018.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
At 31 Dec 2017	£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 loan-to-value[1] of stock – indexed		56.1%		54.1%		55.8%
Average loan-to-value of new business[2]		70.0%		59.7%		68.1%

1 The average loan-to-value of stock and new business is balance weighted.
2 New business includes lending since 1 January 2017.

The average indexed LTV of the overall mortgage portfolio increased marginally by 1.3 percentage points as at 30 June 2018, reflecting new business growth and negative HPI movements observed in some regions during the first six months of the year. The average indexed LTV is well within the current Group portfolio risk appetite limit of 70%.

Forbearance

The value of forbearance stock totalled £202.1 million at 30 June 2018, representing a 14.6% (£25.7 million) increase during the first six months of the year.

Secured

At 30 June 2018, £185.8 million (1 January 2018: £161.2 million) of retail secured loans and advances were subject to forbearance. The increase is primarily due to a series of definitional changes following a review of forbearance activity and the data capture process. These changes have been applied from 1 January 2018. Secured loans with a payment arrangement in place increased due to the definition now capturing accounts in both overpayment and underpayment arrangements.

Secured forbearance as a percentage of stock is below 0.6% of the portfolio. Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment. The loans are not considered as credit-impaired unless they meet the Group's definition of a credit-impaired asset.

Unsecured

At 30 June 2018, total retail unsecured loans and advances benefiting from forbearance totalled £16.3 million (1 January 2018: £15.2 million).

A breakdown of secured and unsecured forbearance is shown below.

	Total		**Of which in Stage 3**	
At 30 Jun 2018	**£m**	**%**	**£m**	**%**
Secured				
Payment arrangement	**35.1**	**18.9**	**21.6**	**81.8**
Transfer to interest only	**29.7**	**16.0**	**1.3**	**4.9**
Term extension	**49.8**	**26.8**	**2.9**	**11.0**
Payment holiday	**71.2**	**38.3**	**0.6**	**2.3**
Total secured forbearance	**185.8**	**100.0**	**26.4**	**100.0**
Unsecured				
Accounts where the customer has been approved on a payment plan	**16.3**	**100.0**	**12.2**	**100.0**
Total forbearance	**202.1**	**100.0**	**38.6**	**100.0**

	Total		Of which in Stage 3	
At 1 Jan 2018	£m	%	£m	%
Secured				
Payment arrangement	2.0	1.2	1.0	7.6
Transfer to interest only	30.9	19.2	1.1	8.3
Term extension	64.3	39.9	10.3	78.0
Payment holiday	64.0	39.7	0.8	6.1
Total secured forbearance	161.2	100.0	13.2	100.0
Unsecured				
Accounts where the customer has been approved on a payment plan	15.2	100.0	11.4	100.0
Total forbearance	176.4	100.0	24.6	100.0

Wholesale credit risk

Wholesale credit risk exposures increased by £2.1 billion during the first six months of the year to £6.2 billion at 30 June 2018, primarily due to increased deposits at the Bank of England. This 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 risk exposures of the Group.

	At 30 Jun 2018	At 1 Jan 2018	At 31 Dec 2017
	£m	£m	£m
Loans and advances to banks excluding central banks	**309.0**	359.2	359.4
Cash and balances at central banks	**4,164.2**	2,579.0	2,579.0
Debt securities classified as available-for-sale financial assets	**-**	-	1,048.7
Debt securities classified as fair value through other comprehensive income	**1,635.8**	1,048.7	-
Gross positive fair value of derivative contracts	**74.3**	78.8	78.8
Other assets[1]	**0.1**	0.3	0.3
Total	**6,183.4**	4,066.0	4,066.2

1 Other assets relates to debt securities at amortised cost (previously debt securities classified as loans and receivables under IAS 39.)

The Group has increased its holdings of high-quality wholesale assets during the period including supranational, covered bond and RMBS investments. Wholesale credit risk exposures are assessed by reference to credit rating. There were no wholesale credit exposures classified as credit-impaired at 30 June 2018, 1 January 2018 or 31 December 2017.

An impairment allowance of £0.2 million as at 30 June 2018 (1 January 2018: £0.2 million; 31 December 2017: £nil) is recognised in relation to loans and advances to banks.

Full disclosure of the Group's portfolio of liquid assets can be found on page 30.

FUNDING AND LIQUIDITY MANAGEMENT

Overview

The Group is funded predominantly through retail customer deposits. During the first six months of 2018, the Group maintained a strong presence in the retail savings market. Total customer deposits increased by £637.2 million in the first half of 2018 and represented 72.6% of the Group's funding at 30 June 2018. The Group's retail funding demonstrated stability throughout the first six months of 2018 with fixed rate ISA origination driving new product growth. Retention performance was in line with expectation. Refinancing risk concentrations are controlled within portfolio risk appetite limits.

The Group adopts a prudent wholesale funding strategy which meets a series of balance sheet metrics which limit concentration and refinancing risk exposures. The Bank of England's Term Funding Scheme (TFS) closed in February 2018. Prior to its closure, the Group made further drawings of £2.2 billion to repay all remaining FLS funding, taking total TFS drawings to £6.4 billion as at 30 June 2018. Repayment of the TFS lending is scheduled to be completed in a controlled manner, ahead of the contractual maturity date. The Group completed its inaugural MREL-eligible Medium Term Note issuance of £350 million in April 2018. This represents 0.8% of total funding as at 30 June 2018.

Group funding sources

The Group's loan-to-deposit ratio decreased to 118.3% during the first half of 2018 from 119.1% at 31 December 2017.

The table below shows the Group's funding position.

	At 30 Jun 2018 £m	At 1 Jan 2018 £m	At 31 Dec 2017 £m
Loans and advances to customers	**37,176.0**	36,695.4	36,740.2
Loans and advances to banks	**309.0**	359.2	359.4
Available-for-sale financial assets (encumbered)	**-**	-	149.4
Financial instruments classified as fair value through other comprehensive income (encumbered)	**362.9**	149.4	-
Cash and balances at central banks (encumbered)	**251.2**	215.7	215.7
Funded assets	**38,099.1**	37,419.7	37,464.7
Other assets	**407.6**	388.8	377.4
Total assets (excluding liquid assets)	**38,506.7**	37,808.5	37,842.1
On balance sheet primary liquid assets			
Cash and balances at central banks – primary	**3,913.0**	2,363.3	2,363.3
Available-for-sale financial assets (unencumbered)	**-**	-	902.4
Financial instruments classified as fair value through other comprehensive income (unencumbered)	**1,275.4**	901.4	-
Equity investments classified as fair value through profit or loss (unencumbered)	**1.0**	1.0	-
Total assets	**43,696.1**	41,074.2	41,107.8
Less: Other liabilities	**(376.1)**	(371.6)	(371.6)
Funding requirement	**43,320.0**	40,702.6	40,736.2
Funded by			
Customer deposits	**31,445.6**	30,808.4	30,808.4
Wholesale funding	**10,013.2**	8,102.9	8,102.9
Total equity	**1,861.2**	1,791.3	1,824.9
Total funding	**43,320.0**	40,702.6	40,736.2

Analysis of total wholesale funding by residual maturity

At 30 Jun 2018	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Debt securities in issue	-	-	**304.8**	**2,634.4**	**2,939.2**
Liabilities in respect of securities sold under repurchase agreements	**312.0**	**375.0**	-	-	**687.0**
Secured loans	-	-	**6,387.0**	-	**6,387.0**
Total on-balance sheet sources of funds	**312.0**	**375.0**	**6,691.8**	**2,634.4**	**10,013.2**
Treasury bills raised through FLS	-	-	-	-	-
Total	**312.0**	**375.0**	**6,691.8**	**2,634.4**	**10,013.2**

At 31 Dec 2017	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Debt securities in issue	-	-	302.8	2,434.1	2,736.9
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	5.0	850.0	4,813.8	2,434.1	8,102.9
Treasury bills raised through FLS	-	1,098.5	935.0	-	2,033.5
Total	5.0	1,948.5	5,748.8	2,434.1	10,136.4

Secured loans relate to the Group's drawings from the Bank of England's TFS. The increase is due to additional drawings during the first six months of the year to repay remaining FLS funding. The Group manages funding concentration risk arising from wholesale maturities through Board-approved risk appetite which limits the amount of funding refinancing over a 90-day period and requires the early accumulation of liquidity ahead of refinancing events.

Encumbered assets

The Group's assets are used to support collateral requirements for central bank operations, third party re-purchase agreements, swap transactions, securitisation and balances at central banks. Assets 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 Group at 30 June 2018, 1 January 2018 and 31 December 2017.

	Encumbered assets		**Unencumbered assets**		
	Pledged as collateral[1]	**Other[2]**	**Available as collateral[3]**	**Other[4]**	**Total**
At 30 Jun 2018	**£m**	**£m**	**£m**	**£m**	**£m**
Cash and balances at central banks	-	**251.2**	-	**3,913.0**	**4,164.2**
Financial instruments classified as fair value through other comprehensive income	**220.0**	**142.9**	**1,272.9**	**2.5**	**1,638.3**
Equity investments classified as fair value through profit or loss	-	-	-	**1.0**	**1.0**
Derivative financial assets	-	-	-	**74.3**	**74.3**
Loans and advances to banks	**77.3**	**168.9**	-	**62.8**	**309.0**
Loans and advances to customers	**12,548.1**	-	**5,380.3**	**19,247.6**	**37,176.0**
Other assets	**3.9**	-	**0.1**	**329.3**	**333.3**
Total assets	**12,849.3**	**563.0**	**6,653.3**	**23,630.5**	**43,696.1**
Treasury bills raised through FLS held off balance sheet[5]	-	-	-	-	-
Total assets plus off-balance sheet Treasury bills raised through FLS	**12,849.3**	**563.0**	**6,653.3**	**23,630.5**	**43,696.1**

At 1 Jan 2018	Encumbered assets: Pledged as collateral[1] £m	Encumbered assets: Other[2] £m	Unencumbered assets: Available as collateral[3] £m	Unencumbered assets: Other[4] £m	Total £m
Cash and balances at central banks	-	215.7	-	2,363.3	2,579.0
Financial instruments classified as fair value through other comprehensive income	-	-	-	1.0	1.0
Equity investments classified as fair value through profit or loss	-	149.4	899.3	2.1	1,050.8
Derivative financial assets	-	-	-	78.8	78.8
Loans and advances to banks	93.0	201.1	-	65.1	359.2
Loans and advances to customers	13,109.4	-	4,670.3	18,915.7	36,695.4
Other assets	8.5	-	0.3	301.2	310.0
Total assets	13,210.9	566.2	5,569.9	21,727.2	41,074.2
Treasury bills raised through FLS held off balance sheet[5]	182.9	-	1,850.6	-	2,033.5
Total assets plus off balance sheet FLS	13,393.8	566.2	7,420.5	21,727.2	43,107.7

At 31 Dec 2017	Encumbered assets: Pledged as collateral[1] £m	Encumbered assets: Other[2] £m	Unencumbered assets: Available as collateral[3] £m	Unencumbered assets: Other[4] £m	Total £m
Cash and balances at central banks	-	215.7	-	2,363.3	2,579.0
Available-for-sale financial assets	-	149.4	899.3	3.1	1,051.8
Derivative financial assets	-	-	-	78.8	78.8
Loans and advances to banks	93.0	201.1	-	65.3	359.4
Loans and advances to customers	13,109.4	-	4,670.3	18,960.5	36,740.2
Other assets	8.5	-	0.3	289.8	298.6
Total assets	13,210.9	566.2	5,569.9	21,760.8	41,107.8
Treasury bills raised through FLS held off balance sheet[5]	182.9	-	1,850.6	-	2,033.5
Total assets plus off balance sheet FLS	13,393.8	566.2	7,420.5	21,760.8	43,141.3

1 Encumbered assets pledged as collateral include amounts to OTC derivative counterparties of £77.3 million (2017: £93.0 million) and amounts in respect of centrally cleared derivatives of £3.9 million (2017: £8.5 million). Encumbered loans and advances to customers of £12,548.1 million (2017: £13,109.4 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 30 June 2018, £8,283.9 million (2017: £6,219.8 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements.
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 of £251.2 million (2017: £215.7 million) and cash reserves supporting secured funding structures of £168.9 million (2017: £201.1 million).
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 Group through FLS, which are not recognised on the balance sheet. The Group 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 Group has used them in re-purchase transactions or unencumbered when it has not.

The Group's total level of asset encumbrance reduced by £547.7 million to 30.7% at 30 June 2018 (1 January 2018 and 31 December 2017: 32.4%). This was primarily driven by asset growth, partially supported by unsecured wholesale funding activity in the first six months of the year. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Liquid asset portfolio

The Group 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 by the EBA in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above High Quality Liquid Assets (HQLA). These are intended to cover more extreme stress events and provide flexibility for liquidity management.

The table below shows the composition of the Group's liquidity portfolio.

	At 30 Jun 2018	**2018 Average**	At 31 Dec 2017	2017 Average
	£m	**£m**	£m	£m
Level 1				
Cash and balances at central banks	**4,075.7**	**4,040.8**	2,525.9	1,923.0
UK Government securities	**202.2**	**123.8**	207.3	221.8
Other HQLA level 1 eligible	**28.3**	**12.1**	-	-
Supranational securities	**395.6**	**330.0**	234.1	178.0
Treasury bills raised through FLS	**-**	**486.1**	1,850.6	2,219.7
Covered bonds (Level 1 eligible)	**470.3**	**425.2**	374.7	378.8
Total level 1	**5,172.1**	**5,418.0**	5,192.6	4,921.3
Level 2a				
Covered bonds (Level 2a eligible)	**29.8**	**22.3**	21.7	22.2
Total level 2a	**29.8**	**22.3**	21.7	22.2
Level 2b				
Eligible RMBS	**136.2**	**101.7**	50.1	52.6
Total level 2b	**136.2**	**101.7**	50.1	52.6
High quality liquid assets (Level 1 + 2a + 2b)	**5,338.1**	**5,542.0**	5,264.4	4,996.1
Other liquidity resources				
Non-eligible RMBS	**10.5**	**11.1**	11.4	8.6
Certificates of deposit	**-**	**-**	-	40.8
Floating rate notes	**-**	**-**	-	6.3
Money market loans	**15.0**	**18.3**	13.8	13.3
Total other liquidity resources	**25.5**	**29.4**	25.2	69.0
Self-issued RMBS	**839.7**	**825.4**	601.7	958.2
Total liquidity	**6,203.3**	**6,396.8**	5,891.3	6,023.3

During the first half of 2018, the Group maintained a strong funding and liquidity position in excess of risk appetite and the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Group's LCR as at 30 June 2018 was 175.6%, representing a material surplus above the UK regulatory minimum requirement of 100%. The LCR reduced from 203.1% at 31 December 2017 due to the increased mortgage lending pipeline. The Group monitors the Net Stable Funding Ratio (NSFR) based on its own interpretations of current guidance available on CRD IV NSFR reporting.

CAPITAL MANAGEMENT

Overview

During 2018, the Group made a submission to the PRA seeking approval for improvements to its mortgage risk-weight models. These improvements have been approved and, as a result, the common equity tier 1 (CET 1) capital ratio for the Group increased by 2.5 percentage points to 16.3% as at 30 June 2018.

The Group also received notification from the PRA of its revised Pillar 2A capital requirement, which includes both fixed and variable elements, and took effect from 5 July 2018. Had it applied at 30 June 2018, it would have equated to an estimated Pillar 2A capital add-on of 5.4%.

The leverage ratio for the Group (based on the Basel III definition of January 2014, and the revised CRD IV definition of October 2014) is 3.8%. The Group is not required to comply with the UK leverage ratio framework until core retail deposits exceed the £50 billion threshold. However, during 2016, the EBA recommended a 3.0% minimum regulatory requirement should apply from January 2018. This has not yet been written into regulation but the Group maintains prudent risk appetite for leverage, above the expected EBA requirement.

Regulation

CRD IV introduced new capital limits and buffers for banks, and includes a combined buffer requirement which is the sum of the capital conservation buffer and the countercyclical buffer. The capital conservation buffer has been set at 2.5% with a transitional period between 1 January 2016 and 31 December 2018. During 2018, the transitional buffer is set at 1.875%, increasing to 2.5% on 1 January 2019.

The Bank of England increased the countercyclical buffer from 0.0% to 0.5% in June 2018, with a further increase to 1.0% due in November 2018. The Group reviews the capital structure on an on-going basis to ensure it is well placed to react to prevailing economic and regulatory conditions.

Ring-fencing is scheduled to be implemented by 1 January 2019. The Bank of England requires all banks with core deposits over £25 billion to ring-fence their core activities. The Group’s application to form its ring-fenced group has been submitted to the PRA for approval.

The framework for a systemic risk buffer (SRB) for ring-fenced banks will be applied to individual institutions by the Bank of England and will be introduced from 2019. Current guidance states that firms with balance sheet assets less than £175 billion will have an SRB of 0%.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL) were applicable from 1 January 2016 on a transitional basis, with full implementation required by 1 January 2022. From 1 January 2020 until 31 December 2021 the Group will be required to hold 18% of risk-weighted assets, in the form of MREL. From 1 January 2022, the Group will be subject to an end state MREL of two times Pillar 1 and Pillar 2A capital. The Group is working towards implementation of these requirements and has reflected them in the strategic planning process.

IFRS 9 came into force from 1 January 2018 and, in parallel, CRD IV has introduced transitional capital arrangements. These arrangements allow both the initial impact of the increase in the impairment allowance under IFRS 9, and the impact of subsequent increases, to be phased in over five years. The five year transitional period allows a percentage of the IFRS 9 adjustment to be added back each year. In 2018, 95% of the impact of IFRS 9 is added back as a transitional adjustment.

The table below shows the Group's capital resources.

	At 30 Jun 2018 £m	At 31 Dec 2017 £m
Share capital and share premium account	**654.6**	654.6
Other equity instruments	**384.1**	384.1
Other reserves	**(11.9)**	(18.1)
Retained earnings	**834.4**	804.3
Total equity per balance sheet	**1,861.2**	1,824.9
Regulatory capital adjustments		
Deconsolidation of non-regulated companies	**(0.4)**	(0.3)
Foreseeable distributions on Additional Tier 1 securities	**(3.8)**	(3.8)
Foreseeable distribution on ordinary shares	**(13.9)**	(18.1)
Other equity instruments	**(384.1)**	(384.1)
Cash flow hedge reserve	**17.0**	22.7
Additional valuation adjustment	**(1.8)**	(1.2)
Intangible assets	**(158.5)**	(128.4)
Excess of expected loss over impairment allowance	**(40.1)**	(46.9)
Deferred tax on brought forward tax losses	**-**	(0.6)
IFRS 9 transitional adjustments	**38.7**	-
Total regulatory capital adjustments	**(546.9)**	(560.7)
Common Equity Tier 1 capital	**1,314.3**	1,264.2
Additional Tier 1 securities	**384.1**	384.1
Total Tier 1 capital	**1,698.4**	1,648.3
Tier 2 capital		
General credit risk adjustments	**-**	14.3
Excess of impairments over expected losses	**1.5**	-
IFRS 9 transitional adjustments	**(1.1)**	-
Total Tier 2 capital	**0.4**	14.3
Total own funds	**1,698.8**	1,662.6
Common Equity Tier 1 ratio	**16.3%**	13.8%
Tier 1 ratio	**21.1%**	18.0%
Total capital ratio	**21.1%**	18.1%

As required by Article 26(2) of the Capital Requirements Regulation, a deduction has been made for foreseeable dividends on 2018 profit. Capital ratios include verified profit for H1 2018.

Were the IFRS 9 transitional capital arrangements not applied, the table below shows the fully loaded position as at 30 June 2018.

	At 30 Jun 2018 £m
Common Equity Tier 1 capital	**1,275.6**
Total Tier 1 capital	**1,659.7**
Total own funds	**1,661.2**
Common Equity Tier 1 ratio	**15.9%**
Tier 1 ratio	**20.7%**
Total capital ratio	**20.7%**

Movements in Common Equity Tier 1 Capital

	2018 £m
At 31 Dec 2017	**1,264.2**
Changes on adoption of IFRS 9	**(33.6)**
Movement in retained earnings	**63.7**
Additional valuation adjustment	**(0.6)**
Movement in revaluation reserve	**0.5**
Distributions on ordinary shares paid during the year	**18.1**
Distributions on ordinary shares accrued during the year	**(13.9)**
AT1 coupons accrued at previous year end	**3.8**
AT1 coupons accrued at this year end	**(3.8)**
Movement in reserves of non-regulated companies	**(0.1)**
Movement in intangible assets	**(30.1)**
Movement in excess of expected loss over impairment	**6.8**
Movement in deferred tax on tax losses carried forward	**0.6**
IFRS 9 transitional adjustments	**38.7**
At 30 Jun 2018	**1,314.3**

The main drivers for the increase in capital resources are the increase in retained earnings, net of distributions and increased intangible assets.

Risk-weighted assets

	At 30 Jun 2018 £m	At 31 Dec 2017 £m
Retail mortgages	**4,394.3**	5,790.5
Retail unsecured lending	**2,389.4**	2,282.9
Treasury	**170.5**	134.8
Other assets	**227.0**	204.3
Credit valuation adjustments	**10.8**	10.4
Operational risk	**867.3**	755.7
Total risk-weighted assets	**8,059.3**	9,178.6

Were the IFRS 9 transitional capital arrangements not applied, total risk-weighted assets would be £8,029.3 million as at 30 June 2018.

Movement in risk-weighted assets

	IRB mortgage £m	Standardised lending £m	Other standardised assets £m	Credit valuation adjustment £m	Operational risks £m	Total £m
RWAs at 31 Dec 2017	**5,790.5**	**2,282.9**	**339.1**	**10.4**	**755.7**	**9,178.6**
Book growth	**249.2**	**122.4**	**-**	**-**	**-**	**371.6**
Other movements	**(1,645.4)**	**(15.9)**	**58.4**	**0.4**	**111.6**	**(1,490.9)**
RWAs at 30 Jun 2018	**4,394.3**	**2,389.4**	**397.5**	**10.8**	**867.3**	**8,059.3**

The table above shows the movement in risk-weighted assets during the period to 30 June 2018. During 2018, the Group carried out a re-segmentation of the mortgage AIRB models, resulting in a £1.6 billion reduction in mortgage risk-weighted assets.

For credit cards, growth in risk-weighted assets was largely in line with growth in customer balances as unsecured risk-weighted assets are calculated using the standardised approach.

Other movements includes an increase due to growth in the Group's deferred tax asset as a consequence of the implementation of IFRS 9. In addition, there was an increase in exposure to wholesale assets following replacement of off-balance sheet FLS treasury bills with on-balance sheet liquidity.

There was an additional increase in operational risk-weighted assets of £111.6 million. This increase was in line with the standardised approach for the calculation of operational risk, where the growth in average income over the past three years is recognised in higher levels of operational risk-weighted assets.

Leverage ratio

The leverage ratio is risk insensitive, requiring capital to be held against total on and off-balance sheet exposures, including undrawn credit facilities.

The Group's leverage ratio as at 30 June 2018 was 3.8% (31 December 2017: 3.9%).

	At 30 Jun 2018 £m	At 31 Dec 2017 £m
Common Equity Tier 1 capital	**1,314.3**	1,264.2
Additional Tier 1 capital	**384.1**	384.1
Tier 1 capital	**1,698.4**	1,648.3
Exposures measure		
Statutory balance sheet assets	**43,696.1**	41,107.8
Deconsolidation adjustments	**(0.5)**	(0.4)
Derivative adjustments	**70.7**	14.1
Securities Financing Transactions (SFT) adjustments	**122.5**	364.3
Off-balance sheet items	**862.8**	776.8
Regulatory deductions and other adjustments	**(183.4)**	(154.4)
IFRS 9 adjustments	**38.7**	-
Total exposures	**44,606.9**	42,108.2
Leverage ratio	**3.8%**	3.9%

Were the IFRS 9 transitional capital arrangements not applied, the fully loaded leverage ratio as at 30 June 2018 would be 3.7%.

Exposure values associated with derivatives and securities financing transactions have been reported in compliance with CRD IV rules. For the purposes of the leverage ratio, the derivative measure has been adjusted for regulatory netting rules, potential future exposures and cash collateral.

Off-balance sheet items are made up of undrawn credit facilities. Credit conversion factors have been applied to these items to convert them to an on-balance sheet equivalent in compliance with the CRD IV rules.

Other regulatory adjustments consist of adjustments that have been applied to Tier 1 capital which are also applied to the leverage ratio exposure measure. This ensures consistency between Tier 1 capital and the total exposures component of the ratio.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED INCOME STATEMENT

	Note	**Half-year to 30 Jun 2018 £ million**	Half-year to 30 Jun 2017 £ million	Half-year to 31 Dec 2017 £ million
Interest and similar income		**518.4**	465.4	492.6
Interest and similar expense		**(215.3)**	(176.9)	(186.5)
Net interest income	3	**303.1**	288.5	306.1
Net fee and commission income		**17.0**	14.4	15.2
Other operating income		**19.9**	24.3	17.5
Fair value gains/(losses) on financial instruments		**0.2**	1.3	(4.6)
Other income		**37.1**	40.0	28.1
Total income		**340.2**	328.5	334.2
Operating expenses	4	**(182.6)**	(182.5)	(173.4)
Profit before tax from operating activities		**157.6**	146.0	160.8
Impairment charge	6	**(30.4)**	(22.2)	(22.0)
Profit before tax		**127.2**	123.8	138.8
Taxation	7	**(33.7)**	(33.3)	(37.2)
Profit for the period		**93.5**	90.5	101.6
Profit attributable to equity owners		**93.5**	90.5	101.6
Profit for the period		**93.5**	90.5	101.6
Basic earnings per share (pence)	8	**18.3**	17.7	20.2
Diluted earnings per share (pence)	8	**18.1**	17.5	20.0

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Half-year to 30 Jun 2018 £ million[1]	Half-year to 30 Jun 2017 £ million	Half-year to 31 Dec 2017 £ million
Profit for the period	**93.5**	90.5	101.6
Other comprehensive income/(expense)			
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	**-**	12.0	2.1
Income statement transfers in respect of disposals	**-**	(10.4)	(3.1)
Taxation	**-**	(0.4)	0.3
	-	1.2	(0.7)
Movements in revaluation reserve for debt instruments at fair value through other comprehensive income:			
Change in fair value	**3.4**	-	-
Income statement transfers in respect of disposals	**(3.3)**	-	-
Taxation	**0.2**	-	-
	0.3	-	-
Movements in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	**3.5**	2.1	(3.3)
Net income statement transfers	**4.3**	6.6	6.0
Taxation	**(2.1)**	(2.4)	(0.2)
	5.7	6.3	2.5
Items that will not be reclassified to profit or loss:			
Movements in revaluation reserve for equity investments designated at fair value through other comprehensive income:			
Change in fair value	**0.3**	-	-
Taxation	**(0.1)**	-	-
	0.2	-	-
Other comprehensive income for the period, net of tax	**6.2**	7.5	1.8
Total comprehensive income for the period	**99.7**	98.0	103.4
Total comprehensive income attributable to equity shareholders	**99.7**	98.0	103.4

1 Under IFRS 9 ‘Financial Instruments’, debt investments previously classified in the available-for-sale category were reclassified to the new fair value through other comprehensive income category at 1 January 2018 (see note 19).

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED BALANCE SHEET

	Note	**At 30 Jun 2018 £ million**	At 31 Dec 2017 £ million
Assets			
Cash and balances at central banks		**4,164.2**	2,579.0
Derivative financial instruments		**74.3**	78.8
Loans and advances to banks		**309.0**	359.4
Loans and advances to customers	11	**37,176.0**	36,740.2
Financial instruments at fair value through other comprehensive income[1]		**1,638.3**	-
Equity investments at fair value through profit or loss		**1.0**	-
Available-for-sale financial assets[1]		**-**	1,051.8
Intangible assets	12	**158.5**	128.4
Tangible fixed assets		**73.0**	74.5
Deferred tax assets		**21.7**	11.5
Other assets		**60.4**	84.2
Disposal group assets held for sale	10	**19.7**	-
Total assets		**43,696.1**	41,107.8

1 Under IFRS 9 ‘Financial Instruments’, debt investments previously classified in the available-for-sale category were reclassified to the new fair value through other comprehensive income category at 1 January 2018 (see note 19).

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED BALANCE SHEET (continued)

Equity and liabilities	Note	At 30 Jun 2018 £ million	At 31 Dec 2017 £ million
Liabilities			
Deposits from banks		**7,083.4**	5,379.0
Customer deposits	13	**31,445.6**	30,808.4
Derivative financial instruments		**49.2**	93.5
Debt securities in issue	14	**2,939.2**	2,736.9
Current tax liabilities		**28.6**	23.6
Other liabilities		**285.9**	241.5
Disposal group liabilities held for sale	10	**3.0**	-
Total liabilities		**41,834.9**	39,282.9
Equity			
Share capital and share premium		**654.6**	654.6
Other equity instruments		**384.1**	384.1
Other reserves		**(11.9)**	(18.1)
Retained earnings		**834.4**	804.3
Total equity		**1,861.2**	1,824.9
Total liabilities and equity		**43,696.1**	41,107.8

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Attributable to equity holders

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2018	**654.6**	**384.1**	**(18.1)**	**804.3**	**1,824.9**
Changes on adoption of IFRS 9 (see note 19)	**-**	**-**	**-**	**(33.6)**	**(33.6)**
Restated balance at 1 January 2018	**654.6**	**384.1**	**(18.1)**	**770.7**	**1,791.3**
Comprehensive income					
Profit for the period	**-**	**-**	**-**	**93.5**	**93.5**
Other comprehensive income					
Net movement in revaluation reserve in respect of financial assets held at fair value through other comprehensive income	**-**	**-**	**0.5**	**-**	**0.5**
Net movement in cash flow hedge reserve	**-**	**-**	**5.7**	**-**	**5.7**
Total other comprehensive income	**-**	**-**	**6.2**	**-**	**6.2**
Total comprehensive income for the period	**-**	**-**	**6.2**	**93.5**	**99.7**
Transactions with equity holders					
Dividends paid to ordinary shareholders	**-**	**-**	**-**	**(18.2)**	**(18.2)**
Distribution to Additional Tier 1 security holders	**-**	**-**	**-**	**(16.4)**	**(16.4)**
Tax attributable to Additional Tier 1 securities	**-**	**-**	**-**	**3.9**	**3.9**
Purchase of own shares	**-**	**-**	**-**	**(4.3)**	**(4.3)**
Share based payments – charge for the period (net of tax)	**-**	**-**	**-**	**5.2**	**5.2**
Total transactions with equity holders	**-**	**-**	**-**	**(29.8)**	**(29.8)**
Balance at 30 June 2018	**654.6**	**384.1**	**(11.9)**	**834.4**	**1,861.2**

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

Attributable to equity holders

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2017	654.6	384.1	(27.4)	659.2	1,670.5
Comprehensive income					
Profit for the period	-	-	-	90.5	90.5
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	-	-	1.2	-	1.2
Net movement in cash flow hedge reserve	-	-	6.3	-	6.3
Total other comprehensive income	-	-	7.5	-	7.5
Total comprehensive income for the period	-	-	7.5	90.5	98.0
Transactions with equity holders					
Dividends paid to ordinary shareholders	-	-	-	(15.5)	(15.5)
Distribution to Additional Tier 1 security holders	-	-	-	(16.4)	(16.4)
Tax attributable to Additional Tier 1 securities	-	-	-	4.0	4.0
Purchase of own shares	-	-	-	(7.7)	(7.7)
Share based payments – charge for the period (net of tax)	-	-	-	5.1	5.1
Total transactions with equity holders	-	-	-	(30.5)	(30.5)
Balance at 30 June 2017	654.6	384.1	(19.9)	719.2	1,738.0

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

Attributable to equity holders

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 July 2017	654.6	384.1	(19.9)	719.2	1,738.0
Comprehensive income					
Profit for the period	-	-	-	101.6	101.6
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	-	-	(0.7)	-	(0.7)
Net movement in cash flow hedge reserve	-	-	2.5	-	2.5
Total other comprehensive income	-	-	1.8	-	1.8
Total comprehensive income for the period	-	-	1.8	101.6	103.4
Transactions with equity holders					
Dividends paid to ordinary shareholders	-	-	-	(8.4)	(8.4)
Distribution to Additional Tier 1 security holders	-	-	-	(16.3)	(16.3)
Tax attributable to Additional Tier 1 securities	-	-	-	4.4	4.4
Purchase of own shares	-	-	-	(0.8)	(0.8)
Share based payments – charge for the period (net of tax)	-	-	-	4.8	4.8
Other distributions	-	-	-	(0.2)	(0.2)
Total transactions with equity holders	-	-	-	(16.5)	(16.5)
Balance at 31 December 2017	654.6	384.1	(18.1)	804.3	1,824.9

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Half-year to 30 Jun 2018 £ million	Half-year to 30 Jun 2017 £ million	Half-year to 31 Dec 2017 £ million
Profit before taxation	**127.2**	123.8	138.8
Adjustments for:			
Changes in operating assets	**(525.7)**	(2,309.5)	(2,048.3)
Changes in operating liabilities	**2,373.6**	5,511.7	294.9
Non-cash and other items	**45.7**	34.5	13.7
Tax paid	**(23.9)**	(16.6)	(28.5)
Net cash provided by/(used in) operating activities	**1,996.9**	3,343.9	(1,629.4)
Cash flows from investing activities			
Purchase of securities	**(852.3)**	(374.7)	(166.8)
Proceeds from sale and redemption of securities	**248.1**	185.7	311.4
Purchase and investment in intangible assets	**(41.5)**	(34.6)	(39.7)
Purchase of tangible fixed assets	**(2.6)**	(1.7)	(4.1)
Net cash (used in)/provided by investing activities	**(648.3)**	(225.3)	100.8
Cash flows from financing activities			
Dividends paid to ordinary shareholders	**(18.2)**	(15.5)	(8.4)
Distributions to Additional Tier 1 security holders	**(16.4)**	(16.4)	(16.3)
Other distributions	**-**	-	(0.2)
Net proceeds from issue of debt securities	**548.1**	-	746.2
Repayments of debt securities in issue	**(352.5)**	(302.7)	(305.6)
Purchase of own shares	**(4.3)**	(7.7)	(0.8)
Net cash provided by/(used in) financing activities	**156.7**	(342.3)	414.9
Change in cash and cash equivalents	**1,505.3**	2,776.3	(1,113.7)
Cash and cash equivalents at beginning of period	**3,034.8**	1,372.2	4,148.5
Cash and cash equivalents at end of period[1]	**4,540.1**	4,148.5	3,034.8

1 The composition of cash and cash equivalents is consistent with the basis applied in the 2017 Annual Report and Accounts.

NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of preparation

1.1 Basis of preparation and going concern

The condensed consolidated half-year financial statements of Virgin Money Holdings (UK) plc and its subsidiaries (the Group) for the six months ended 30 June 2018 were authorised for issue in accordance with a resolution of the Directors on 25 July 2018.

These condensed consolidated half-year financial statements for the six months ended 30 June 2018 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and IAS 34 '*Interim Financial Reporting'* as adopted by the European Union (EU). They do not include all the information required by International Financial Reporting Standards (IFRS) in full annual financial statements and should be read in conjunction with the Annual Report and Accounts for the year ended 31 December 2017. Copies of the 2017 Annual Report and Accounts are available on the Group's website.

The comparative financial information for the year ended 31 December 2017 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditors' report on those accounts was not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

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

1.2 Accounting policies

The accounting policies and methods of computation are consistent with those applied in the 2017 Annual Report and Accounts (pages 207 to 216) with the exception of new accounting policies in respect of IFRS 9 *'Financial Instruments'* and IFRS 15 *'Revenue',* which were both adopted on 1 January 2018.

IFRS 9 replaces IAS 39 *'Financial Instruments: Recognition and Measurement'*. This new accounting standard has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Group are from the changes to impairment. Details of the new accounting policies applied and the impact of transition to IFRS 9 can be found in note 19.

IFRS 15 replaces IAS 18 *'Revenue*' and IAS 11 '*Construction contracts*' as a comprehensive standard 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. IFRS 15 has not had a significant impact on the Group, as a substantial proportion of the Group's income is generated from financial instruments.

1.3 Future accounting developments

A number of IFRS pronouncements of new accounting standards and amendments to accounting standards have been issued by the IASB that are not yet effective and therefore have not been applied in preparing these condensed consolidated half-year financial statements. Those which may have a significant impact on the Group in future periods are consistent with those disclosed in the 2017 Annual Report and Accounts (page 250).

1.4 Presentation of information

Presentation of risk disclosures

IAS 34 '*Interim Financial Statements'* requires certain disclosures outlined in IFRS 7 '*Financial Instruments: Disclosure'.* These include disclosures concerning the nature and extent of risks relating to financial instruments and have been included within the Risk Management Report.

1.5 Critical estimates and judgements

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

The following updates are provided on critical estimates and judgements, which should be read in conjunction with the 2017 Annual Report and Accounts (pages 216 and 217).

Note 1: Basis of preparation (continued)

a) Effective interest rates

Effective interest rate (EIR) accounting for unsecured lending remains an area of critical judgement and estimate for the Group. 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. 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 income recognition.

As at 30 June 2018 the EIR method gave rise to an adjustment of £192.6 million (31 December 2017: £159.8 million) to the balance sheet value of unsecured loans. This adjustment represented 6.1% (31 December 2017: 5.3%) of the balance sheet carrying value of unsecured loans.

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.

As at 30 June 2018 a full and in depth analysis of all customer behaviours was undertaken, which included the 49,000 customers who have come off their zero per cent promotion period during the first half of the year. The customer behaviours and future cash flow assumptions, in respect of the seven year modelling period used within the EIR calculations, have been updated across the portfolio to reflect these latest observed data points. This resulted in a net reduction to total income of £(7.8) million. £(5.4) million of the total represents income previously recognised and £(2.4) million represents the present value of income not yet earned.

In relation to future sensitivities, 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 would be approximately £(12.3) million as at 30 June 2018 (31 December 2017: £(10.2) million).

The level of repayment immediately post-promotional period is a key estimate in the EIR calculation. Management have undertaken a sensitivity on post-promotion payment rates for all cohorts which are still within their promotional periods as at 30 June 2018. 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 £(24.3) million as at 30 June 2018 (31 December 2017: £(30.8) million). In such an adjustment, £(10.9) million (31 December 2017: £(11.5) million) would relate to write-off of income previously recognised in the income statement, with £(13.4) million (31 December 2017: £(19.3) million) representing an adjustment to reflect a lower level of interest income expected in future accounting periods.

b) Capitalisation of intangible assets

Management judgement is required in assessing intangible assets for impairment, including those not yet in use at the reporting date. As part of that judgement, Management have considered the outlook for the Group and the current intention to deliver the Group's stated strategic objectives. On this basis Management are satisfied with the carrying value of intangible assets at 30 June 2018.

In the event of a future change in ownership, there may be changes that affect the Group's current strategic objectives. Management acknowledge such a change in circumstance may give rise to a requirement to review this judgement at a future date.

c) Impairment of loans and receivables

Impairment of loans and receivables is now accounted for under IFRS 9 *'Financial Instruments'*. Details of the new critical estimates and judgements made under IFRS 9 can be found in note 19.

d) Disposal Group

On 20 March 2018 the Group announced that it had agreed in principle to enter into a new strategic joint venture for the provision of asset management services with Aberdeen Standard Investments. The transaction is expected to result in the deconsolidation of the Group's wholly owned subsidiary, Virgin Money Unit Trust Managers Limited, which will be recognised as a joint venture under the new arrangement. Management have concluded that it is highly probable the sale will occur within the next 12 months. As a result the assets and liabilities of Virgin Money Unit Trust Managers Limited, which is not a separate major line of business, have been classified as a disposal group (see note 10) in accordance with IFRS 5 '*Non-current assets held for sale and discontinued operations'.*

Note 2: Segmental analysis and reconciliation to underlying basis

The Group falls within the scope of IFRS 8 *'Operating Segments'*. The Group's chief operating decision maker (which has been determined to be the Executive Committee) assesses performance and makes decisions based on the performance of the Group as a whole. The Group has therefore determined that it has one reportable operating segment and is therefore not required to produce additional segmental disclosure.

The Group operates in a single geographic segment, being the UK, and the Group is not reliant on a single customer.

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results. The tables below reconcile the statutory results to the underlying basis.

		Adjusted for		
	Statutory results	**Strategic items**	**Fair value losses on financial instruments**	**Underlying basis**
Half-year to 30 June 2018	**£m**	**£m**	**£m**	**£m**
Net interest income	**303.1**	**-**	**-**	**303.1**
Other income	**37.1**	**-**	**2.8**	**39.9**
Total income	**340.2**	**-**	**2.8**	**343.0**
Operating expenses	**(182.6)**	**11.6**	**-**	**(171.0)**
Profit before tax from operating activities	**157.6**	**11.6**	**2.8**	**172.0**
Impairment	**(30.4)**	**-**	**-**	**(30.4)**
Profit before tax	**127.2**	**11.6**	**2.8**	**141.6**

		Adjusted for			
	Statutory results	IPO share based payments	Strategic items	Fair value gains on financial instruments	Underlying basis
Half-year to 30 June 2017	£m	£m	£m	£m	£m
Net interest income	288.5	-	-	-	288.5
Other income	40.0	-	-	(1.3)	38.7
Total income	328.5	-	-	(1.3)	327.2
Operating expenses	(182.5)	0.6	5.5	-	(176.4)
Profit before tax from operating activities	146.0	0.6	5.5	(1.3)	150.8
Impairment	(22.2)	-	-	-	(22.2)
Profit before tax	123.8	0.6	5.5	(1.3)	128.6

Note 2: Segmental analysis and reconciliation to underlying basis (continued)

		Adjusted for			
	Statutory results	IPO share based payments	Strategic items	Fair value losses on financial instruments	Underlying basis
Half-year to 31 December 2017	£m	£m	£m	£m	£m
Net interest income	306.1	-	-	-	306.1
Other income	28.1	-	-	4.6	32.7
Total income	334.2	-	-	4.6	338.8
Operating expenses	(173.4)	0.3	1.0	-	(172.1)
Profit before tax from operating activities	160.8	0.3	1.0	4.6	166.7
Impairment	(22.0)	-	-	-	(22.0)
Profit before tax	138.8	0.3	1.0	4.6	144.7

Note 3: Net interest income

	Half-year to 30 Jun 2018 £m	Half-year to 30 Jun 2017 £m	Half-year to 31 Dec 2017 £m
Interest and similar income:			
Loans and advances to customers	**502.2**	460.6	484.6
Loans and advances to banks	**0.8**	0.4	0.5
Available-for-sale financial assets	**-**	2.6	3.0
Financial instruments at fair value through other comprehensive income	**4.9**	-	-
Cash and balances at central banks	**10.5**	1.8	4.5
Total interest and similar income	**518.4**	465.4	492.6
Interest and similar expense:			
Deposits from banks	**(19.3)**	(5.7)	(10.8)
Customer deposits	**(174.6)**	(152.9)	(157.9)
Debt securities in issue	**(20.9)**	(15.4)	(15.6)
Other	**(0.5)**	(2.9)	(2.2)
Total interest and similar expense	**(215.3)**	(176.9)	(186.5)
Net interest income	**303.1**	288.5	306.1

Note 4: Operating expenses

	Half-year to 30 Jun 2018 £m	Half-year to 30 Jun 2017 £m	Half-year to 31 Dec 2017 £m
Staff costs:			
Wages and salaries	**86.1**	75.3	86.6
Social security costs	**7.6**	7.5	8.0
Other pension costs	**5.7**	5.4	5.5
Employee share schemes	**5.2**	5.1	4.8
	104.6	93.3	104.9
Premises and equipment:			
Hire of equipment	**2.3**	2.3	2.3
Rent and rates	**7.8**	7.4	7.0
Other property costs	**5.8**	5.8	5.2
	15.9	15.5	14.5
Other expenses:			
Marketing costs	**10.8**	10.3	11.5
Telecommunications and IT	**8.9**	9.6	8.9
Professional fees	**12.8**	9.5	13.6
Other	**14.1**	24.5	4.6
	46.6	53.9	38.6
Depreciation, amortisation and impairment:			
Depreciation of tangible fixed assets	**4.1**	4.3	4.4
Amortisation of intangible assets	**11.4**	10.7	11.0
Impairment of intangible assets	**-**	4.8	-
	15.5	19.8	15.4
Total operating expenses	**182.6**	182.5	173.4

Note 5: Share based payments

All share based payment charges relate to equity settled schemes. Details of the existing share plans can be found in note 7 of the 2017 Annual Report and Accounts.

In the six months to 30 June 2018 the Group granted new awards under the Deferred Bonus Share Plan and the Long Term Incentive Plan.

Note 6: Allowance for impairment losses on loans and advances to customers

The following table explains the changes in the loss allowance between the beginning and the end of the period:

	Half-year to 30 Jun 2018 £m	Half-year to 30 Jun 2017 £m	Half-year to 31 Dec 2017 £m
Opening allowance at 31 December	**59.4**	50.1	55.7
Changes on adoption of IFRS 9 at 1 January 2018 (see note 19)	**44.8**	-	-
Restated opening balance at 1 January	**104.2**	50.1	55.7
Advances written off	**(21.5)**	(16.6)	(18.3)
Charge to the income statement	**30.4**	22.2	22.0
Closing allowance	**113.1**	55.7	59.4
In respect of:			
Secured loans	**12.8**	11.7	12.1
Unsecured loans	**100.3**	44.0	47.3
Total closing allowance	**113.1**	55.7	59.4

A loss allowance of £0.2 million (30 June 2017 and 31 December 2017: £nil) is recognised in relation to loans and advances to banks.

Note 7: Taxation

Analysis of the tax charge for the period:

	Half-year to 30 Jun 2018 £m	Half-year to 30 Jun 2017 £m	Half-year to 31 Dec 2017 £m
Profit before tax	**127.2**	123.8	138.8
Tax charge at standard tax rate of 19.00% (30 June 2017: 19.25%, 31 December 2017: 19.25%)	**(24.2)**	(23.8)	(26.7)
Factors affecting tax charge:			
Disallowed items	**(0.8)**	(0.8)	(0.2)
Bank corporation tax surcharge	**(8.5)**	(8.4)	(10.5)
UK corporation tax rate changes	**(0.2)**	(0.1)	(0.3)
Deferred tax charge in respect of share schemes	**0.1**	-	-
Adjustments in respect of prior periods	**-**	(0.1)	0.4
Other	**(0.1)**	(0.1)	0.1
Total tax charge	**(33.7)**	(33.3)	(37.2)

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.

In accordance with IAS 34 '*Interim Financial Reporting*', the Group's tax charge for the half-year to 30 June 2018 is based on the best estimate of the weighted-average annual corporation tax rate expected for the full financial year. The tax effects of one-off items are not included in the weighted-average annual corporation tax rate, but are recognised in the relevant period.

Note 8: Earnings per share

	Half-year to 30 Jun 2018 £m	Half-year to 30 Jun 2017 £m	Half-year to 31 Dec 2017 £m
Profit attributable to equity owners – basic and diluted	**93.5**	90.5	101.6
Distributions to Additional Tier 1 security holders (net of tax)	**(12.5)**	(12.4)	(12.4)
Profit attributable to equity shareholders for the purposes of basic and diluted EPS	**81.0**	78.1	89.2

	30 Jun 2018 Number of shares (million)	30 Jun 2017 Number of shares (million)	31 Dec 2017 Number of shares (million)
Weighted-average number of ordinary shares in issue – basic	**442.7**	442.2	442.5
Adjustment for share options and awards	**3.9**	4.2	4.2
Weighted-average number of ordinary shares in issue – diluted	**446.6**	446.4	446.7
Basic earnings per share (pence)	**18.3**	17.7	20.2
Diluted earnings per share (pence)	**18.1**	17.5	20.0

Basic earnings per share has been calculated after deducting 2.5 million (30 June 2017: 2.8 million; 31 December 2017: 2.8 million) ordinary shares representing the weighted-average of the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 30 June 2018 none were anti-dilutive (30 June and 31 December 2017: nil).

Note 9: Dividends

An interim dividend for 2018 of 2.3 pence per ordinary share, amounting to £10.2 million, was declared on 25 July 2018 and will be paid on 21 September 2018 to shareholders on the share register at close of business on 10 August 2018.

An interim dividend for 2017 of 1.9 pence per ordinary share, amounting to £8.4 million, was paid in September 2017. A final dividend in respect of the year ended 31 December 2017 of 4.1 pence per ordinary share, amounting to £18.2 million, was paid in May 2018.

Note 10: Disposal group assets and liabilities held for sale

On 20 March 2018 the Group announced that it had agreed in principle to enter into a new strategic joint venture for the provision of asset management services with Aberdeen Standard Investments (ASI). For accounting purposes, the transaction is expected to result in the deconsolidation of the Group's wholly owned subsidiary, Virgin Money Unit Trust Managers Limited, which will be recognised as a joint venture under the new arrangement.

The transaction is expected to complete within the next 12 months. In accordance with the accounting requirements, the assets and liabilities of Virgin Money Unit Trust Managers Limited, which is not a separate major business line, have been presented as a disposal group following the announcement.

	At 30 Jun 2018 £m
Assets	
Loans and advances to banks	**12.4**
Other assets	**7.3**
Total assets	**19.7**
Liabilities	
Current tax liabilities	**1.7**
Other liabilities	**1.3**
Total liabilities	**3.0**

Note 11: Loans and advances to customers

	At 30 Jun 2018 £m	At 31 Dec 2017 £m
Secured residential loans and advances not subject to securitisation	**22,342.1**	21,878.7
Secured residential loans and advances subject to securitisation	**5,112.5**	5,438.5
	27,454.6	27,317.2
Secured residential buy-to-let loans and advances not subject to securitisation	**6,626.9**	6,367.3
Total loans and advances to customers secured on residential property	**34,081.5**	33,684.5
Unsecured loans and advances not subject to securitisation	**3,240.7**	3,071.4
Total loans and advances to customers before allowance for impairment losses	**37,322.2**	36,755.9
Impairment allowance (refer note 6)	**(113.1)**	(59.4)
Total loans and advances to customers excluding portfolio hedging	**37,209.1**	36,696.5
Fair value of portfolio hedging	**(33.1)**	43.7
Total loans and advances to customers	**37,176.0**	36,740.2

Note 12: Intangible assets

	Core deposit intangible £m	Software £m	Banking platforms £m	Total £m
Cost:				
At 1 January 2018	4.8	144.9	59.8	209.5
Additions	**-**	**21.1**	**20.4**	**41.5**
Disposals	**(4.8)**	**-**	**-**	**(4.8)**
At 30 June 2018	**-**	**166.0**	**80.2**	**246.2**
Accumulated amortisation and impairment:				
At 1 January 2018	4.8	66.2	10.1	81.1
Charge for the period	**-**	**9.9**	**1.5**	**11.4**
Disposals	**(4.8)**	**-**	**-**	**(4.8)**
At 30 June 2018	**-**	**76.1**	**11.6**	**87.7**
Balance sheet amount at 30 June 2018	**-**	**89.9**	**68.6**	**158.5**
Balance sheet amount at 31 December 2017	-	78.7	49.7	128.4

During the year, the core deposit intangible was removed from the asset register. This asset was recognised in respect of the intrinsic value of the retail savings book when the Group acquired Northern Rock plc in 2012. All of these accounts have now matured, and the full benefit to the Group has been realised.

Note 13: Customer deposits

	At 30 Jun 2018 £m	At 31 Dec 2017 £m
Savings and investment accounts	**31,005.6**	30,393.0
Personal current accounts	**440.0**	415.4
Total customer deposits	**31,445.6**	30,808.4

Note 14: Debt securities in issue

	Securitisation programmes £m	Medium Term Notes £m	Total £m
At 1 January 2018	2,434.1	302.8	2,736.9
Repayments	**(352.5)**	**-**	**(352.5)**
Issues	**199.5**	**348.6**	**548.1**
Revaluation	**4.9**	**-**	**4.9**
Other movements	**1.5**	**0.3**	**1.8**
At 30 June 2018	**2,287.5**	**651.7**	**2,939.2**

Other movements comprise amortisation of issuance costs and hedge accounting adjustments.

Securitisation programmes

In January 2018, the Group raised £199.5 million from a private sale of previously retained Residential Mortgage Backed Securities in the Gosforth 2017-1 transaction.

Medium Term Notes

In April 2018, the Group issued callable Medium Term Notes with a nominal value of £350.0 million at a coupon of 3.375% per annum, repayable on 24 April 2026. They were issued as part of the Group's £3 billion Global Medium Term Note programme and qualify for Minimum Requirements for Own Funds and Eligible Liabilities (MREL).

Note 15: Contingent liabilities and commitments

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 30 June 2018 (31 December 2017: none).

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 Group.

Loan commitments

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

	At 30 Jun 2018 £m	At 31 Dec 2017 £m
Not later than 1 year	**6,835.8**	5,815.9
Later than 1 year and not later than 5 years	**85.2**	97.1
Later than 5 years	**257.5**	280.5
Total loan commitments	**7,178.5**	6,193.5

Note 16: Fair value of financial assets and financial liabilities

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 Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in the 31 December 2017 Annual Report and Accounts sets out the key principles for estimating the fair values of financial instruments.

	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total fair value £m**	**Total carrying value £m**
At 30 June 2018					
Cash and balances at central banks	**-**	**4,164.2**	**-**	**4,164.2**	**4,164.2**
Loans and advances to banks	**-**	**309.0**	**-**	**309.0**	**309.0**
Loans and advances to customers	**-**	**-**	**37,442.6**	**37,442.6**	**37,176.0**
Other assets	**0.1**	**37.2**	**-**	**37.3**	**37.3**
Disposal group assets	**-**	**19.5**	**-**	**19.5**	**19.5**
Total financial assets	**0.1**	**4,529.9**	**37,442.6**	**41,972.6**	**41,706.0**
Deposits from banks	**-**	**7,083.4**	**-**	**7,083.4**	**7,083.4**
Customer deposits	**-**	**31,433.7**	**-**	**31,433.7**	**31,445.6**
Debt securities in issue	**2,946.0**	**-**	**-**	**2,946.0**	**2,939.2**
Other liabilities	**-**	**266.8**	**-**	**266.8**	**266.8**
Disposal group liabilities	**-**	**1.3**	**-**	**1.3**	**1.3**
Total financial liabilities	**2,946.0**	**38,785.2**	**-**	**41,731.2**	**41,736.3**

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
At 31 December 2017					
Cash and balances at central banks	-	2,579.0	-	2,579.0	2,579.0
Loans and advances to banks	-	359.4	-	359.4	359.4
Loans and advances to customers	-	-	36,951.6	36,951.6	36,740.2
Available-for-sale financial assets	-	-	0.3	0.3	0.3
Other assets	0.3	55.0	-	55.3	55.3
Total financial assets	0.3	2,993.4	36,951.9	39,945.6	39,734.2
Deposits from banks	-	5,379.0	-	5,379.0	5,379.0
Customer deposits	-	30,800.5	-	30,800.5	30,808.4
Debt securities in issue	2,748.3	-	-	2,748.3	2,736.9
Other liabilities	-	215.1	-	215.1	215.1
Total financial liabilities	2,748.3	36,394.6	-	39,142.9	39,139.4

Note 16: Fair value of financial assets and financial liabilities (continued)

Fair value hierarchy

The tables above summarise the carrying value and fair value of assets and liabilities held on the balance sheet. 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).

There is no significant change to what was disclosed in the 31 December 2017 Annual Report and Accounts in respect of the valuation methodology (techniques and inputs) applied for calculations of fair values in the tables above.

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. The accounting policy in the 31 December 2017 Annual Report and Accounts sets out the key principles for estimating the fair values of financial instruments.

30 June 2018	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Derivative financial instruments	**-**	**74.3**	**-**	**74.3**
Financial instruments at fair value through other comprehensive income	**1,635.8**	**-**	**2.5**	**1,638.3**
Equity investments at fair value through profit or loss	**-**	**-**	**1.0**	**1.0**
Financial liabilities				
Derivative financial instruments	**-**	**49.2**	**-**	**49.2**

31 December 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	-	78.8	-	78.8
Available-for-sale financial assets	1,048.7	-	2.8	1,051.5
Financial liabilities				
Derivative financial instruments	-	93.5	-	93.5

Level 1 Valuations

The fair value of debt securities recognised at fair value through other comprehensive income are 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 financial assets represent the Group's best estimates of the value of certain equity investments in unlisted companies and of 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.

Note 17: Related party transactions

Full details of the Group's related party transactions for the year to 31 December 2017 can be found in note 35 of the 2017 Annual Report and Accounts.

Related party transactions for the half-year to 30 June 2018 are similar in nature to those for the year to 31 December 2017. There are no other changes to related party transactions that have had a material effect on the financial position or performance of the Group.

Note 18: Events after the balance sheet date

There have been no significant events between 30 June 2018 and the date of approval of the condensed consolidated half-year financial statements which would require a change to or additional disclosure in the financial statements apart from the declaration of the interim dividend as disclosed in note 9.

Note 19: Transition to IFRS 9 'Financial Instruments'

On 1 January 2018 the Group adopted IFRS 9 *'Financial Instruments'* which replaces IAS 39 *'Financial Instruments: Recognition and Measurement'*. This new accounting standard has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Group are from the changes to impairment.

(a) Transitional disclosures and impact

In relation to classification and measurement, the primary impact of IFRS 9 is the reclassification of debt investments in the available-for-sale (AFS) category to the new fair value through other comprehensive income (FVOCI) category. Management also have an option to classify non-trading equity investments as fair value through profit or loss (FVPL) or irrevocably designate them as FVOCI, on an investment by investment basis.

The material retail financial asset portfolios (primarily secured and unsecured loans) retain their classification as amortised cost, so there is no change in the classification and measurement of these financial assets. The classification requirements for financial liabilities are unchanged on adoption of IFRS 9.

The following table sets out the reclassification impacts of transitioning from IAS 39 to IFRS 9 on 1 January 2018:

	IAS 39		IFRS 9	
	Measurement category	**Carrying amount**	**Measurement category**	**Carrying amount**
Financial assets		**£m**		**£m**
Cash and balances at central banks	Loans and receivables (amortised cost)	2,579.0	Amortised cost	2,579.0
Derivative financial instruments	FVPL (Hedging instrument)	78.8	FVPL (mandatory)	78.8
Loans and advances to banks	Loans and receivables (amortised cost)	359.4	Amortised cost	359.2
Loans and advances to customers	Loans and receivables (amortised cost)	36,740.2	Amortised cost	36,695.4
			FVOCI	1,048.7
Available for sale financial assets	Available for sale	1,051.8	FVOCI (designated)[1]	2.1
			FVPL	1.0

1 Management has the option to designate non-trading equity investments as FVOCI on an investment by investment basis.

Note 19: Transition to IFRS 9 (continued)

The following table sets out the one-off balance sheet reclassification and remeasurement impacts of transitioning from IAS 39 to IFRS 9 on 1 January 2018 and for comparison purposes the ongoing impact of IFRS 9 at 30 June 2018:

	IAS 39			IFRS 9	**IAS 39**			**IFRS 9**
	At 1 Jan 2018	Reclassification	Remeasurement	At 1 Jan 2018	**At 30 Jun 2018**	**Reclassification**	**Remeasurement**	**At 30 Jun 2018**
Financial assets	£m	£m	£m	£m	**£m**	**£m**	**£m**	**£m**
Cash and balances at central banks	2,579.0	-	-	2,579.0	**4,164.2**	**-**	**-**	**4,164.2**
Derivative financial instruments	78.8	-	-	78.8	**74.3**	**-**	**-**	**74.3**
Loans and advances to banks	359.4	-	(0.2)	359.2	**309.2**	**-**	**(0.2)**	**309.0**
Loans and advances to customers	36,740.2	-	(44.8)	36,695.4	**37,225.5**	**-**	**(49.5)**	**37,176.0**
Financial instruments at fair value through other comprehensive income	-	1,050.8	-	1,050.8	**-**	**1,638.3**	**-**	**1,638.3**
Available-for-sale financial assets	1,051.8	(1,051.8)	-	-	**1,639.3**	**(1,639.3)**	**-**	**-**
Equity investments at fair value through profit or loss	-	1.0	-	1.0	**-**	**1.0**	**-**	**1.0**
Deferred tax assets	11.5	-	11.4	22.9	**10.8**	**-**	**10.9**	**21.7**
Other assets	287.1	-	-	287.1	**311.6**	**-**	**-**	**311.6**
Total assets	41,107.8	-	(33.6)	41,074.2	**43,734.9**	**-**	**(38.8)**	**43,696.1**
Total liabilities	39,282.9	-	-	39,282.9	**41,836.1**	**-**	**(1.2)**	**41,834.9**
Total equity	1,824.9	-	(33.6)	1,791.3	**1,898.8**	**-**	**(37.6)**	**1,861.2**

Profit before tax for the six months ending 30 June 2018 would have been £4.7 million higher on an IAS 39 basis (£3.5 million higher on an after tax basis) as a result of earlier recognition of credit losses under an IFRS 9 approach compared with IAS 39.

Note 19: Transition to IFRS 9 (continued)

The table below shows the allocation of the Group's loans and advances to customers by stage at 30 June 2018:

30 June 2018	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Gross Exposure				
Residential mortgage loans	**25,798.8**	**1,484.9**	**170.9**	**27,454.6**
Residential buy-to-let mortgage loans	**6,415.9**	**194.4**	**16.6**	**6,626.9**
Credit cards	**2,869.5**	**337.2**	**33.9**	**3,240.6**
Overdrafts	**-**	**0.1**	**-**	**0.1**
Total	**35,084.2**	**2,016.6**	**221.4**	**37,322.2**
Impairment allowance				
Residential mortgage loans	**2.8**	**5.2**	**3.6**	**11.6**
Residential buy-to-let mortgage loans	**0.1**	**0.4**	**0.7**	**1.2**
Credit cards	**24.8**	**56.0**	**19.4**	**100.2**
Overdrafts	**-**	**0.1**	**-**	**0.1**
Total	**27.7**	**61.7**	**23.7**	**113.1**

The allocation of the Group's loans and advances to customers by stage at 1 January 2018 was:

1 January 2018	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross Exposure				
Residential mortgage loans	25,869.6	1,300.1	147.5	27,317.2
Residential buy-to-let mortgage loans	6,167.8	183.4	16.1	6,367.3
Credit cards	2,741.6	300.3	29.4	3,071.3
Overdrafts	-	0.1	-	0.1
Total	34,779.0	1,783.9	193.0	36,755.9
Impairment allowance				
Residential mortgage loans	3.2	4.5	3.2	10.9
Residential buy-to-let mortgage loans	0.1	0.3	0.8	1.2
Credit cards	23.3	51.5	17.2	92.0
Overdrafts	-	0.1	-	0.1
Total	26.6	56.4	21.2	104.2

In addition an impairment allowance of £0.2 million was recognised in relation to loans and advances to banks at both 1 January and 30 June 2018. All loans and advances to bank balances are classified as stage 1.

Note 19: Transition to IFRS 9 (continued)

(b) Accounting policies

Classification and measurement

Under IFRS 9 financial assets are classified into one of three measurement categories:

- amortised cost;
- fair value through other comprehensive income (FVOCI); or
- fair value through profit or loss (FVPL).

Classification is based on the objectives of the Group'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 and measurement requirements for financial liabilities from IAS 39.

The business model reflects how the Group manages the assets in order to generate cash flows. One of the following business models is identified for each financial instrument depending on how the risks are managed, past experience with the financial asset and how performance is measured and reported:

- hold to collect: it is intended to collect the contractual cash flows from the assets (Amortised cost classification);
- hold to collect and to sell: it is intended to collect both the contractual cash flows and cash flows arising from the sale of the asset (FVOCI classification); or
- hold to sell: it is intended to sell the financial asset in the short to medium term, or the asset is designated FVPL to minimise an accounting mismatch (FVPL classification).

Where the business model is 'held to collect' or 'held to collect and sell' the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with previously separable embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

The Group reclassifies debt investments only when its business model for managing those assets changes. Such changes are expected to be very infrequent and none occurred during the period.

The accounting requirements of the three measurement categories are as follows:

Amortised cost

Financial assets at amortised cost are initially recognised at fair value, including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. The Group's secured and unsecured loan portfolios are classified as amortised cost.

The carrying amount of these assets is adjusted by any expected credit loss allowance. Interest income is included in 'Interest income' using the effective interest rate method.

Fair value through other comprehensive income (FVOCI)

Financial assets at FVOCI are initially measured at fair value, including direct and incremental transaction costs. Subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income, with the exception of impairment gains or losses, interest income and foreign exchange gains and losses on the instruments amortised cost which are recognised in profit or loss. Interest income from these financial assets is included in 'interest income' using the effective interest rate method. The Group's investments in debt securities are classified as FVOCI.

On derecognition of a financial asset, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Fair value gains/losses on financial instruments'.

Note 19: Transition to IFRS 9 (continued)

Fair value through profit or loss (FVPL)

Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL on initial recognition and at each reporting date.

Any gain or loss on an asset that is subsequently measured at FVPL, and is not part of a hedging relationship, is recognised in profit or loss and presented in the profit or loss statement within ‘Fair value gains/losses on financial instruments’.

Interest income from these financial assets is included separately in ‘Net Interest Income’.

Equity instruments

Equity instruments are instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer’s net assets (e.g. basic ordinary shares).

The Group measures all equity investments at fair value through profit or loss, except where Management has elected, at initial recognition, to irrevocably designate the non-trading equity investment at FVOCI. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses are not reported separately from other changes in fair value. Dividends continue to be recognised in profit or loss as ‘Other income’ when the Group’s right to receive payments is established.

Gains or losses on equity investments at FVPL are included in the ‘Fair value gains/losses on financial instruments’ line in the Income Statement.

Fair value measurement

The measurement of fair value has not changed as a result of adopting IFRS 9. Fair value measurement is determined by IFRS 13 *‘Fair Value Measurement’* and the accounting policy for determining fair value can be found in the 2017 Annual Report and Accounts.

Expected Credit Loss (Impairment)

The Group assesses all financial assets and off-balance sheet commitments for impairment at each reporting date. For the Group, this is primarily loans and advances to customers and undrawn lending commitments. Under IFRS 9 a ‘three-stage’ model for calculating Expected Credit Losses (ECL) is used, and is based on changes in credit quality since initial recognition as summarised below:

- Stage 1 - A financial instrument that is not credit-impaired on initial recognition and has not significantly increased in credit risk;
- Stage 2 - If a significant increase in credit risk has occurred since initial recognition, the financial instrument is moved to stage 2 but is not yet deemed to be credit-impaired; and
- Stage 3 - If the financial instrument is credit-impaired, the financial instrument is then moved to stage 3.

ECL is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk (SICR) has occurred since initial recognition or whether an asset is considered to be credit-impaired. 12 month ECL is recognised on stage 1 accounts and lifetime ECL is recognised on stage 2 and 3 accounts. Interest income is recognised on the gross carrying value of stage 1 and 2 assets and the net carrying value of stage 3 assets.

ECL is calculated using a Probability of Default (PD), which reflects the likelihood of a borrower defaulting over either the next 12 months or the lifetime of the account, and includes forward-looking economic information in this estimation. The Exposure at Default (EAD) and Loss Given Default (LGD) for each account are also calculated to estimate actual loss at the point of default. These assumptions incorporate expected contractual payments, utilisation of available credit limits, collateral values and forced sale discounts. The LGD component incorporates forward-looking economic variables (e.g. house price inflation).

These variables (PD, LGD and EAD) are projected for each future month and for each individual exposure or collective segment. Segmentation is used in the determination of these variables where accounts have similar characteristics and are expected to behave in uniform ways. This allows for an ECL to be calculated for each account for each future month, which is then discounted back to the reporting date to create a total ECL at account level. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

Note 19: Transition to IFRS 9 (continued)

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices than the current IAS 39 requirements and follow a principles-based approach. However, there is an option in IFRS 9 to maintain existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. This option has been provided because the macro hedging project is still in the consultation phase, with a second discussion paper due to be issued by the International Accounting Standards Board (IASB) in 2019.

Management have analysed the benefits of adopting IFRS 9 hedge accounting but currently the preferred approach is to continue applying IAS 39 hedge accounting in its entirety. As a result there is no change from the 2017 Annual Report and Accounts accounting policy. The revised disclosure requirements of IFRS 7 '*Financial Instruments: Disclosures*' in relation to hedge accounting will be applied.

(c) Critical judgements and estimates

IFRS 9 requires Management to make estimates and judgements in its application that affect the allowance for expected credit loss. Estimates and judgements are based on Management's knowledge and historical experience. The nature of the calculation of ECL and the various estimates included means that Management recognise the potential for possible volatility in the level of ECL in the coming periods. The critical estimates and judgements made are:

Significant increase in credit risk (SICR) assessment

A significant increase in credit risk is not a defined term, and is determined by Management, based on their experience and judgement. In assessing whether the credit risk has significantly increased the Group has identified a series of quantitative, qualitative and backstop criteria (30 days past due as set by IFRS 9) which take into account forward-looking macroeconomic factors. These are referred to as the staging criteria.

The staging criteria have been extensively tested to ensure the characteristics of the portfolio are correctly reflected and accounts appropriately flow through the stages prior to default, without either a prolonged duration in stage 2 or introducing significant volatility by moving unnecessarily between the stages. For unsecured exposures, a cure period of two months has been applied to reduce volatility between stages. This means that an account remains in stage 2 for a period of two months after it ceases to meet any stage 2 criteria.

The staging criteria take into account the following:

- Quantitative criteria – if an account's current lifetime PD is greater than a multiple of origination lifetime PD then the credit risk of the account is considered to have increased significantly;
- Qualitative criteria – if an account enters forbearance or demonstrates other indicators of financial difficulty, not yet caught by an increase in PD, then the credit risk of the account is considered to have increased significantly; and
- Backstop – if the account is 30 days past due it will automatically transition to Stage 2.

The staging criteria are monitored and revisited in advance of each reporting date.

Definition of default

The definition of default is used to determine both the PD and the transition to stage 3 (all accounts which have defaulted are recognised in stage 3).

For the retail portfolios, the Group defines a financial instrument as in default, when it meets one or more of the following criteria:

- The customer is more than 90 days past due on their contractual payments;
- The customer meets unlikeliness to pay criteria, which indicates the customer is in significant financial difficulty; or
- The account term has expired, but the account has not been fully paid down or refinanced (secured lending).

A secured loan can transition (cure) back to stage 2 when it has not met any of the default criteria for six consecutive months. For unsecured loans, an account cannot cure from stage 3 as the account is blocked from future use once the customer enters default.

For secured exposures, the definition of default for regulatory expected loss capital purposes is 180 days past due. However for accounting purposes Management have elected not to rebut the 90 days past due presumption under IFRS 9 for both secured and unsecured loan portfolios.

Note 19: Transition to IFRS 9 (continued)

Probability of default (PD)

PD is a key component in the calculation of ECL and the transition from stage 1 to stage 2. It is an estimate of the likelihood of default over either 12 months or the lifetime of the account. Management have used historical data, assumptions and expectations of future conditions to model PD over time for the secured and unsecured portfolios. An origination PD is required for each account. Where origination PDs were not available at the origination date, the origination PD was approximated, based on available account level data.

Exposure at default (EAD)

EAD is the amount that the Group expects the exposure to be at the point of default. For secured loans, this is a highly predictable amount based on the contractual payment profile and historic behaviours. For unsecured loans, the estimated balance utilisation at default is determined based on the characteristics of the account, including arrears status, consumer credit index of the account, and the current utilisation of the account (including whether the card is inactive).

Loss given default (LGD)

LGD is the amount of loss that will be incurred in the event of default. It represents the actual cash flows expected to be recovered for an individual account, and takes in to account collateral values and other cash recovered (e.g. through debt sale arrangements).

Expected life

The calculation of ECL is over the contractual life of the account, or the period over which the account exposes the Group to credit risk. For secured loans, this is the contractual period of the mortgage. For unsecured loans, the lifetime is the behavioural life of the credit card, which is the period over which the Group is exposed to credit risk.

Origination dates

The origination date of an exposure is the contractual origination date. The origination date is when the origination PD is determined, which will be referenced at each reporting period when determining if there has been a significant increase in credit risk.

For newly originated accounts, the origination PD is recorded on the contractual origination date. For acquired portfolios, Management have considered the facts around the purchase of each portfolio to determine the origination date to be applied.

Macro-economic scenarios

Unbiased macro-economic scenarios covering multiple potential outcomes are required by IFRS 9 to be incorporated into the ECL calculation.

Macro-economic variables impacting credit risk and expected credit losses for each portfolio have been investigated by performing statistical regression analysis to understand how changes in these variables have historically impacted default rates and the components of LGD. The macro-economic variables with the most significant impact on PD and LGD, for the Group, are judged to be house price inflation; unemployment rate; household debt-to-income ratio[1]; and bank base rate.

The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and has therefore sourced economic scenarios from a third party to form the basis of the economic scenarios used. The Group has considered a minimum of three scenarios on a probability-weighted approach. These scenarios include a base, an upside and a downside scenario. The combination of the three scenarios provides an unbiased but representative macro view of reasonably possible future outcomes, not biased to extreme, or stressed, scenarios. At 1 January 2018, three scenarios were used and weighted 40% to the base and 30% to each of the upside and downside scenarios. The scenarios include the key variables which ECL is sensitive to, resulting in an asymmetric and non-linear impact on ECL.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes based on reliable available information.

1 Household debt service ratio is used to inform the debt-to-income ratio used in the calculation of ECL.

Note 19: Transition to IFRS 9 (continued)

Where there are specific events, which due to timing or their nature, have not been incorporated into the macro-economic scenarios Management may overlay additional adjustments to ECL to take account of additional economic assumptions. This is considered when Management believe the impact of a specific event or change in market sentiment has not been appropriately captured in the ECL calculation inputs, for example events occurring very close to the reporting date.

The macro-economic assumptions adopted in the ECL calculation of the Group, and the impact of multiple economic scenarios on the ECL calculation were:

		Scenarios	
As at 30 June 2018	**Base**	**Upside**	**Downside**
House price index (5 year average)	**2.0%**	**3.9%**	**(1.1)%**
Unemployment rate (5 year average)	**4.9%**	**3.8%**	**7.1%**
Household debt service ratio (5 year average)	**11.6%**	**11.8%**	**11.2%**
Bank base rate (5 year average)	**1.2%**	**1.5%**	**0.3%**
Weighting assigned	**40%**	**30%**	**30%**

	Base case ECL	**Probability weighted ECL**	**Difference**
Impairment allowance as at 30 June 2018	**£112.4m**	**£113.3m**	**£0.9m**

		Scenarios	
As at 1 January 2018	Base	Upside	Downside
House price index (5 year average)	2.0%	3.5%	0.5%
Unemployment rate (5 year average)	5.2%	4.2%	6.8%
Household debt service ratio (5 year average)	11.8%	12.0%	11.4%
Bank base rate (5 year average)	1.2%	1.7%	0.2%
Weighting assigned	40%	30%	30%

	Base case ECL	Probability weighted ECL	Difference
Impairment allowance as at 1 January 2018	£103.2m	£104.4m	£1.2m

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors confirm that these condensed consolidated half-year financial statements have been prepared in accordance with International Accounting Standard 34 '*Interim Financial Reporting'*, as adopted by the European Union and that the interim management report includes a fair review of the information required by DTR 4.2.7 and DTR 4.2.8, namely:

- an indication of important events that have occurred during the first six months and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the first six months and any material changes in the related party transactions described in the last annual report.

By order of the Board,

Jayne-Anne Gadhia CBE
Chief Executive
25 July 2018

INDEPENDENT AUDITORS' REVIEW REPORT TO VIRGIN MONEY HOLDINGS (UK) PLC

Report on the condensed consolidated half-year financial statements

Our conclusion

We have reviewed Virgin Money Holdings (UK) plc's condensed consolidated half-year financial statements (the "interim financial statements") in the 2018 half-year results of Virgin Money Holdings (UK) plc for the six month period ended 30 June 2018. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the condensed consolidated balance sheet as at 30 June 2018;
- the condensed consolidated income statement and condensed consolidated statement of comprehensive income for the period then ended;
- the condensed consolidated cash flow statement for the period then ended;
- the condensed consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2018 half-year results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The 2018 half-year results, including the interim financial statements, is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the 2018 half-year results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the 2018 half-year results based on our review. This report, including the conclusion, has been prepared for and only for the Company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, 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.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the 2018 half-year results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Edinburgh
25 July 2018

1 The maintenance and integrity of the Virgin Money Holdings (UK) plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the interim financial statements since they were initially presented on the website.

2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdiction.

ALTERNATIVE PERFORMANCE MEASURES

The Group analyses its performance on an underlying basis, as described in the basis of presentation, and reconciled to the statutory results in note 2 to the condensed consolidated half-year financial statements. These are consistent with the Board and the Executive's view of the Group's underlying performance without the distortions of items and timing differences which are not reflective of the Group's ongoing business activities.

The Group also calculates a number of metrics that are commonly used and reported throughout the banking industry on an underlying basis, as these provide the Board and the Executive with a consistent view of these measures from period to period and provide relevant information to investors and other external stakeholders.

Descriptions of alternative performance measures used throughout this half-year report, including their basis of calculation, are set out below.

Banking net interest margin	Net interest income, calculated on an underlying basis, as a percentage of simple average interest-earning banking assets.
Cost of funds (spread)	Funding costs divided by average funding balances less the average 3 month Libor interest rate for the period.
Cost of risk	Impairment charges, net of debt recoveries, divided by simple average gross loans for the period.
Cost:income ratio	Operating expenses divided by total income, calculated on an underlying basis.
JAWS	The difference between the period on period percentage change in total income less the period on period change in operating expenses calculated on an underlying basis.
Loan-to-deposit ratio	The ratio of loans and advances to customers, net of allowances for impairment, divided by customer deposits (each excluding adjustments for fair value of portfolio hedging).
Net interest margin (NIM)	Net interest income, calculated on an underlying basis, as a percentage of simple average interest-earning assets.
Return on assets	Profit attributable to equity owners divided by closing total assets.
Return on tangible equity (RoTE)	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by simple average tangible equity. Tangible equity is calculated as total equity less other equity instruments and intangible assets.
Tangible net asset value per share	Net assets excluding intangible assets and Additional Tier 1 securities divided by the closing number of Ordinary Shares (excluding own shares held).
Underlying profit before tax	Statutory profit/(loss) before tax adjusted for certain items as detailed on pages 3 and 9 and note 2 to the condensed consolidated half-year financial statements.
Underlying return on assets	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by simple average total assets.
Underlying total income	Statutory total income adjusted for a subset of certain items as detailed on pages 3 and 9 and note 2 to the condensed consolidated half-year financial statements.

The Group also discloses a number of capital and liquidity metrics relevant to its financial position for which calculation is required under prudential rules issued by the PRA and FCA, in line with requirements of UK/EU legislation and Basel III. The bases of calculation of those metrics is defined within the relevant legislation (for example CRD IV) and are disclosed in the Glossary of the 2017 Annual Report and Accounts.

Capital metrics disclosed in this News Release have been calculated inclusive of verified profit for the half-year to 30 June 2018.

OTHER INFORMATION

In light of the CYBG offer, and an expected completion in Q4, Virgin Money does not anticipate issuing a Q3 trading update. Should circumstances change, details will be provided on the Investor Relations section of the Virgin Money website.

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NOTES TO EDITORS

About Virgin Money

- Virgin Money offers savings, mortgages, credit cards, current accounts, currency services, pensions, investments and protection products to customers across the UK.
- Virgin Money's business ambition is to make "everyone better off" – this philosophy underpins our approach to business by offering good value to customers, treating employees well, making a positive contribution to society and delivering a profit to shareholders.
- More than 14,500 charities have registered with Virgin Money Giving and by the end of June 2018, over £660 million had been donated to charities through the service since its launch in 2009, resulting in an estimated £20.6 million more donated to charities because of its not-for-profit model.

Note: all figures in this News Release are unaudited.

Virgin Money Holdings (UK) plc - Registered in England and Wales (Company No. 03087587).
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