# Virgin Money UK PLC Results Announcement 2019

28 November 2019
**Results Announcement**
For the year ended 30 September 2019

Classification: Private

## BASIS OF PRESENTATION

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

**Statutory basis:** Statutory information is set out on pages 18 to 21 and within the financial statements.

**Pro forma results:** On 15 October 2018, the Company acquired all the voting rights in Virgin Money Holdings (UK) PLC by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006, with the transaction being accounted for as an acquisition of Virgin Money Holdings (UK) PLC. We believe that it is helpful to also provide additional information which is more readily comparable with the historic results of the combined businesses. Therefore we have also prepared pro forma results for the Group as if Virgin Money UK PLC and Virgin Money Holdings (UK) PLC had always been a combined group, in order to assist in explaining trends in financial performance by showing a full year performance for the combined group for both the current year and prior year. A reconciliation between the results on a pro forma basis and a statutory basis is included on page 21. The pro forma results are also presented on an underlying basis as there have been a number of factors which have had a significant effect on the comparability of the Group's financial position and results.

**Underlying basis:** The pro forma results are adjusted to remove certain items that do not promote an understanding of historical or future trends of earnings or cash flows, which therefore allows a more meaningful comparison of the Group's underlying performance. A reconciliation from the underlying pro forma results to the pro forma basis is shown on page 21 and management's rationale for the adjustments is shown on page 108.

**Alternative performance measures (APMs):** The financial key performance indicators (KPIs) used by management in monitoring the Group's performance and reflected throughout this results announcement are determined on a combination of bases (including statutory, regulatory and alternative performance measures), as detailed at 'Measuring financial performance – glossary' on pages 106 to 108. APMs are closely scrutinised to ensure that they provide genuine insights into the Group's progress; however statutory measures are the key determinant of dividend paying capability.

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

## FORWARD LOOKING STATEMENTS

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

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

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

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# 28 November 2019

# Virgin Money UK PLC - results for the full year to 30 September 2019

*Note: this summary is on a pro forma basis as if Virgin Money was acquired on 01-Oct-17 (actual completion 15-Oct-18)*

## David Duffy, Chief Executive Officer:

*"In the first year of our newly combined business, we have delivered a good operating performance in challenging conditions and made great progress on the integration and rebrand to Virgin Money.*

*Our statutory result was significantly affected by additional PPI provisions, driven by the unprecedented surge in PPI information requests in August, along with anticipated Virgin Money acquisition-related costs.*

*Our customer divisions have performed well – we have delivered a further c.£2bn in net lending to support UK SMEs and consumers, attracted c.£3bn in customer deposits, and made marked improvements to our customer experience.*

*We achieved all the required approvals in 2019 to enable us to operate as one bank, with one brand, and are ready to deliver our strategy to disrupt the status quo with brilliant customer service and unique Virgin Money products. In December we are launching Virgin Money's first digital personal current account and three new Virgin Money concept stores. A unique loyalty and rewards programme for customers featuring a number of Virgin Group companies will follow in 2020, along with the launch of our brand new Virgin Money business account."*

## Key financial highlights

- Resilient operating performance in a challenging environment – NIM of 1.66% in line with guidance and 6% reduction in underlying costs to £942m; pre-provision operating profit improved +1% in 2019
- Underlying profit of £539m down 7% due to higher impairments from IFRS 9 adoption and normalisation
- Transformation on track – £53m of run rate net cost savings achieved; on track for c.£200m FY22 target
- Statutory loss after tax of £194m due to legacy conduct costs and restructuring & acquisition costs; Q4 PPI provision of £385m is within the Group's previous guidance range
- Robust capital position with CET1 ratio of 13.3%; provides capacity to execute our strategy and deliver all of the targets announced at our Capital Markets Day (CMD) in June
- Dividend suspended for FY19 in light of additional PPI provisions; the Board will reconsider dividends for FY20 in line with normal practice

## Delivering our strategic priorities

- **Pioneering Growth** - strong growth in lending and deposits in line with our strategy - above market asset growth in Business (+4.5%) and Personal (+16%), and disciplined growth in Mortgages (+1.7%); good growth in lower-cost relationship deposits (+7%) across both Business and Personal
- **Delighted Customers & Colleagues** - improved Group NPS of +37 (2018: +34), with B digital banking service NPS of +52, and customer experience enhancements such as the new Virgin Money credit card app, our JV with Salary Finance offering workplace personal lending and an energy switching partnership with GoCompare; colleague engagement score of 76% despite major change agenda
- **Super Straightforward Efficiency** - significant progress made in the first year of the Virgin Money integration; all 6.6m customers can now be served under the Virgin Money brand after successful completion of the FSMA Part VII process
- **Discipline & Sustainability** - robust capital position supports delivery of CMD strategy and targets; cost of risk of 21bps was stable through the year and we maintained our prudent underwriting approach

## Significant new developments for customers as our full rebrand is launched

- First ever Virgin Money digital current account ready to launch in December, built on our innovative FinTech-friendly digital platform
- First three new concept Virgin Money stores will also open in December
- New Digital Disruption Hub in Newcastle will accelerate customer experience and digital functionality improvements from January 2020 in support of our target for Top 3 CMA service quality rankings
- Plans to launch a unique personal rewards and loyalty programme leveraging the wider Virgin Group and a business banking proposition in 2020 are progressing well
- FY20 guidance in line with medium-term strategic and financial targets

# Full Year 2019 financial results summary

## Above market growth in Business and Personal; good growth in relationship deposits

- Customer lending growth of 2.9% to £73.0bn, all within our existing risk appetite:
  - Business lending growth of 4.5% to £7.9bn; supported by originations of £2.2bn during 2019
  - Personal lending growth of 16.1% to £5.0bn driven by high-quality Virgin Money credit card growth, new balances from our Salary Finance partnership and an improved online personal loan proposition
  - Mortgage lending growth of 1.7% to £60.1bn, maintaining market share at c.4% in line with strategy
- Deposit growth of 4.6% to £63.8bn, with 7.1% growth in lower-cost relationship deposits to £21.3bn
- Robust asset quality with a cost of risk of 21bps stable through 2019 but increased on FY18 (15bps) largely due to the adoption of IFRS9 and normalisation

## Resilient operating performance; statutory loss due to conduct, restructuring & acquisition costs

- Statutory loss after tax of £194m reflects legacy conduct costs and restructuring & acquisition costs
- Additional PPI provisions of £385m taken in Q4 (FY18: £415m); c.9% information request complaint conversion rate
- Underlying profit of £539m is 7% lower YoY due to higher impairments; pre-provision operating profit increased 1%:
  - FY19 NIM of 1.66% in line with guidance (Q4: 1.60%) reflecting competitive market conditions
  - Non-interest income reduced 10% primarily due to a £12m lower contribution from our Investments business and £9m of hedging-related adverse fair value movements
  - Costs down 6% to £942m in line with guidance; cost:income ratio of 57% and positive jaws of 3%
- Underlying Return on Tangible Equity (RoTE) of 10.8% (FY18: 11.0%)

## Integration on track with great progress made during the year

- Integration is progressing well with FSMA Part VII banking business transfer completed in October 2019; can now begin the integration of our customer propositions and platforms, and commence our rebrand
- Run rate net cost savings of £53m delivered; on track for c.£200m net cost savings target by FY22
- £156m of restructuring costs includes accelerated office closures and redundancies; c.£360m estimate for FY19-21 remains
- Acquisition costs of £189m comprises £102m of one-off costs and £87m of acquisition accounting unwind

## Robust capital position supports execution of strategy and delivery targets; ordinary dividend suspended

- CET1 ratio of 13.3% reflects legacy conduct and restructuring & acquisition costs (FY18: 15.1%)
- Ordinary dividend suspended for FY19; progressive and sustainable dividend ambition remains and the Board will reconsider dividends for FY20 in line with normal practice
- CET1 ratio above medium-term operating level of c.13%; retains a significant buffer to CRD IV regulatory requirement of 11.0%, supports delivery of CMD strategy and targets
- TNAV per share of 249.2p; down 10.8p vs FY18 due to PPI

## Capital Markets Day strategy on track and all targets re-affirmed

- Guidance for FY20:
  - NIM of c.160-165bps
  - Underlying operating costs of <£900m
  - CET1 ratio operating level of c.13%
- CMD strategy remains on track with all targets re-affirmed, including: modest improvement in NIM by FY22, <£780m FY22 operating costs and statutory RoTE of >12% by FY22

# Contact details

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Virgin Money UK PLC will be hosting a presentation for analysts and investors covering the 2019 full year financial results starting at 08:30 GMT (19:30 AEDT) and this will be webcast live and available at:

https://webcast.openbriefing.com/virginmoney-FY19/

Alternatively, a conference call facility will be available to listen to the meeting. The dial in details for the call are:

**Conference Call Details:**

- Australia 02 8417 2995
- United Kingdom 0800 640 6441
- United Kingdom (Local) 020 3936 2999
- United States 1 646 664 1960
- All other locations +44 20 3936 2999

Participant Access Code - **391935**

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

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

# Chief Executive Officer's review

## "In 2019 we refreshed our strategy, launched our three new divisions and delivered significant integration milestones. We are now one Bank with the culture and capabilities to deliver on our strategy of disrupting the status quo."

**2019 has seen us build our platform for the future. Designing our refreshed strategy was crucial and developing it with our new Purpose and Values at its core gives us a clear direction in support of our ambition to disrupt the status quo.**

The combination of Virgin Money and CYBG has created a unique digitally-enabled competitor that combines the strengths of both the major banks and the neo banks, enabling us to offer a differentiated customer proposition.

Working closely with the Board, we formulated our strategy and targets, which we announced to a positive reception at our Capital Markets Day (CMD) in June. This strategy will support what we believe is a compelling investment case and positions us to compete effectively with current and alternative providers of customer propositions in the banking models of the future.

### A year of progress and achievements

Our integration programme has been a key focus throughout the year. The critical achievement of this work was the FSMA Part VII banking business transfer approval in October 2019, which we delivered faster than expected. This means we can now begin the integration of our customer propositions and offer the full range of products and services from across the combined business. We can also now launch the Group rebrand activity and proceed with the platform integration activities that support our cost savings targets.

Our Group strategy will be brought to life for our customers through our three new customer-facing divisions: Business, Personal and Mortgages, each with their own customer-focused ambitions, strategies and KPIs.

We have also made good progress in realising some of our initial integration cost savings, including addressing senior management duplication, starting the rationalisation of our office and branch footprints, and commencing deduplication of suppliers. This has enabled us to deliver £53m of run-rate net cost savings in 2019, a strong start towards our targeted c.£200m of net cost savings.

### Resilient operating performance

In line with the balance sheet optimisation strategy we outlined at our CMD, we grew above market in Business (+4.5%) and Personal (+16%), but tempered our growth in Mortgages. We also delivered 7% growth in relationship deposits, as we optimise our funding mix.

This strategy contributed to the delivery of a resilient operating performance in a competitive environment. Although we increased operating profit by 1% through our initial cost savings, underlying profit before tax reduced by 7%, due to higher impairments from IFRS 9 and normalisation.

### Statutory loss driven by legacy conduct and acquisition costs

We, like the rest of the industry, were surprised by the scale of the PPI information requests and complaints during August. We have moved swiftly to address the issue and are leveraging innovative technology solutions to enable us to deal with genuine customer complaints as quickly, and as cost effectively, as we can. It is nonetheless frustrating to incur a further £385m in provisions in Q4 as we look to close out this legacy issue.

The scale of PPI provisions and acquisition costs incurred during the year led to a statutory loss of £194m for FY2019. However, as outlined at our CMD, we have a clear path to statutory profitability and a statutory return on tangible equity of >12% by FY2022.

### Robust capital position supports our strategy

Although the sizeable PPI provision did impact our capital position, the Board and I are confident that our CET1 ratio of 13.3% retains both a significant buffer to our regulatory requirement of 11% and provides the capacity to deliver our strategy. We have however taken the difficult decision to suspend the dividend in 2019. The Board, incorporating feedback from our major shareholders, believes this is the right short-term action to enable us to deliver on our longer-term strategy and targets.

### Customer experience improvements

We have almost completed the transfer of all CYBG customers and products onto our FinTech-friendly banking platform, and we can now commence the integration of the Virgin Money customer platforms too. We have launched EZBob as an SME solution, Salary Finance for unsecured lending and a money-saving utility app with GoCompare. We want to accelerate the pace of these and other initiatives and we have therefore announced the creation of a new digital disruption hub in Newcastle. This scaled capability will allow our three business divisions to deliver disruptive propositions to enhance the customer experience in a rapid and agile manner, with our innovations benchmarked to all markets and industries globally.

### Outlook

Our ambition is to deliver the product and service diversity and benefits of a large-scale bank with the customer experience and innovation of the neo banks, and we will also expand our partnership platform to facilitate the delivery of further value-based propositions like GoCompare. We are working on new propositions with a number of the 25+ other Virgin Group companies and plan to launch reward and loyalty offerings.

Ultimately, we hope to demonstrate the unique advantages of being linked to the broader Virgin Group. We will be the only bank that offers a full range of banking and lifestyle services through a linked rewards programme that offers value back to our customers. We will begin bringing these capabilities to market during 2020.

# Chief Executive Officer's review

We recognise the continuously changing landscape in financial services and will evaluate partnerships where we believe there is an opportunity to provide our customers with a unique proposition, a class-leading service and a value for money outcome. We need to remain vigilant around the competitive landscape while at the same time delivering a significant amount of change in our organisation. Finally, we are reinforcing our governance to ensure compliance with the regulatory requirements as a new Tier 1 bank.

We are a Purpose-driven organisation with a refreshed strategy and priorities. We have a clear path to statutory profitability and a statutory return on tangible equity of >12% by FY2022. We are also focused on an ambitious sustainability strategy centred on inclusion, community engagement and protecting and nurturing the environment. Our Virgin Money Giving platform and charitable foundation will help us to achieve our goals in these areas.

2019 has been a year of immense work to build the foundations for our future success across the Board, my Leadership Team and all of our colleagues, and I would like to thank everybody for their efforts. I am excited about what we will achieve together in 2020 as we start to deliver on our ambition to disrupt the status quo.

**David Duffy**
Chief Executive Officer
27 November 2019

# Chief Financial Officer's review

## "In 2019 we delivered a resilient operating performance and made good progress against our financial targets. We have a strong balance sheet and are well placed to deliver our strategy."

### Review of the year

2019 has seen the combined Group make a strong start. We delivered a resilient operating performance in a challenging environment, while executing on key integration milestones that now enable us to commence the customer and platform integration programme. We have also made good initial progress in the delivery of our refreshed strategy and targets that we set out at our Capital Markets Day (CMD) in June. The Group experienced an unwelcome and unexpected surge in PPI claims ahead of August's complaint deadline, but we have been able to absorb the additional cost impact and remain focused on implementing our CMD strategy.

#### Balance sheet progress

Our strategy to reshape the balance sheet is off to a good start with asset growth of 2.9%. This was achieved through above market growth in Business and Personal lending, with more muted growth in Mortgages as we optimised for value in line with our strategy. We also delivered strong growth of 7.1% in relationship deposits as we look to rebalance our funding away from less sticky and more expensive non-linked savings and term deposits.

#### Resilient operating performance

The Group delivered a resilient operating performance with pro forma underlying profit before tax of £539m (2018: £581m) and underlying return on tangible equity of 10.8% (2018: 11.0%).

The Group delivered slightly lower income of £1,639m (down 3% year-on-year) in a challenging environment, but more than offset this with reduced costs of £942m (down 6%) to deliver an increased operating profit of £692m (up 1%). Impairments rose to £153m (up 44%) following the adoption of IFRS 9 and normalisation, but underlying asset quality remains strong. As a result, underlying profit before tax was 7% lower than 2018.

#### Statutory loss driven by legacy conduct

In line with the rest of the industry, we received an unprecedented surge in PPI information requests and complaints during August, which required us to take additional PPI provisions of £385m in the second half of the year (£415m for the full year).

The scale of the PPI provision, coupled with the restructuring and acquisition costs incurred this year (£345m), meant that the Group has reported a statutory loss after tax of £194m (2018: £145m loss after tax).

#### Robust capital position supports strategy

While the PPI provision clearly had a significant impact on the Group's capital position, thanks to the significant buffer the Group was prudently holding, we have been able to absorb the impact and remain robustly capitalised. However we have, incorporating feedback from our major shareholders, taken the prudent decision to suspend the dividend in 2019.

Our CET1 ratio of 13.3% as at 30 September 2019 retains a significant buffer to our CRD IV regulatory requirement of 11.0% and provides sufficient capacity to deliver our CMD strategy.

#### Conclusion

2019 has been a year of building our foundations for the future, while seeking to close out legacy issues. Our refreshed strategy is predicated on actions within our own control and leverages the key strategic advantages available to us. We look forward to another year of strong delivery and progress in 2020.

### Basis of preparation note

*The information and commentary in this section presents the Group results on a pro forma basis as if CYBG PLC and Virgin Money Holdings (UK) PLC had always been a combined group. This assists in explaining trends in financial performance by showing a full 12-month performance for the combined group for both the current and prior year.*

*The acquisition has had a significant impact on the Group's statutory results and financial position and we believe that it is most helpful to provide historical information which is more readily comparable with the results of the combined businesses.*

*The statutory results, which include the results of Virgin Money Holdings (UK) PLC from the date of acquisition on 15 October 2018 are set out at the end of this section on pages 18 to 21.*

*A reconciliation between the results on a pro forma basis and a statutory basis is also included on page 20.*

# Chief Financial Officer's review

**Statistory loss after tax**

£(194)m

2018: £(145)m

**Underlying profit before tax**

£539m

2018: £581m

**Underlying Return on Tangible Equity**

10.8%

2018: 11.0%

**Net Interest Margin (NIM)**

1.66%

2018: 1.78%

**Underlying cost to income ratio**

57%

2018: 59%

**Cost of risk**

21bps

2018: 15bps

**CET1 ratio**

13.3%

2018: 15.1%

**Asset growth**

+2.9%

2018: N/A

**Relationship deposit growth**

+7.1%

2018: N/A

## Income

| Summary for the year ended 30 September | 2019 £M | 2018 £M | CHANGE |
|---|---|---|---|
| Underlying net interest income | **1,433** | 1,457 | (2)% |
| Non-interest income | **206** | 228 | (10)% |
| **Total underlying operating income** | **1,639** | 1,685 | (3)% |
| Net interest margin (NIM) | **1.66%** | 1.78% | (12)bps |
| Average interest-earning assets | **86,362** | 81,934 | 5% |

# Chief Financial Officer's review

## Overview

Total income of £1,639m was 3% lower year-on-year, reflecting competitive market conditions impacting net interest income, a lower contribution from our investments business, and adverse fair value movements within non-interest income.

**Net interest income and NIM**

Net interest income declined 2% year-on-year reflecting the continued competitive pressures in the marketplace.

In Mortgages, sustained competition in recent years has driven front book mortgage pricing well below average back book rates. This has impacted our book more than others over the past few years as we have a less seasoned, shorter duration book. The average yield on the mortgage book declined 12bps due to a negative c.30bps average front book vs. back book variance during 2019. However, growth in average mortgage balances helped mitigate these pressures to deliver broadly stable mortgage interest income. In Business, expanding yields due to higher rates and growth in average balances has driven increased interest income. In Personal, better yields due to the seasoning of the credit card book and growth in average balances also increased interest income.

Our customer deposit costs increased by 10bps in 2019 to 98bps, 4bps of which relates to the full year impact of the base rate increase in August 2018. The remainder of the increase is due to increased deposit pricing pressure on non-linked savings and term deposits. Wholesale funding costs increased primarily due to rate increases and additional MREL issuance.

As a result, and as expected and guided, the Group's Net Interest Margin (NIM) declined by 12bps to 1.66%. Mortgage pricing pressures reduced NIM by 8bps and deposit pricing, including the base rate increase impact, led to a further 10bps of NIM reduction. This was offset by 7bps of benefit from growth in Business and Personal lending, with a further 1bps of net reduction from other items, including wholesale funding and liquidity impacts.

The Group manages the risk to its earnings from movements in interest rates centrally, by hedging assets, liabilities and equity which are less sensitive to movements in rates. The weighted average life of this structural hedge was unchanged at 2.5 years (2018: 2.5 years), in line with the expected life of liabilities of 5 years. The average hedge balance increased to £24.0bn (2018: £21.5bn) due to the alignment of the treatment of some administered rate deposits acquired from Virgin Money with the Group's policy. Total structural hedge balances generated gross incremental net interest income of £228m (2018: £198m), representing a yield of 0.9% (2018: 0.9%).

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| **Average balance sheet** | AVERAGE BALANCE £M | INTEREST INCOME/ (EXPENSE) £M | AVERAGE YIELD/(RATE) % | AVERAGE BALANCE £M | INTEREST INCOME/ (EXPENSE) £M | AVERAGE YIELD/(RATE) % |
| **INTEREST-EARNING ASSETS** | | | | | | |
| Mortgages | **60,288** | **1,551** | **2.57** | 57,960 | 1,557 | 2.69 |
| Business lending[(1)] | **7,542** | **314** | **4.17** | 7,311 | 288 | 3.94 |
| Personal lending | **4,670** | **359** | **7.69** | 4,360 | 298 | 6.84 |
| Liquid assets | **12,298** | **98** | **0.79** | 11,007 | 62 | 0.56 |
| Due from other banks | **1,564** | **13** | **0.86** | 1,296 | 6 | 0.42 |
| Swap income/other | **–** | **(11)** | **n/a** | – | (38) | n/a |
| **Total average interest-earning assets** | **86,362** | **2,324** | **2.69** | 81,934 | 2,173 | 2.65 |
| **Total average non-interest-earning assets** | **3,545** | | | 3,167 | | |
| **Total average assets** | **89,907** | | | 85,101 | | |
| **INTEREST-BEARING LIABILITIES** | | | | | | |
| Current accounts | **11,570** | **(19)** | **(0.16)** | 11,555 | (12) | (0.11) |
| Savings accounts | **24,366** | **(214)** | **(0.88)** | 22,265 | (143) | (0.64) |
| Term deposits | **22,877** | **(370)** | **(1.62)** | 22,847 | (364) | (1.60) |
| Wholesale funding | **19,427** | **(288)** | **(1.48)** | 16,783 | (197) | (1.17) |
| **Total average interest-bearing liabilities** | **78,240** | **(891)** | **(1.14)** | 73,450 | (716) | (0.98) |
| **Total average non-interest-bearing liabilities** | **6,590** | | | 6,379 | | |
| **Total average liabilities** | **84,830** | | | 79,829 | | |
| **Total average equity** | **5,077** | | | 5,272 | | |
| **Total average liabilities and average equity** | **89,907** | | | 85,101 | | |
| **Net interest income** | | **1,433** | **1.66** | | 1,457 | 1.78 |

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

# Chief Financial Officer's review

### Non-interest income

Non-interest income reduced £22m year-on-year (down 10%). Fee income across Personal and Business was broadly stable. The major drivers of the reduction were the contribution from our Investments business, which was £12m lower in 2019 as a result of our post-acquisition decision to reduce asset management fees (c.£9m), and the initial impact of the transfer of the business into the JV with Aberdeen Standard Investments (c.£3m). In addition, there were adverse fair value movements relating to hedge accounting ineffectiveness, which should equalise over time, but reduced non-interest income by £9m year-on-year.

## Costs

| For the year ended 30 September | 2019 £M | 2018 £M | CHANGE |
|---|---|---|---|
| Personnel expenses | **365** | 423 | (14)% |
| Depreciation and amortisation expenses | **111** | 121 | (8)% |
| Other operating and administrative expenses | **466** | 454 | 3% |
| **Total underlying operating and administrative expenses** | **942** | 998 | (6)% |
| Underlying cost:income ratio (CIR) | **57%** | 59% | (2)%pts |

### Overview

Underlying operating and administrative expenses reduced by 6% year-on-year to £942m, in line with our guidance for <£950m for the year, as our integration programme gathers pace.

Personnel expenses reduced 14% reflecting early action to address senior management deduplication as well as initial benefits from our other integration workstreams. Other operating expenses increased by 3% as we continued to invest in our customer propositions and also reflected the cost of running two separate banks ahead of the FSMA Part VII approval in October 2019.

### Net cost savings target on track

We have made good initial progress in delivering against our target of c.£200m of net cost savings by the end of FY2022, with £53m of annual run-rate net cost savings achieved already. This has been delivered primarily through deduplication of senior management (c.£20m of run-rate savings), as well as the realisation of initial central costs synergies such as harmonisation of suppliers (c.£27m of run-rate savings) and operational efficiency initiatives including deduplication of head office functions (c.£12m of run-rate savings). This was partly offset by a £7m increase in the Virgin Money brand trademark licence fee.

### Improving efficiency

The 6% reduction in costs more than offset the 3% reduction in income delivering positive jaws of 3%. This enabled the Group to reduce its cost:income ratio by 2%pts to 57%, as we progress on the path towards our target for a mid-40s% ratio by FY2022.

# Chief Financial Officer's review

## Impairments[1]

| | 2019 | | | | 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | MORTGAGES BPS | BUSINESS BPS | PERSONAL BPS | TOTAL BPS | MORTGAGES BPS | BUSINESS BPS | PERSONAL BPS | TOTAL BPS | TOTAL CHANGE (BPS) |
| Gross cost of risk | **1** | **45** | **333** | **27** | 1 | 36 | 250 | 20 | 7 |
| Specific provision releases and recoveries | | | | **(6)** | | | | (5) | (1) |
| **Net cost of risk** | | | | **21** | | | | 15 | 6 |

(1) IFRS 9 transitional disclosures are available in note 5.4 within the notes to the consolidated financial statements

### Overview

The impairment charge increased by 44% or £47m, in line with expectations. This reflected the full adoption of IFRS 9 across the Group, portfolio seasoning and a return to more normal levels of impairment in Business. The cost of risk of 21bps was therefore 6bps higher than FY2018, but was stable across the year as asset quality has remained resilient.

**Divisional performance**

Mortgage impairment levels remain very low with no signs of asset quality stress in the portfolio.

Business gross cost of risk increased to 45bps, which reflected a more normalised level following an abnormally low level of impairments in FY2018 with no significant one-off charges. We remain focused on managing our Business risk profile through maintaining a diversified portfolio, leveraging our sector specialist underwriting experience and applying strict client exposure limits. The underlying credit quality of the book remains strong, with the probability of default improved on origination in 2019 and unchanged across the portfolio relative to 2018.

Gross cost of risk in Personal increased by 83bps, reflecting the adoption of IFRS 9 and the seasoning of the credit card portfolio. Our focus in Personal is to grow our underweight position through better accessing our existing customer base and leveraging the Virgin Money brand to target more affluent segments of the external market.

Asset quality in the credit card portfolio remains strong, with 30-day arrears of 1.1% well below the industry average of 2.3% and customer affordability remaining robust. Customer indebtedness is also lower than the industry with a debt to income of c.23% vs. c.30% for the industry.

Performance in the personal loan portfolio has benefited from enhanced scorecards and credit tightening strategies, with growth in high-quality customers reducing 90 days past due rates on the book to 0.6% from 0.7% a year ago.

# Chief Financial Officer's review

## Exceptional items and statutory loss

| | 2019 £M | 2018 £M |
|---|---|---|
| **Underlying profit on ordinary activities before tax** | **539** | 581 |
| Exceptional items | | |
| – Restructuring costs | **(156)** | – |
| – Acquisition costs | **(189)** | (39) |
| – Legacy conduct | **(433)** | (396) |
| – Other items | **(26)** | (62) |
| **Pro forma (loss)/profit on ordinary activities before tax** | **(265)** | 84 |
| Add/(deduct) Virgin Money Holdings (UK) PLC pre-acquisition loss/(profit)[(1)] | **33** | (248) |
| **Statutory loss on ordinary activities before tax** | **(232)** | (164) |
| Tax credit | **38** | 19 |
| **Statutory loss for the year** | **(194)** | (145) |

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

### Overview

The Group's pro forma loss before tax was £265m, reflecting £804m of exceptional costs incurred during the year, which have been excluded from the underlying performance of the business. These included significant legacy conduct costs, one-off acquisition costs, as well as the first full year of restructuring costs to achieve integration.

**Restructuring costs**
As outlined at the CMD in June the Group expects to incur c.£360m of restructuring costs across FY2019-21. The Group had anticipated incurring this evenly over the period with c.£120m expected in 2019, however, due to the acceleration of redundancy initiatives and property closures into September 2019, we have incurred £156m of restructuring costs during the year. We will see the synergy benefits of these initiatives in FY2020. The Group expects to incur a further c.£140m in 2020 as we accelerate initiatives to mitigate the timing of investments and inflation, and the remainder in 2021. We continue to expect total restructuring costs to be c.£360m over the three-year period.

**Acquisition costs**
The Group incurred acquisition costs of £189m during the year.

This included a one-off charge of £127m for intangible asset write-offs following a review of the Group's software estate. This identified a number of assets (including £70m in relation to the Virgin Money Digital Bank asset) that are no longer of value to the Group's future strategy and were therefore required to be written down. However, this charge is capital neutral.

Other one-off impacts include £55m of transaction-related costs incurred by Virgin Money Holdings (UK) PLC and an effective interest rate (EIR) adjustment credit of £80m relating to the mortgage portfolio following the harmonisation of accounting policies.

The Group recognised fair value acquisition accounting adjustments of £270m net that will be unwound through the income statement over the lives of the related assets and liabilities (c.5 years) and £87m was charged in 2019.

**Legacy conduct**
Legacy conduct costs of £433m include £415m of PPI provisions, with an additional £385m taken in Q4 following the unprecedented industry-wide surge in information requests and complaints in August ahead of the PPI time bar deadline. This provision reflects the costs of additional complaints (including those from the Official Receiver), processing costs in relation to the large volume of information requests, and the costs to process and remediate valid complaints arising from the information requests. While we still have a residual volume of requests to process, detailed sampling has informed the provision we have taken and this is our best estimate. The Group also incurred £18m of provision costs in relation to a number of other smaller legacy items.

**Other items**
The Group incurred several other one-off exceptional costs during the year, including £30m of costs in preparation for participating in the RBS Incentivised Switching Scheme, an £11m charge for GMP pensions equalisation, and an £18m charge for consent solicitation fees incurred in relation to changing the obligor on Virgin Money Holdings (UK) PLC's outstanding debt instruments to the Group's holding company. These were partially offset by a £35m gain on sale of c.50% of Virgin Money Unit Trust Managers to Aberdeen Standard Investments.

# Chief Financial Officer's review

## Returns and TNAV

| | 2019 | 2018 | CHANGE |
|---|---|---|---|
| Underlying Return on Tangible Equity (RoTE) | **10.8%** | 11.0% | (0.2)%pts |
| Tangible Net Asset Value (TNAV) per share | **249.2p** | 260.0p | (10.8)p |

Underlying RoTE of 10.8% was slightly lower than the prior year, reflecting lower underlying profit, but with a minimal impact on average tangible equity from the conduct charges as the bulk of those costs were incurred on the last day of the financial year. Statutory RoTE was negative reflecting the significant legacy conduct, restructuring and acquisition costs during the year.

TNAV per share reduced c.11p in 2019 to 249.2p, with TNAV build of 31p from underlying profit after tax being more than offset by 28p of legacy conduct charges and a net 14p negative impact from other movements including restructuring and acquisition related adjustments.

## Balance sheet

| **As at 30 September** | 2019 | 2018 | CHANGE |
|---|---|---|---|
| Mortgages | **60,079** | 59,074 | 1.7% |
| Business | **7,876** | 7,538 | 4.5% |
| Personal | **5,024** | 4,327 | 16.1% |
| **Total customer lending** | **72,979** | 70,939 | 2.9% |
| Relationship deposits[(1)] | **21,347** | 19,938 | 7.1% |
| Non-linked savings | **20,197** | 17,175 | 17.6% |
| Term deposits | **22,243** | 23,851 | (6.7)% |
| **Total customer deposits** | **63,787** | 60,963 | 4.6% |
| Risk Weighted Assets (RWAs) | **24,046** | 22,943 | 4.8% |
| of which Mortgages | **8,846** | 8,794 | 0.6% |
| of which Business | **7,124** | 6,604 | 7.9% |
| of which Personal | **4,042** | 3,463 | 16.7% |
| Wholesale funding | **18,506** | 18,675 | (0.9)% |
| of which Term Funding Scheme (TFS) | **7,342** | 8,637 | (15.0)% |
| Loan to Deposit Ratio (LDR) | **114%** | 116% | (2)%pts |
| Liquidity Coverage Ratio (LCR) | **152%** | 161% | (9)%pts |

(1) Current account and linked savings balances.

### Overview

The Group began the execution of its balance sheet optimisation strategy in 2019 in which we seek to rebalance our asset mix towards higher-margin lending and to grow our lower cost relationship deposits to enable us to replace more expensive non-linked savings and term deposits.

**Continued customer balance growth**
Customer lending balances increased by 2.9% during 2019 with above market growth in Personal and Business lending, and more muted growth in Mortgages. Our lending continues to be underwritten within our prudent risk appetite and approach.

Customer deposits increased by 4.6%, including a strong 7.1% growth in our lower cost relationship deposits. We also continued to grow our non-linked savings balances (+17.6%) to enable us to replace our more expensive term deposits and to help fund the balance sheet.

The stronger relative growth in our customer deposits meant that our Loan to Deposit ratio reduced to 114%.

# Chief Financial Officer's review

### Further progress on our wholesale funding strategy

Wholesale funding balances were broadly flat during the year, although there were significant movements within the component parts. Supported by strong deposit and wholesale funding generation we repaid £1.3bn of TFS, as we follow a prudent repayment schedule ahead of contractual maturity.

We were also active in other wholesale funding markets, with a number of successful and over-subscribed transactions during the year, including Virgin Money PLC's inaugural Covered Bond issuance. This new Covered Bond programme raised over £1bn in funding across Euro and Sterling markets across two separate trades. We also issued two further successful transactions from our Lanark mortgage-backed securities platform, raising c.£1.1bn.

These were supported by £250m of Additional Tier 1 (AT1) issuance in March 2019 and £250m of Tier 2 subordinated debt issuance in December 2018 which strengthened our capital stack, as well as £400m of senior unsecured debt issuance in August 2019 as we build towards meeting our final MREL requirements in 2022.

Our balance sheet strength was also underpinned by the consent solicitation activity undertaken to change the obligor on Virgin Money Holdings (UK) PLC's outstanding MREL and AT1 instruments to the Group's parent company. All of the Group's regulatory capital and MREL instruments are now issued out of Virgin Money UK PLC, consistent with the single point of entry resolution model.

Further issuance in secured and unsecured formats is expected in 2020, and we continue to expect that we will issue between £1.5bn and £2.0bn of MREL eligible senior unsecured funding by December 2021.

### Liquidity and LCR

LCR remained strong at 152%. While the current position reflects some excess liquidity to mitigate the risks from the FSMA Part VII process and Brexit uncertainty, the 9%pts reduction in LCR highlights the ability of the combined Group to operate more efficiently while continuing to meet regulatory and internal risk appetite metrics.

### Risk weighted assets

RWAs have grown by 4.8% during the year, with overall risk weight density increasing slightly, largely reflecting the shift in the mix of the Group's lending towards higher RWA density lending in Business and Personal.

Mortgage RWAs remained stable due to lower lending in the year, along with model improvements that have reduced the portfolio risk weight density. RWAs in our Personal portfolios have grown broadly in line with assets, while Business RWAs have increased slightly above asset growth largely reflecting model updates undertaken as part of the final implementation of IRB. Non-credit risk RWAs of £2,989m were broadly stable year-on-year.

## Capital

| As at 30 September | 2019 | 2018 | CHANGE |
|---|---|---|---|
| CET1 ratio | **13.3%** | 15.1% | (1.8)%pts |
| Total capital ratio | **20.1%** | 20.6% | (0.5)%pts |
| MREL ratio | **26.6%** | 24.1% | 2.5%pts |
| UK leverage ratio | **4.9%** | 5.1% | (0.2)%pts |

### Overview

Despite heavy capital utilisation during the year from legacy conduct and restructuring and acquisition costs, the Group maintained a robust capital position with a CET1 ratio of 13.3% and a total capital ratio of 20.1% as at 30 September 2019.

### Capital requirements

Following completion of the Group's ICAAP the PRA has updated the capital requirements for the Group. The Pillar 2A CET1 requirement was reduced from 3.6% to 3.0% and the Group's fully-loaded CRD IV minimum CET1 capital requirement is now 60bps lower at 11.0%.

### CET1 capital movements

Underlying capital generation in the period was 77bps, largely driven by strong underlying profits of 234bps, offset by growth in lending, AT1 distributions and ongoing investment as we continue to invest in developing the business to achieve our strategic ambitions.

Restructuring and acquisition costs, which are elevated this year due to the one-off elements, absorbed 84bps of capital demonstrating that the Group's underlying capital generation of 77bps was sufficient to fund its ongoing strategy. However, the scale of the legacy conduct charge consumed 172bps of capital, leaving the Group's CET1 ratio at 13.3%.

### Robust capital position supports strategy

While the PPI provision did have a significant impact on the Group's capital position, thanks to the significant buffer the Group was prudently holding, we have been able to absorb the impact and remain robustly capitalised.

However, after incorporating feedback from our major shareholders, the Board has concluded that it is prudent to conserve capital through the suspension of an ordinary dividend for 2019.

Our closing CET1 ratio of 13.3% remains above our medium-term operating level of c.13% and retains a significant management buffer to our CRD IV regulatory requirement of 11.0%. The Group has assessed its revised capital plan and determined that it has sufficient capacity to deliver the strategy and targets as outlined at the CMD in June.

# Chief Financial Officer's review

**MREL**

The Group's MREL ratio increased to 26.6%, reflecting £400m of senior unsecured debt issuance in August 2019 and £250m of Tier 2 subordinated debt issuance in December 2018. We are comfortably ahead of our interim 2020 MREL requirement of 21.5%, and while the final MREL requirements are not yet confirmed, we expect to issue between £1.5bn and £2.0bn of further MREL eligible senior unsecured between now and 2022 to meet our estimated final MREL requirements.

| | 2019 |
|---|---|
| **Opening CET1 ratio** | **10.5%** |
| IRB accreditation impact | **3.5%** |
| **IRB pro forma CET1 ratio** | **14.0%** |
| Virgin Money acquisition impact | **1.1%** |
| **Opening Combined Group pro forma CET1 ratio (pre-IFRS 9 impact)** | **15.1%** |
| IFRS 9 transitional impact (bps) | **(2)** |
| **Opening Combined Group pro forma CET1 ratio as of 1 October 2018 (post-IFRS 9 impact)** | **15.1%** |
| Generated (bps) | **234** |
| RWA growth (bps) | **(65)** |
| Investment spend (bps) | **(65)** |
| AT1 distributions (bps) | **(27)** |
| **Underlying capital generated (bps)** | **77** |
| Restructuring and acquisition costs (bps) | **(84)** |
| Legacy conduct (bps) | **(172)** |
| FY2018 ordinary dividends paid (bps) | **(19)** |
| Other (bps) | **18** |
| Net capital absorbed (bps) | **(180)** |
| **Closing CET1 ratio** | **13.3%** |

## On track to deliver targets

### FY2020 guidance

Net Interest Margin (NIM)

c.1.60-1.65%

Underlying costs

<£900m

CET1 ratio operating level

c.13%

Dividend

Reconsider in FY2020

### All CMD targets reaffirmed, including:

>12%

**Statutory RoTE by FY22**

>100bps

**CET1 generation p.a. by FY22**

Progressive and sustainable

**ordinary dividend c.50% payout ratio over time**

# Chief Financial Officer's review

## Outlook and guidance

The political and economic outlook remains highly uncertain. With the inevitable volatility arising from an impending General Election and lack of clarity as to the final shape of any Brexit arrangements, the UK's near-term economic prospects remain hard to forecast. Although sentiment has improved as the threat of a no-deal Brexit has receded, GDP growth may remain muted and we are prepared for an outcome in which other key economic indicators decline.

Our strategy was designed to mitigate a muted economic outlook and the evident industry pressures, with a focus on leveraging the significant self-help opportunities available to us from reshaping our balance sheet and becoming more cost-efficient through deduplication, platform integration and digital transformation.

Despite the short-term external challenges, we remain confident in the prospects for the Group and we are reaffirming all of the targets we set at our CMD. We continue to believe that the delivery of our strategy and targets will deliver increased shareholder value as measured by the achievement of a statutory RoTE of >12% by FY2022, CET1 capital generation of >100bps per annum by FY2022 and an ordinary dividend ambition that is progressive and sustainable, moving towards a c.50% payout ratio over time.

In the near term, we foresee continuing industry pressures and economic uncertainty, but our self-help strategy is well placed to mitigate these. While 2020 will be a year of continued integration activity and associated costs, it will also see some exciting developments launched for our customers, now that the FSMA Part VII banking business transfer process is complete.

Our Net Interest Margin (NIM) for FY2020 is expected to be in a range of between 1.60% and 1.65%. Pressure from back book repricing in our mortgage portfolio will ease in FY2020 as our front book versus back book variance narrows. We will also start to see benefits from further growth in margin accretive lending and lower-cost relationship deposits, although pressures from wholesale funding costs and TFS repayment will continue.

On costs, we will continue working towards our net cost savings target of c.£200m by FY2022 and expect the Group's underlying operating expenses to be less than £900m in FY2020. This will be underpinned by the delivery of further integration and digitisation initiatives, but will be partly offset by continued cost inflation and ongoing investment.

On capital, we intend to operate in line with our CET1 ratio operating level of c.13%. Underlying capital generation will be used to fund the capital consumption from restructuring and acquisition costs, but we will also look to take further opportunities to optimise our RWAs as we reshape the balance sheet.

While it was necessary to suspend our dividends in 2019 due to the unexpected legacy conduct charge, we remain committed to our dividend ambition and the Board will reconsider dividends in line with normal practice in FY2020.

Lending and deposit growth will continue as set out at the CMD, with above system growth in Business and Personal, while Mortgages will grow in line with the market. On deposits, we expect a high single-digit CAGR in our relationship deposits, underpinned by the launch and development of the digitally-enabled Virgin Money Personal Current Account at the end of 2019.

Finally, we will participate in the Bank of England's annual cyclical scenario (ACS) stress tests for the first time in 2020. We have begun preparatory work which will be completed next year, with the published results expected in late 2020.

In summary, the year ahead promises to be another busy but exciting period as we execute our strategy in support of delivering on our ambition to disrupt the status quo.

**Ian Smith**
Group Chief Financial Officer

27 November 2019

# Overview of Group results – Pro forma basis

## Summary income statement – underlying and pro forma basis[1]

| | 2019 £M | 2018 £M | CHANGE % |
|---|---|---|---|
| Underlying net interest income | **1,433** | 1,457 | (2) |
| Non-interest income | **206** | 228 | (10) |
| **Total underlying operating income** | **1,639** | 1,685 | (3) |
| Underlying operating and administrative expenses | **(942)** | (998) | (6) |
| UK Bank levy | **(5)** | – | |
| **Underlying operating profit before impairment losses** | **692** | 687 | 1 |
| Underlying impairment losses on credit exposures | **(153)** | (106) | 44 |
| **Underlying profit on ordinary activities before tax** | **539** | 581 | (7) |
| – Restructuring costs | **(156)** | – | |
| – Acquisition costs | **(189)** | (39) | 385 |
| – Legacy conduct | **(433)** | (396) | 9 |
| – Other items[2] | **(26)** | (62) | (58) |
| **Pro forma (loss)/profit on ordinary activities before tax** | **(265)** | 84 | n/a |

(1) The summary income statement is presented on an underlying and pro forma basis as explained in the Basis of Presentation.

(2) Other includes a £30m charge in relation to SME transformation, including preparations to participate in the RBS Incentivised Switching Scheme, £18m of consent solicitation costs relating to the change in obligor of senior debt from Virgin Money Holdings (UK) PLC to CYBG PLC, a charge of £11m for Guaranteed Minimum Pension (GMP) equalisation in the Group's defined benefit scheme, £5m of legacy restructuring and separation costs, and £1m of expenses relating to the transition of Virgin Money Unit Trust Managers (VMUTM) into the joint venture. Offsetting this is a £35m gain on the partial disposal of VMUTM and a £4m gain recognised on the disposal of the Group's VocaLink share.

## Summary balance sheet - pro forma basis

| **As at 30 September** | 2019 £M | 2018 £M | CHANGE % |
|---|---|---|---|
| Customer loans | **72,979** | 70,939 | 2.9 |
| Other financial assets | **16,391** | 16,202 | 1.2 |
| Other non-financial assets | **1,629** | 1,407 | 15.8 |
| **Total assets** | **90,999** | 88,548 | 2.8 |
| | | | |
| Customer deposits | **63,787** | 60,963 | 4.6 |
| Wholesale funding | **18,506** | 18,675 | (0.9) |
| Other liabilities | **3,685** | 3,726 | (1.1) |
| **Total liabilities** | **85,978** | 83,364 | 3.1 |
| | | | |
| Ordinary shareholders' equity | **4,106** | 4,312 | (4.8) |
| AT1 equity | **915** | 450 | 103.3 |
| Non-controlling interests | – | 422 | |
| **Equity** | **5,021** | 5,184 | (3.1) |
| | | | |
| **Total liabilities and equity** | **90,999** | 88,548 | 2.8 |

# Overview of Group results – Pro forma basis

## Key Performance Indicators[1]

| | 12 MONTHS TO 30 SEP 2019 | 12 MONTHS TO 30 SEP 2018 | CHANGE |
|---|---|---|---|
| **PROFITABILITY** | | | |
| Net interest margin | **1.66%** | 1.78% | (12)bps |
| Underlying RoTE | **10.8%** | 11.0% | (0.2)%pts |
| Underlying CIR | **57%** | 59% | (2)%pts |
| Underlying return on assets | **0.54%** | 0.56% | (2)bps |
| Underlying EPS[2] | **28.1p** | 29.8p | (1.7)p |

| **As at** | 30 SEP 2019 | 30 SEP 2018 | CHANGE |
|---|---|---|---|
| **ASSET QUALITY** | | | |
| Impairment charge to average customer loans (cost of risk) | **0.21%** | 0.15% | 6bps |
| Total provision to customer loans | **0.53%** | 0.51% | 2bps |
| Indexed LTV of mortgage portfolio[3] | **57.2%** | 57.3% | (0.1)%pts |
| **REGULATORY CAPITAL** | | | |
| CET1 ratio[4] | **13.3%** | 15.1% | (1.8)%pts |
| Tier 1 ratio | **17.1%** | 18.3% | (1.2)%pts |
| Total capital ratio | **20.1%** | 20.6% | (0.5)%pts |
| MREL ratio | **26.6%** | 24.1% | 2.5%pts |
| CRD IV leverage ratio | **4.3%** | 4.6% | (0.3)%pts |
| UK leverage ratio | **4.9%** | 5.1% | (0.2)%pts |
| TNAV per share[5] | **249.2p** | 260.0p | (10.8)p |
| **FUNDING AND LIQUIDITY** | | | |
| Loan to deposit ratio (LDR) | **114%** | 116% | (2)%pts |
| Liquidity coverage ratio (LCR) | **152%** | 161% | (9)%pts |
| Net stable funding ratio (NSFR) | **128%** | 126% | 2%pts |

(1) For a definition of each of the KPIs, refer to 'Measuring financial performance – glossary' on pages 106 to 108. The KPIs include statutory, regulatory and alternative performance measures.

(2) For pro forma purposes, the weighted average number of ordinary shares in issue assumes that the 540,856,644 share issuance arising on the acquisition of Virgin Money was completed on 1 October 2017, and excludes own shares held.

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

(4) The pro forma CET 1 ratio at 30 September 2018 reflects the impact of the acquisition of Virgin Money and IRB accreditation.

(5) The pro forma total number of ordinary shares in issue used in the TNAV per share calculation for the comparative periods is the number of ordinary shares in issue on 15 October 2018 following the acquisition of Virgin Money (excluding own shares held). This has been applied across all periods for comparability purposes.

# Overview of Group results – Statutory basis

The following tables present the Group on a statutory basis. That is, they include the results of Virgin Money from the date of acquisition on 15 October 2018. The acquisition has had a significant impact on the Group's statutory results and financial position as shown below. Therefore, we believe that it is more helpful to consider the more readily comparable pro forma information set out on the previous pages.

## Summary income statement

| For the year ended 30 September | 2019 £M | 2018 £M | CHANGE % |
|---|---|---|---|
| Net interest income | **1,514** | 851 | 78 |
| Non-interest income | **235** | 156 | 51 |
| **Total operating income** | **1,749** | 1,007 | 74 |
| Operating and administrative expenses | **(1,724)** | (1,130) | 53 |
| UK bank levy | **(5)** | – | |
| **Operating profit/(loss) before impairment losses** | **20** | (123) | (116) |
| Impairment losses on credit exposures[1] | **(252)** | (41) | 515 |
| **Statutory loss on ordinary activities before tax** | **(232)** | (164) | 41 |
| Tax credit | **38** | 19 | 100 |
| **Statutory loss after tax** | **(194)** | (145) | 34 |

(1) Impairment losses on credit exposures for the current period are calculated on an expected credit loss (ECL) basis under IFRS 9, which the Group adopted on 1 October 2018, and includes the IFRS 9 impairment impact on acquired assets (£103m charge). For all other periods, impairment losses are calculated under the incurred loss basis as required by IAS 39.

The Group has recognised a statutory loss after tax of £194m (30 September 2018: loss of £145m). The increased loss reflects additional costs relating to the acquisition of Virgin Money Holdings (UK) PLC in addition to further significant conduct charges. As outlined at the CMD, the Group has a clear path to narrowing the difference between underlying and statutory profit over the next three years as we put legacy conduct behind us and restructuring and acquisition costs reduce over time.

## Summary balance sheet

| As at 30 September | 2019 £M | 2018 £M | CHANGE % |
|---|---|---|---|
| Customer loans | **72,979** | 33,281 | 119 |
| Other financial assets | **16,391** | 9,234 | 78 |
| Other non-financial assets | **1,629** | 941 | 73 |
| **Total assets** | **90,999** | 43,456 | 109 |
| | | | |
| Customer deposits | **63,787** | 28,854 | 121 |
| Wholesale funding | **18,506** | 8,095 | 129 |
| Other liabilities | **3,685** | 3,321 | 11 |
| **Total liabilities** | **85,978** | 40,270 | 114 |
| | | | |
| Ordinary shareholders' equity | **4,106** | 2,736 | 50 |
| AT1 equity | **915** | 450 | 103 |
| **Equity** | **5,021** | 3,186 | 58 |
| | | | |
| **Total liabilities and equity** | **90,999** | 43,456 | 109 |

# Overview of Group results – Statutory basis

## Key Performance Indicators[1]

| | 12 MONTHS TO 30 SEP 2019 | 12 MONTHS TO 30 SEP 2018 | CHANGE |
|---|---|---|---|
| **Profitability** | | | |
| Statutory return on tangible equity (RoTE) | **(6.8)%** | (6.9)% | 0.1%pts |
| Statutory cost to income ratio (CIR) | **99%** | 112% | (13)%pts |
| Statutory return on assets | **(0.23)%** | (0.34)% | 0.11%pts |
| Statutory basic loss per share | **(17.9)p** | (19.7)p | 1.8p |

| As at | 30 SEP 2019 | 30 SEP 2018 | CHANGE |
|---|---|---|---|
| **Regulatory capital** | | | |
| CET1 ratio | **13.3%** | 10.5% | 2.8%pts |
| Tier 1 ratio | **17.1%** | 12.7% | 4.4%pts |
| Total capital ratio | **20.1%** | 15.9% | 4.2%pts |
| MREL ratio | **26.6%** | 19.8% | 6.8%pts |
| CRD IV leverage ratio | **4.3%** | 5.6% | (1.3)%pts |
| UK leverage ratio | **4.9%** | 6.5% | (1.6)%pts |
| Tangible net asset value (TNAV) per share | **249.2p** | 262.3p | (13.1)p |
| **Funding and liquidity** | | | |
| Loan to deposit ratio (LDR) | **114%** | 115% | (1)%pts |
| Liquidity coverage ratio (LCR) | **152%** | 137% | 15%pts |
| Net stable funding ratio (NSFR) | **128%** | 119% | 9%pts |

(1) For a definition of each of the KPIs, refer to 'Measuring financial performance – glossary' on pages 106 to 108. The KPIs include statutory, regulatory and alternative performance measures.

# Overview of Group results – Statutory basis

## Reconciliation of statutory to pro forma results

The statutory basis presented within this section reflects the Group's results as reported in the financial statements, incorporating Virgin Money Holdings (UK) PLC from 15 October 2018. The pro forma basis includes the consolidated results of Virgin Money Holdings (UK) PLC as if the acquisition had occurred on 1 October 2018. The underlying results reflect the Group's results prepared on an underlying basis as presented to the CEO, Executive Leadership Team and Board. These exclude certain items that are included in the statutory results, as management believes that these items are not reflective of the underlying business and do not aid meaningful period-on-period comparison. The table below reconciles the statutory results to the pro forma results, and full details on the adjusted items to the underlying results are included on page 108.

| | STATUTORY BASIS | | INCLUDE VIRGIN MONEY PRE-ACQUISITION RESULTS | | PRO FORMA BASIS | |
|---|---|---|---|---|---|---|
| | 2019 £M | 2018 £M | 1 OCT TO 15 OCT 2018 £M | 2018 £M | 2019 £M | 2018 £M |
| Net interest income | **1,514** | 851 | **22** | 606 | **1,536** | 1,457 |
| Non-interest income[(1)] | **235** | 156 | **9** | 75 | **244** | 231 |
| **Total operating income** | **1,749** | 1,007 | **31** | 681 | **1,780** | 1,688 |
| Operating and administrative expenses | **(1,724)** | (1,130) | **(60)** | (368) | **(1,784)** | (1,498) |
| UK bank levy | **(5)** | – | **–** | – | **(5)** | – |
| **Operating profit/(loss) before impairment losses** | **20** | (123) | **(29)** | 313 | **(9)** | 190 |
| Impairment losses on credit exposures | **(252)** | (41) | **(4)** | (65) | **(256)** | (106) |
| **(Loss)/profit on ordinary activities before tax** | **(232)** | (164) | **(33)** | 248 | **(265)** | 84 |
| Restructuring costs | | | | | **156** | – |
| Acquisition costs | | | | | **189** | 39 |
| Legacy conduct | | | | | **433** | 396 |
| Other items | | | | | **26** | 62 |
| **Underlying profit on ordinary activities before tax** | | | | | **539** | 581 |

(1) 'Fair value gains and losses on financial instruments' were previously treated as an adjustment to underlying profit within the Virgin Money accounts but have been reclassified to underlying non-interest income in line with the Group's presentation.

# Overview of Group results – Statutory basis

## Reconciliation of pro forma to underlying results

The underlying results presented within this section reflect the Group's results prepared on an underlying basis as presented to the CEO, Executive Leadership Team and Board. These exclude certain items that are included in the pro forma results, as management believes that these items are not reflective of the underlying business and do not aid meaningful period on period comparison. The tables below reconcile the pro forma results to the underlying basis, and full details on the adjusted items are included on page 108:

| **2019 income statement** | STATUTORY RESULTS £M | INCLUDE VIRGIN MONEY PRE-ACQUISITION RESULTS £M | PRO FORMA RESULTS £M | RESTRUCTURING COSTS £M | ACQUISITION COSTS £M | LEGACY CONDUCT £M | OTHER £M | UNDERLYING BASIS £M |
|---|---|---|---|---|---|---|---|---|
| Net interest income | **1,514** | **22** | **1,536** | **–** | **(103)** | **–** | **–** | **1,433** |
| Non-interest income | **235** | **9** | **244** | **–** | **–** | **–** | **(38)** | **206** |
| **Total operating income** | **1,749** | **31** | **1,780** | **–** | **(103)** | **–** | **(38)** | **1,639** |
| Total operating and administrative expenses before impairment losses | **(1,724)** | **(60)** | **(1,784)** | **156** | **189** | **433** | **64** | **(942)** |
| UK bank levy | **(5)** | **–** | **(5)** | **–** | **–** | **–** | **–** | **(5)** |
| **Operating profit/(loss) before impairment losses** | **20** | **(29)** | **(9)** | **156** | **86** | **433** | **26** | **692** |
| Impairment losses on credit exposures | **(252)** | **(4)** | **(256)** | **–** | **103** | **–** | **–** | **(153)** |
| **(Loss)/profit on ordinary activities before tax** | **(232)** | **(33)** | **(265)** | **156** | **189** | **433** | **26** | **539** |
| **Financial performance measures** | | | | | | | | |
| RoTE | **(6.8)%** | **(0.7)%** | **(7.5)%** | **3.5%** | **4.3%** | **9.9%** | **0.6%** | **10.8%** |
| CIR | **99%** | **1%** | **100%** | **(10)%** | **(5)%** | **(26)%** | **(2)%** | **57%** |
| Return on assets | **(0.23)%** | **(0.03)%** | **(0.26)%** | **0.15%** | **0.19%** | **0.43%** | **0.03%** | **0.54%** |
| Basic EPS | **(17.9)p** | **(1.7)p** | **(19.6)p** | **9.3p** | **11.2p** | **25.7p** | **1.5p** | **28.1p** |

| **2018 income statement** | STATUTORY RESULTS £M | INCLUDE VIRGIN MONEY PRE-ACQUISITION RESULTS £M | PRO FORMA RESULTS £M | ACQUISITION COSTS £M | LEGACY CONDUCT £M | OTHER £M | UNDERLYING BASIS £M |
|---|---|---|---|---|---|---|---|
| Net interest income | 851 | 606 | 1,457 | – | – | – | 1,457 |
| Non-interest income | 156 | 75 | 231 | – | – | (3) | 228 |
| **Total operating income** | 1,007 | 681 | 1,688 | – | – | (3) | 1,685 |
| Total operating and administrative expenses before impairment losses | (1,130) | (368) | (1,498) | 39 | 396 | 65 | (998) |
| **Operating (loss)/profit before impairment losses** | (123) | 313 | 190 | 39 | 396 | 62 | 687 |
| Impairment losses on credit exposures | (41) | (65) | (106) | – | – | – | (106) |
| **(Loss)/profit on ordinary activities before tax** | (164) | 248 | 84 | 39 | 396 | 62 | 581 |
| **Financial performance measures** | | | | | | | |
| RoTE | (6.9)% | 6.4% | (0.5)% | 0.9% | 9.1% | 1.5% | 11.0% |
| CIR | 112% | (23)% | 89% | (2)% | (24)% | (4)% | 59% |
| Return on assets | (0.34)% | 0.38% | 0.04% | 0.04% | 0.41% | 0.07% | 0.56% |
| Basic EPS | (19.7)p | 18.4p | (1.3)p | 2.4p | 24.8p | 3.9p | 29.8p |

# Credit risk

The Group's approach to and management of risk is defined in the Group's Risk Management Framework (RMF). Integral to the RMF is the identification of principal risks, the process by which the Group sets its risk appetite which is the nature and extent of risk it is willing to assume to achieve its strategic objectives. The framework identifies nine principal risks: operational risk; people risk; financial risk; credit risk; technology risk; regulatory and compliance risk; conduct risk; financial crime risk; and strategic and enterprise risk.

The Group's risks are continually reassessed and reviewed through a horizon scanning process, with escalation and reporting to the Board. The horizon scanning process fully considers all relevant internal and external factors, and is designed to consider and capture those risks which are current but have not yet fully crystallised, as well as those which are expected to crystallise in future periods. These risks include, but are not limited to, geopolitical and macroeconomic environment; competition; regulatory change; and climate change. These risks and the overall risk landscape are regularly monitored by both Executive and Board Risk Committees.

Further detail on the Group's risks and how they are managed is available in the 2019 Annual Report and Accounts.

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument. Credit risk manifests itself in the financial instruments and/or products that the Group offers, and those in which the Group invests (including, among others, loans, guarantees, credit-related commitments, letters of credit, acceptances, inter-bank transactions, foreign exchange transactions, swaps and bonds). Credit risk can be found both on-balance sheet and off-balance sheet.

## Key credit metrics

| | AS AT | | |
|---|---|---|---|
| | 30 SEP 2019 (AUDITED) £M | 1 OCT 2018[1] (UNAUDITED) £M | 30 SEP 2018[1] (AUDITED) £M |
| **IMPAIRMENT PROVISIONS HELD ON CREDIT EXPOSURES** | | | |
| Business lending | **147** | 150 | 136 |
| Mortgage and Personal lending | **215** | 74 | 59 |
| | **362** | 224 | 195 |

| | FOR THE YEAR ENDED | | |
|---|---|---|---|
| | 30 SEP 2019 (AUDITED) £M | 1 OCT 2018[1] (UNAUDITED) £M | 30 SEP 2018[1] (AUDITED) £M |
| **UNDERLYING IMPAIRMENT CHARGE ON CREDIT EXPOSURES** | | | |
| Business lending | **25** | N/a | 15 |
| Mortgage and Personal lending | **123** | N/a | 26 |
| | **148** | N/a | 41 |
| **ASSET QUALITY MEASURES:** | | | |
| Underlying impairment charge[2] to average customer loans (cost of risk) | **0.21%** | N/a[3] | 0.12% |
| 90+ days past due (DPD) plus impaired assets to customer loans | **N/a** | N/a | 0.91% |
| Stage 3 assets to customer loans | **1.09%** | 1.77% | N/a |
| Total provision to customer loans | **0.50%** | 0.68% | 0.61% |
| Specific provision to impaired assets | **N/a** | N/a | 35.50% |
| Stage 3 provision to Stage 3 loans | **14.32%** | 14.55% | N/a |

(1) These exclude the impact of the acquisition of Virgin Money Holdings (UK) PLC with September 2018 figures presented on an IAS 39 basis.
(2) Inclusive of gains/losses on assets held at fair value and elements of fraud loss but excludes the acquisition accounting impact on impairment losses shown on page 108.
(3) An underlying impairment charge was not calculated as at 1 October 2018 and therefore this metric cannot be calculated for that date.

# Credit risk

A number of the Group's key credit metrics are no longer applicable as a result of the change to an IFRS 9 basis of calculating expected credit losses (ECLs) and have been replaced with metrics appropriate to the revised basis as shown in the table above.

The increase in underlying impairment charge from £41m to £148m primarily reflects a higher charge on our personal exposures which includes the charge relative to the acquired credit cards portfolio. The charge relative to business and mortgage exposures has also increased. The cost of risk, at 21bps, is reflective of a return to normalisation, however it remains below our expectation of a long-term loss rate of 30bps.

Asset quality measures remain resilient, reflective of the focus on responsible credit decisions and controlled risk appetite. The level of Stage 3 assets remains modest against a growing book. This reflects the credit quality of the portfolios, supported by the low interest rate environment. The ratio of total provisions to customer loans at 0.50% is reflective of a well-collateralised portfolio, supported by the increase in the size of the mortgage portfolio which proportionately requires a lower provision coverage and is a key driver of the overall reduction.

**Reconciliation of the impairment loss provision from IAS 39 to IFRS 9**

The movement in the Group's opening impairment provision as a result of adopting an ECL impairment methodology as required by IFRS 9 from 1 October 2018 is illustrated below:

| | £M |
|---|---|
| Closing IAS 39 impairment provision as at 30 September 2018 | 195 |
| Less: removal of IAS 39 collective provision | (152) |
| Add: introduction of a 12-month ECL calculation (Stage 1) | 53 |
| Add: introduction of a lifetime ECL calculation (Stage 2 and 3) | 121 |
| Add: undrawn balances | 5 |
| Add: multiple economic scenarios | 2 |
| **Opening IFRS 9 impairment loss provision as at 1 October 2018** | 224 |

**Removal of IAS 39 collective provision**
The IAS 39 concept of a collective impairment provision to cover losses that have been incurred but not yet identified on loans subject to an individual assessment is no longer an acceptable basis for impairment provisioning under IFRS 9.

**Introduction of a 12-month ECL calculation**
IFRS 9 requires a 12-month ECL calculation on all assets which have not undergone a significant increase in credit risk since origination. These are classed as Stage 1 under IFRS 9, with the calculation on loans and advances allocating the ECL at an individual account level. The 12-month ECL calculation is based on the possibility of default occurring within 12 months of the reporting date.

**Introduction of a lifetime ECL calculation**
IFRS 9 requires a lifetime ECL calculation where a financial asset has been assessed as experiencing a significant increase in credit risk based on the Group's staging criteria. These can be classed as either Stage 2 or Stage 3 under IFRS 9, with the calculation on loans and advances allocating the ECL at an individual account level. Not all of these accounts would have been included in the IAS 39 collective provision, with the quantum of the ECL calculation also higher due to the requirement for lifetime losses to be included. The lifetime ECL calculation is based on the possibility of credit losses occurring over the lifetime of the asset.

**Undrawn balances**
IFRS 9 requires that impairment allowances be held on an expected loss basis rather than the incurred loss basis under IAS 39. This change has brought into scope pipeline exposures where an irrevocable commitment has been made to a customer, but no drawdown had occurred at the IFRS 9 adoption date, and for which no impairment allowance was held previously.

**Multiple economic scenarios**
This represents the difference, at adoption of IFRS 9, between calculated provisions under the Group's base scenario and the final aggregate position over the three scenarios (base, mild upside and severe downside).

## Gross loans and advances by IFRS 9 stage allocation (audited)

The distribution of the Group's gross loans and advances by IFRS 9 stage allocation is analysed below.

| Gross loans and advances to customers as at 30 September 2019 | STAGE 1 £M | STAGE 2 <30 DPD £M | STAGE 2 >30 DPD £M | STAGE 2 TOTAL £M | STAGE 3 £M | STAGE 3 POCI £M | TOTAL £M |
|---|---|---|---|---|---|---|---|
| Mortgages | **58,120** | **1,637** | **168** | **1,805** | **363** | **103** | **60,391** |
| Personal of which: | **4,787** | **392** | **32** | **424** | **61** | **8** | **5,280** |
| – credit cards | **3,806** | **353** | **25** | **378** | **46** | **8** | **4,238** |
| – personal overdrafts | **53** | **–** | **1** | **1** | **4** | **–** | **58** |
| – other personal lending | **928** | **39** | **6** | **45** | **11** | **–** | **984** |
| Business | **5,018** | **2,280** | **5** | **2,285** | **272** | **–** | **7,575** |
| **Closing balance** | **67,925** | **4,309** | **205** | **4,514** | **696** | **111** | **73,246** |

| Gross loans and advances to customers[(1)] as at 1 October 2018 (excluding Virgin Money) | STAGE 1 £M | STAGE 2 <30 DPD £M | STAGE 2 >30 DPD £M | STAGE 2 TOTAL £M | STAGE 3 £M | STAGE 3 POCI £M | TOTAL £M |
|---|---|---|---|---|---|---|---|
| Mortgages | 23,572 | 605 | 84 | 689 | 279 | – | 24,540 |
| Personal of which: | 1,143 | 28 | 10 | 38 | 22 | – | 1,203 |
| – credit cards | 370 | 1 | 3 | 4 | 7 | – | 381 |
| – personal overdrafts | 50 | – | 1 | 1 | 4 | – | 55 |
| – other personal lending | 723 | 27 | 6 | 33 | 11 | – | 767 |
| Business | 4,741 | 2,161 | 9 | 2,170 | 263 | – | 7,174 |
| **Closing balance** | 29,456 | 2,794 | 103 | 2,897 | 564 | – | 32,917 |

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

Overall, the lending portfolio increased by £40.3bn between 1 October 2018 and 30 September 2019. In addition to underlying growth, the increase reflects the acquisition of Virgin Money Holdings (UK) PLC on 15 October 2018, with the acquired portfolio totalling £39.5bn as at 30 September 2019. Of this, £111m is Stage 3 purchased or originated credit impaired (POCI), representing the acquired assets that were classed as credit impaired at date of acquisition.

### Mortgages

With total gross loans and advances of £60.4bn as at 30 September 2019, there has been underlying growth in the portfolio year-on-year, although the increase in lending balance results mainly from the impact of the acquired portfolio. Over 95% are classed as Stage 1. Stage 3 POCI for Mortgages reduced from £137m on acquisition to £103m as at 30 September 2019 as a result of customer redemptions and balance paydowns.

### Personal

Of the £5.3bn total personal portfolio, the majority is credit cards, at £4.2bn. The year-on-year growth results mainly from the acquired credit cards portfolio, however, underlying growth is evident on both the credit card and other personal lending portfolios. The personal portfolio evidences stable performance with 91% of balances classed as Stage 1. Stage 3 POCI has reduced from £34m on acquisition to £8m as at 30 September 2019, due to write-offs and customer balance paydowns.

### Business

At £7.6bn, business lending continues to evidence core underlying growth. The proportion of lending in Stage 2 has remained stable at 30% year-on-year, reflective of the Group's controlled and cautious approach to identifying customers experiencing financial difficulty and, where appropriate, providing early intervention assistance such as forbearance, to support customers in meeting their financial commitments to the Group.

## Credit quality of loans and advances

The following tables highlight the significant exposure to credit risk in respect of which ECL model is applied for the Group's mortgage, personal and business loans and advances, including loan commitments and financial guarantee contracts, based on the following risk gradings:

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

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

| | GROSS CARRYING AMOUNT | | | | |
|---|---|---|---|---|---|
| **As at 30 September 2019** | STAGE 1 12-MONTH ECLS £M | STAGE 2 (NOT CREDIT IMPAIRED) LIFETIME ECLS £M | STAGE 3 (CREDIT IMPAIRED) LIFETIME ECLS £M | STAGE 3 (POCI) LIFETIME ECLS £M | TOTAL £M |
| **MORTGAGES** | | | | | |
| <0.15 | **38,816** | **389** | **–** | **–** | **39,205** |
| 0.15 to <0.25 | **5,836** | **103** | **–** | **–** | **5,939** |
| 0.25 to <0.50 | **7,983** | **245** | **–** | **–** | **8,228** |
| 0.50 to <0.75 | **2,422** | **96** | **–** | **–** | **2,518** |
| 0.75 to <2.50 | **2,648** | **455** | **–** | **–** | **3,103** |
| 2.50 to <10.00 | **376** | **274** | **–** | **–** | **650** |
| 10.00 to <100.00 | **39** | **243** | **–** | **–** | **282** |
| 100.00 (Default) | **–** | **–** | **363** | **103** | **466** |
| **Total** | **58,120** | **1,805** | **363** | **103** | **60,391** |
| **PERSONAL** | | | | | |
| <0.15 | **93** | **–** | **–** | **–** | **93** |
| 0.15 to <0.25 | **68** | **–** | **–** | **–** | **68** |
| 0.25 to <0.50 | **1,326** | **6** | **–** | **–** | **1,332** |
| 0.50 to <0.75 | **967** | **8** | **–** | **–** | **975** |
| 0.75 to <2.50 | **1,743** | **36** | **–** | **–** | **1,779** |
| 2.50 to <10.00 | **553** | **231** | **–** | **–** | **784** |
| 10.00 to <100.00 | **37** | **143** | **–** | **–** | **180** |
| 100.00 (Default) | **–** | **–** | **61** | **8** | **69** |
| **Total** | **4,787** | **424** | **61** | **8** | **5,280** |
| **BUSINESS** | | | | | |
| <0.15 | **530** | **5** | **–** | **–** | **535** |
| 0.15 to <0.25 | **440** | **17** | **–** | **–** | **457** |
| 0.25 to <0.50 | **718** | **52** | **–** | **–** | **770** |
| 0.50 to <0.75 | **537** | **101** | **–** | **–** | **638** |
| 0.75 to <2.50 | **2,199** | **1,019** | **–** | **–** | **3,218** |
| 2.50 to <10.00 | **592** | **919** | **–** | **–** | **1,511** |
| 10.00 to <100.00 | **2** | **172** | **–** | **–** | **174** |
| 100.00 (Default) | **–** | **–** | **272** | **–** | **272** |
| **Total** | **5,018** | **2,285** | **272** | **–** | **7,575** |

| As at 1 October 2018 (excluding Virgin Money) | GROSS CARRYING AMOUNT | | | | |
|---|---|---|---|---|---|
| | STAGE 1 12-MONTH ECLS £M | STAGE 2 (NOT CREDIT IMPAIRED) LIFETIME ECLS £M | STAGE 3 (CREDIT IMPAIRED) LIFETIME ECLS £M | STAGE 3 (POCI) LIFETIME ECLS £M | TOTAL £M |
| **MORTGAGES** | | | | | |
| <0.15 | 8,085 | 13 | – | – | 8,098 |
| 0.15 to <0.25 | 4,292 | 27 | – | – | 4,319 |
| 0.25 to <0.50 | 6,199 | 77 | – | – | 6,276 |
| 0.50 to <0.75 | 1,791 | 49 | – | – | 1,840 |
| 0.75 to <2.50 | 2,813 | 205 | – | – | 3,018 |
| 2.50 to <10.00 | 370 | 194 | – | – | 564 |
| 10.00 to <100.00 | 22 | 124 | – | – | 146 |
| 100.00 (Default) | – | – | 279 | – | 279 |
| Total | 23,572 | 689 | 279 | – | 24,540 |
| **PERSONAL** | | | | | |
| <0.15 | 113 | – | – | – | 113 |
| 0.15 to <0.25 | 97 | – | – | – | 97 |
| 0.25 to <0.50 | 249 | – | – | – | 249 |
| 0.50 to <0.75 | 153 | – | – | – | 153 |
| 0.75 to <2.50 | 354 | 2 | – | – | 356 |
| 2.50 to <10.00 | 166 | 15 | – | – | 181 |
| 10.00 to <100.00 | 11 | 21 | – | – | 32 |
| 100.00 (Default) | – | – | 22 | – | 22 |
| **Total** | 1,143 | 38 | 22 | – | 1,203 |
| **BUSINESS** | | | | | |
| <0.15 | 571 | 8 | – | – | 579 |
| 0.15 to <0.25 | 371 | 13 | – | – | 384 |
| 0.25 to <0.50 | 549 | 34 | – | – | 583 |
| 0.50 to <0.75 | 700 | 157 | – | – | 857 |
| 0.75 to <2.50 | 1,930 | 917 | – | – | 2,847 |
| 2.50 to <10.00 | 594 | 943 | – | – | 1,537 |
| 10.00 to <100.00 | 26 | 98 | – | – | 124 |
| 100.00 (Default) | – | – | 263 | – | 263 |
| **Total** | 4,741 | 2,170 | 263 | – | 7,174 |

## ECL impairment allowance by IFRS 9 stage allocation (audited)

The following tables disclose the impairment allowance by portfolio:

| As at 30 September 2019 | STAGE 1 £M | STAGE 2 <30 DPD £M | STAGE 2 >30 DPD £M | STAGE 2 TOTAL £M | STAGE 3 £M | STAGE 3 POCI £M | TOTAL £M |
|---|---|---|---|---|---|---|---|
| Mortgages | **6** | **5** | **4** | **9** | **26** | **(1)** | **40** |
| Personal of which: | **53** | **71** | **16** | **87** | **37** | **(2)** | **175** |
| – credit cards | **42** | **65** | **12** | **77** | **28** | **(2)** | **145** |
| – personal overdrafts | **2** | **–** | **1** | **1** | **3** | **–** | **6** |
| – other personal lending | **9** | **6** | **3** | **9** | **6** | **–** | **24** |
| Business | **20** | **72** | **–** | **72** | **55** | **–** | **147** |
| **Closing balance** | **79** | **148** | **20** | **168** | **118** | **(3)** | **362** |

| As at 1 October 2018 (excluding Virgin Money) | STAGE 1 £M | STAGE 2 <30 DPD £M | STAGE 2 >30 DPD £M | STAGE 2 TOTAL £M | STAGE 3 £M | STAGE 3 POCI £M | TOTAL £M |
|---|---|---|---|---|---|---|---|
| Mortgages | 3 | 2 | 1 | 3 | 23 | – | 29 |
| Personal of which: | 15 | 5 | 7 | 12 | 18 | – | 45 |
| – credit cards | 6 | – | 1 | 1 | 7 | – | 14 |
| – personal overdrafts | 2 | – | 1 | 1 | 3 | – | 6 |
| – other personal lending | 7 | 5 | 5 | 10 | 8 | – | 25 |
| Business | 35 | 71 | – | 71 | 44 | – | 150 |
| **Closing balance** | 53 | 78 | 8 | 86 | 85 | – | 224 |

The Group’s impairment allowance has increased by £138m in the period from 1 October 2018 to 30 September 2019, which is primarily due to the impact of the acquisition of Virgin Money Holdings (UK) PLC. Acquisition accounting requires that the acquired loans and advances balance is fair valued on acquisition, resulting in a nil ECL allowance on acquisition. The loans and advances balance is then subject to the IFRS 9 ECL methodology with a full ECL allowance calculated, which resulted in a charge of £67m being recognised in the Group income statement immediately following the acquisition date. The ECL allowance for the acquired portfolio subsequently increased to £136m as at 30 September 2019.

### Mortgages

The Mortgage impairment allowance of £40m is reflective of the level of collateral held and the low expected credit loss for this portfolio. The increase of £11m from 2018 is due to the impact of the acquired mortgage portfolio.

### Personal

The total impairment allowance for the personal portfolio of £175m has increased by £130m in the period. This is primarily due to the level of impairment allowance relative to the acquired credit cards portfolio, where the ECL at point of acquisition was £60m and subsequently increased to £125m as at 30 September 2019. The underlying impairment allowance for the personal exposures increased over the period as a result of the combined effect of portfolio growth, higher default rates due to seasoning and maturation of the portfolio and routine recalibration of underlying provisioning models.

### Business

Total impairment allowance for the business portfolio decreased by £3m to £147m. This is the result of a £15m reduction in Stage 1 ECL, primarily due to IFRS 9 modelling adjustments, partially offset by an £11m increase in Stage 3 due to a higher level of single name, individually assessed provisions.

### ECL impairment allowance coverage ratios (audited)

| As at 30 September 2019 | STAGE 1 % | STAGE 2 <30 DPD % | STAGE 2 >30 DPD % | STAGE 2 TOTAL % | STAGE 3 % | STAGE 3 POCI % | TOTAL % |
|---|---|---|---|---|---|---|---|
| Mortgages | **0.01** | **0.29** | **2.26** | **0.47** | **7.13** | **(0.80)** | **0.07** |
| Personal of which: | **1.15** | **18.22** | **51.18** | **20.64** | **62.14** | **(22.61)** | **3.39** |
| – credit cards | **1.11** | **18.49** | **46.91** | **20.35** | **60.39** | **(22.61)** | **3.42** |
| – personal overdrafts | **5.00** | **14.17** | **66.02** | **56.00** | **91.21** | **–** | **11.41** |
| – other personal lending | **1.09** | **15.56** | **68.29** | **22.35** | **60.64** | **–** | **2.75** |
| Business | **0.40** | **3.13** | **2.27** | **3.13** | **19.99** | **–** | **1.93** |
| **Closing balance** | **0.12** | **3.41** | **9.68** | **3.69** | **16.89** | **(2.30)** | **0.50** |

| As at 1 October 2018 (excluding Virgin Money) | STAGE 1 % | STAGE 2 <30 DPD % | STAGE 2 >30 DPD % | STAGE 2 TOTAL % | STAGE 3 % | STAGE 3 POCI % | TOTAL % |
|---|---|---|---|---|---|---|---|
| Mortgages | 0.01 | 0.32 | 1.61 | 0.48 | 8.19 | – | 0.12 |
| Personal of which: | 1.38 | 18.17 | 65.20 | 30.04 | 80.36 | – | 3.78 |
| – credit cards | 1.78 | 9.52 | 53.16 | 39.89 | 94.32 | – | 3.94 |
| – personal overdrafts | 3.66 | 10.02 | 59.21 | 51.07 | 78.12 | – | 10.06 |
| – other personal lending | 1.03 | 18.61 | 71.71 | 28.05 | 72.56 | – | 3.24 |
| Business | 0.73 | 3.25 | 5.13 | 3.26 | 16.79 | – | 2.08 |
| **Closing balance** | 0.18 | 2.77 | 7.86 | 2.95 | 15.05 | – | 0.68 |

The impact of the Virgin Money Holdings (UK) PLC acquisition results in a proportionately higher volume of the total portfolio being mortgage lending which requires a lower proportionate impairment allowance, consequently the total portfolio coverage has reduced by 18bps in line with the revised portfolio profile.

**Mortgages**

The coverage ratio reduced by 5bps in the period as a result of the composition, quality and value of the acquired mortgage portfolio.

**Personal**

The total coverage ratio reduced by 39bps, primarily in the credit card portfolio where the quality of the acquired portfolio, in particular the growing Virgin Atlantic credit card portfolio, is stronger than the pre-existing portfolios.

**Business**

Coverage for the business portfolio decreased by 15bps, reflective of portfolio growth in Stage 1 where proportionately less provision coverage is required, and a small number of significant write-offs from Stage 3.

### Mortgage lending by average LTV (audited)

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

| | 2019 % | 2018[1] % |
|---|---|---|
| **LTV[2]** | | |
| Less than 50% | **35** | 31 |
| 50% to 75% | **48** | 51 |
| 76% to 80% | **6** | 6 |
| 81% to 85% | **5** | 5 |
| 86% to 90% | **4** | 4 |
| 91% to 95% | **2** | 2 |
| 96% to 100% | **–** | – |
| Greater than 100% | **–** | – |
| Unknown | **–** | 1 |
| | **100** | 100 |

(1) 30 September 2018 shown as reported, excluding Virgin Money.
(2) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance. Currently the Clydesdale Bank PLC portfolio is indexed using the MIAC Acadametrics indices at a given date, while the Virgin Money Holdings (UK) PLC portfolio is indexed using the Markit indices. The Group view is a combined summary of the two portfolios. 'Unknown' in the prior period represented loans where data was not available due to front book data matching and a de minimis amount due to weaknesses in historic data capture processes.

## Forbearance

### Mortgage and personal forbearance

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

| | TOTAL LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | | | IMPAIRMENT ALLOWANCE ON LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | |
|---|---|---|---|---|---|
| **As at 30 September 2019 (audited)** | NUMBER OF LOANS | GROSS CARRYING AMOUNT £M | % OF TOTAL PORTFOLIO | IMPAIRMENT ALLOWANCE £M | COVERAGE % |
| **MORTGAGES** | | | | | |
| Formal arrangements | **1,352** | **157** | **0.26** | **4.4** | **2.83** |
| Temporary arrangements | **913** | **119** | **0.20** | **3.1** | **2.62** |
| Payment arrangement[1] | **1,118** | **113** | **0.19** | **1.6** | **1.41** |
| Payment holiday[1] | **981** | **114** | **0.19** | **0.7** | **0.58** |
| Interest only conversion | **358** | **54** | **0.09** | **0.3** | **0.57** |
| Term extension | **174** | **16** | **0.03** | **0.1** | **0.64** |
| Other | **35** | **3** | **0.00** | **–** | **0.50** |
| Legal | **130** | **13** | **0.02** | **0.3** | **2.46** |
| **Total mortgage forbearance** | **5,061** | **589** | **0.98** | **10.5** | **1.79** |
| Personal forbearance – credit cards | **5,522** | **24** | **0.53** | **9.5** | **41.30** |
| **Total** | **10,583** | **613** | **0.95** | **20.0** | **3.31** |

(1) Payment arrangement and payment holiday have been introduced as additional concession types within the Group's mortgage forbearance policy.

| As at 30 September 2018 (excluding Virgin Money) (audited) | TOTAL LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | | | IMPAIRMENT ALLOWANCE ON LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | |
|---|---|---|---|---|---|
| | NUMBER OF LOANS | GROSS CARRYING AMOUNT £M | % OF TOTAL PORTFOLIO | IMPAIRMENT ALLOWANCE £M | COVERAGE % |
| **MORTGAGES** | | | | | |
| Formal arrangements | 1,497 | 168 | 0.68 | 3.3 | 2.00 |
| Temporary arrangements | 1,275 | 161 | 0.66 | 2.3 | 1.45 |
| Interest only conversion | 231 | 32 | 0.13 | 0.1 | 0.18 |
| Term extension | 150 | 12 | 0.05 | 0.1 | 0.48 |
| Other | 41 | 4 | 0.02 | – | 0.36 |
| Legal | 148 | 15 | 0.06 | 0.5 | 3.34 |
| **Total mortgage forbearance** | 3,342 | 392 | 1.60 | 6.3 | 1.61 |
| Personal forbearance – credit cards | 787 | 2 | 0.18 | 0.9 | 40.68 |
| **Total** | 4,129 | 394 | 1.58 | 7.2 | 1.83 |

The increase in mortgage and credit card forbearance is attributable to the acquisition of the Virgin Money Holdings (UK) PLC portfolios.

When all other avenues of resolution including forbearance have been explored, the Group will take steps to repossess and sell underlying collateral. In the 12-month period to 30 September 2019, there were 66 repossessions of which 14 were voluntary (12 months to 30 September 2018 (excluding Virgin Money): 38 including 16 voluntary).

### Forbearance – other personal lending

Excluding credit cards, the Group currently exercises limited forbearance strategies in relation to other types of personal lending; namely current accounts and personal loans. The Group has assessed the total loan balances subject to forbearance on other types of personal lending to be £11.5m as at 30 September 2019 (30 September 2018 (excluding Virgin Money): £10.1m), representing 1.10% of the personal lending portfolio (30 September 2018: 1.22%).

Impairment provisions on forborne balances totalled £3.6m as at 30 September 2019 (30 September 2018 (excluding Virgin Money): £2.8m) providing overall coverage of 31.58% (30 September 2018: 28.30%).

### Business forbearance

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

| As at 30 September 2019 (audited) | TOTAL LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | | | IMPAIRMENT ALLOWANCE ON LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | |
|---|---|---|---|---|---|
| | NUMBER OF CUSTOMERS | GROSS CARRYING AMOUNT £M | % OF TOTAL PORTFOLIO | IMPAIRMENT ALLOWANCE £M | COVERAGE % |
| Term extension | **187** | **153** | **1.93** | **14.9** | **9.70** |
| Deferral of contracted capital repayments | **98** | **134** | **1.68** | **15.0** | **11.16** |
| Reduction in contracted interest rate | **3** | **1** | **0.02** | **–** | **3.37** |
| Alternative forms of payment | **2** | **7** | **0.08** | **0.4** | **5.37** |
| Debt forgiveness | **2** | **4** | **0.05** | **–** | **1.06** |
| Refinancing | **16** | **10** | **0.12** | **1.5** | **15.03** |
| Covenant breach/reset/waiver | **60** | **200** | **2.50** | **23.6** | **11.82** |
| Total business forbearance | **368** | **509** | **6.38** | **55.4** | **10.87** |

| As at 30 September 2018 (audited) | TOTAL LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | | | IMPAIRMENT ALLOWANCE ON LOANS AND ADVANCES SUBJECT TO FORBEARANCE MEASURES | |
|---|---|---|---|---|---|
| | NUMBER OF CUSTOMERS | GROSS CARRYING AMOUNT £M | % OF TOTAL PORTFOLIO | IMPAIRMENT ALLOWANCE £M | COVERAGE % |
| Term extension | 179 | 162 | 2.15 | 10.5 | 6.48 |
| Deferral of contracted capital repayments | 103 | 129 | 1.73 | 15.6 | 12.02 |
| Reduction in contracted interest rate | 2 | 1 | 0.01 | – | 4.05 |
| Alternative forms of payment | 4 | 25 | 0.33 | 7.5 | 30.46 |
| Debt forgiveness | 4 | 11 | 0.14 | 0.6 | 5.64 |
| Refinancing | 17 | 10 | 0.13 | 1.0 | 9.87 |
| Covenant breach/reset/waiver | 61 | 207 | 2.75 | 9.2 | 4.43 |
| Total business forbearance | 370 | 545 | 7.24 | 44.4 | 8.14 |

Included in other financial assets at fair value is a portfolio of loans that is included in the above table. The gross value of fair value loans subject to forbearance as at 30 September 2019 is £8m (30 September 2018: £15m), representing 0.11% of the total business portfolio (30 September 2018: 0.19%). The credit risk adjustment on these amounts totalled £0.6m (30 September 2018: £2m), a coverage of 6.94% (30 September 2018: 11.66%).

# Financial risk

Financial risk covers several categories of risk which impact the manner in which the Group can support its customers in a safe and sound manner. They include capital risk, funding risk, liquidity risk, market risk, model risk, pension risk and financial risks arising from climate change.

## Capital

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

### Capital position

The Group's capital position as at 30 September 2019 is summarised below:

**Regulatory capital (unaudited)[1]**

| | 2019 £M | 2018 £M |
|---|---|---|
| **Statutory total equity** | **5,021** | 3,186 |
| **CET1 CAPITAL: REGULATORY ADJUSTMENTS[2]** | | |
| AT1 capital instruments | **(915)** | (450) |
| Defined benefit pension fund assets | **(257)** | (138) |
| Prudent valuation adjustment | **(5)** | (3) |
| Intangible assets | **(501)** | (412) |
| Goodwill | **(11)** | – |
| Deferred tax asset relying on future profitability | **(146)** | (99) |
| Cash flow hedge reserve | **26** | 39 |
| Excess expected losses | **(88)** | – |
| AT1 coupon accrual | **(20)** | (10) |
| IFRS 9 transitional adjustments | **100** | – |
| **Total CET1 capital** | **3,204** | 2,113 |
| **AT1 CAPITAL** | | |
| AT1 capital instruments | **915** | 450 |
| **Total AT1 capital** | **915** | 450 |
| **Total Tier 1 capital** | **4,119** | 2,563 |
| **TIER 2 CAPITAL** | | |
| Subordinated debt | **721** | 474 |
| Credit risk adjustments[3] | **–** | 152 |
| **Total Tier 2 capital** | **721** | 626 |
| **Total regulatory capital** | **4,840** | 3,189 |

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

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

(3) The current period does not include Tier 2 credit risk adjustments due to the transition to IFRS 9 reporting.

# Financial risk

| Regulatory capital flow of funds (unaudited)[(1)] | CRD IV 2019 £M | CRD IV 2018 £M |
|---|---|---|
| **CET1 CAPITAL[(2)]** | | |
| CET1 capital at 1 October | **2,113** | 2,437 |
| Share capital and share premium | **3** | 1 |
| Retained earnings and other reserves (including special purpose entities) | **(210)** | (217) |
| Acquisition of Virgin Money Holdings (UK) plc | **1,567** | – |
| Prudent valuation adjustment | **(2)** | 1 |
| Intangible assets | **(89)** | (73) |
| Goodwill arising on acquisition of Virgin Money Holdings (UK) plc | **(11)** | – |
| Deferred tax asset relying on future profitability | **(47)** | (71) |
| Defined benefit pension fund assets | **(119)** | (3) |
| Cash flow hedge reserve | **(13)** | 38 |
| IRB shortfall of credit risk adjustments to expected losses | **(88)** | – |
| IFRS 9 transitional relief | **100** | – |
| **Total CET1 capital at 30 September** | **3,204** | 2,113 |
| **AT1 CAPITAL** | | |
| AT1 capital at 1 October | **450** | 450 |
| AT1 capital issued and transferred from Virgin Money Holdings (UK) plc | **465** | – |
| **Total AT1 capital at 30 September** | **915** | 450 |
| **Total Tier 1 capital at 30 September** | **4,119** | 2,563 |
| **TIER 2 CAPITAL** | | |
| Tier 2 capital at 1 October | **626** | 627 |
| Credit risk adjustments[(3)] | **(152)** | (2) |
| Other movements | **–** | 1 |
| Capital instruments issued: subordinated debt | **247** | – |
| **Tier 2 capital at 30 September** | **721** | 626 |
| **Total capital at 30 September** | **4,840** | 3,189 |

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

The Group's CET1 capital increased by £1,091m in the year primarily driven by the positive impact of the acquisition of Virgin Money Holdings (UK) plc, offset by exceptional items in the year.

# Financial risk

During the year, there were also increases in AT1 and Tier 2 capital. The Group issued an additional £250m of Tier 2 capital in December 2018 in the form of Fixed Rate Reset 10 non-call 5-year Subordinated Contingent Convertible Notes. In addition, in August 2019, Virgin Money Holdings (UK) plc successfully received investor consent to transfer obligations on its outstanding AT1 (£230m) to Virgin Money UK PLC.

| **Minimum Pillar 1 capital requirements (unaudited)** | 2019 £M | 2018 £M |
|---|---|---|
| Credit risk | **1,685** | 1,449 |
| Operational risk | **209** | 132 |
| Counterparty credit risk | **15** | 10 |
| Credit valuation adjustment | **15** | 17 |
| **Total Pillar 1 regulatory capital requirements** | **1,924** | 1,608 |

**IFRS 9 transitional arrangements (unaudited)[(1)]**

| | 30 SEPTEMBER 2019 (£M) | |
|---|---|---|
| **Available capital (amounts)** | IFRS 9 TRANSITIONAL BASIS | IFRS 9 FULLY LOADED BASIS |
| CET1 capital | **3,204** | **3,104** |
| Tier 1 capital | **4,119** | **4,019** |
| Total capital | **4,840** | **4,740** |
| **RWA (amounts)** | | |
| Total RWA | **24,046** | **23,983** |
| **CAPITAL RATIOS** | | |
| CET1 (as a percentage of RWA) | **13.3%** | **12.9%** |
| Tier 1 (as a percentage of RWA) | **17.1%** | **16.8%** |
| Total capital (as a percentage of RWA) | **20.1%** | **19.8%** |
| **LEVERAGE RATIO** | | |
| Leverage ratio total exposure measure | **94,744** | **94,644** |
| Leverage ratio | **4.3%** | **4.2%** |

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

**RWA movements (unaudited)**

| | 12 MONTHS TO 30 SEPTEMBER 2019 | | | | | 12 MONTHS TO 30 SEPTEMBER 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **RWA flow statement** | IRB RWA £M | STD RWA £M | OTHER RWA £M | TOTAL £M | CAPITAL REQUIRED £M | IRB RWA £M | STD RWA £M | OTHER RWA[(2)] £M | TOTAL £M | CAPITAL REQUIRED £M |
| RWA at 1 October | **–** | **18,104** | **1,998** | **20,102** | **1,608** | – | 17,753 | 1,925 | 19,678 | 1,574 |
| Asset size | **958** | **478** | **10** | **1,446** | **116** | – | 347 | 73 | 420 | 34 |
| Asset quality | **(291)** | **(8)** | **–** | **(299)** | **(24)** | – | 4 | – | 4 | – |
| Model updates | **(396)** | **–** | **–** | **(396)** | **(32)** | – | – | – | – | – |
| Methodology and policy | **250** | **–** | **–** | **250** | **20** | – | – | – | – | – |
| Acquisitions and disposals | **4,330** | **2,870** | **962** | **8,162** | **654** | – | – | – | – | – |
| IRB accreditation | **10,247** | **(15,592)** | **–** | **(5,345)** | **(428)** | – | – | – | – | – |
| Other | **6** | **101** | **19** | **126** | **10** | – | – | – | – | – |
| **RWA at 30 September** | **15,104** | **5,953** | **2,989** | **24,046** | **1,924** | – | 18,104 | 1,998 | 20,102 | 1,608 |

In October 2018, the Group received IRB accreditation from the PRA for both the mortgage and business portfolios. The impact of this can be seen in the IRB accreditation line above. Also in October 2018, the Group acquired Virgin Money Holdings (UK) plc, which calculates RWA on mortgages under IRB methodology and on all other portfolios under standardised methodology. This impact can be seen in the Acquisitions and disposals line above.

# Financial risk

Formal FIRB accreditation for the business portfolios was received in October 2018 for a suite of recalibrated models which were implemented during November 2018, resulting in a £170m model impact, included within the Model updates line above. The differential is predominantly in relation to the retail mortgage quarterly PD model calibrations. Since this implementation, no additional model changes have occurred.

Methodology and processing enhancements implemented prior to formal IRB reporting are captured within the Methodology and policy line.

Other includes operational risk, CVA and counterparty credit risk.

**Pillar 1 RWAs and capital requirements by business line (unaudited)**

| | AT 30 SEPTEMBER 2019 | | | AT 30 SEPTEMBER 2018 | | |
|---|---|---|---|---|---|---|
| **Capital requirements for calculating RWA** | CAPITAL REQUIRED £M | RWA £M | EXPOSURE £M | CAPITAL REQUIRED £M | RWA £M | EXPOSURE £M |
| Corporates | **501** | **6,258** | **8,587** | – | – | – |
| Retail | **708** | **8,846** | **64,067** | – | – | – |
| **Total IRB approach** | **1,209** | **15,104** | **72,654** | – | – | – |
| Central governments or central banks | **1** | **9** | **11,663** | – | 1 | 11,361 |
| Regional governments or local authorities | **1** | **13** | **175** | 1 | 12 | 143 |
| Public sector entities | **–** | **5** | **335** | – | 2 | 155 |
| Multilateral development banks | **–** | **–** | **1,034** | – | – | 155 |
| Financial institutions | **16** | **195** | **948** | 11 | 136 | 630 |
| Corporates | **28** | **347** | **376** | 316 | 3,956 | 4,311 |
| Retail | **319** | **3,993** | **5,324** | 90 | 1,124 | 1,499 |
| Secured by mortgages on immovable property | **40** | **498** | **875** | 938 | 11,708 | 28,423 |
| Exposures in default | **5** | **59** | **55** | 45 | 562 | 465 |
| Collective investments undertakings | **–** | **1** | **1** | – | 1 | 1 |
| Equity exposures | **1** | **11** | **9** | – | 5 | 4 |
| Items associated with particularly high risk | **1** | **11** | **7** | 4 | 49 | 33 |
| Covered bonds | **11** | **141** | **1,415** | 5 | 61 | 615 |
| Other items | **53** | **670** | **754** | 39 | 487 | 715 |
| **Total standardised approach** | **476** | **5,953** | **22,971** | 1,449 | 18,104 | 48,510 |
| **Total credit risk** | **1,685** | **21,057** | **95,625** | 1,449 | 18,104 | 48,510 |
| Operational risk | **209** | **2,606** | | 132 | 1,655 | |
| Counterparty credit risk | **15** | **191** | | 10 | 125 | |
| Credit valuation adjustment | **15** | **192** | | 17 | 218 | |
| **Total Pillar 1 regulatory capital requirements** | **1,924** | **24,046** | | 1,608 | 20,102 | |

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

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

Prior period comparatives are reported under the standardised approach to credit risk as accreditation for IRB was received in October 2018.

# Financial risk

| Capital position and CET1 (unaudited) | 2019 £M | PRO FORMA 2018 £M | REPORTED 2018 £M |
|---|---|---|---|
| **RWA[1]** | | | |
| Retail mortgages | **8,846** | 8,794 | 9,002 |
| Business lending | **7,124** | 6,604 | 7,407 |
| Other retail lending | **4,042** | 3,463 | 981 |
| Other lending | **481** | 109 | 109 |
| Other[2] | **564** | 1,013 | 605 |
| Credit risk | **21,057** | 19,983 | 18,104 |
| Credit valuation adjustment | **192** | 243 | 218 |
| Operational risk | **2,606** | 2,523 | 1,655 |
| Counterparty credit risk | **191** | 194 | 125 |
| **Total RWA** | **24,046** | 22,943 | 20,102 |
| | | | |
| **CAPITAL RATIOS** | | | |
| CET1 ratio | **13.3%** | 15.1% | 10.5% |
| Tier 1 ratio | **17.1%** | 18.3% | 12.7% |
| **Total capital ratio** | **20.1%** | 20.6% | 15.9% |

(1) RWA are calculated under the Advanced internal ratings-based (AIRB) approach for the mortgage portfolio and the FIRB approach for the business portfolio, with all other portfolios being calculated under the standardised approach, via either sequential IRB implementation or Permanent Partial Use (PPU).

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

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

| Minimum requirements (unaudited) | AS AT 30 SEP 2019 | |
|---|---|---|
| | CET1 | TOTAL CAPITAL |
| Pillar 1[1] | **4.5%** | **8.0%** |
| Pillar 2A | **3.0%** | **5.3%** |
| **Total capital requirement** | **7.5%** | **13.3%** |
| | | |
| Capital conservation buffer | **2.5%** | **2.5%** |
| UK countercyclical capital buffer[2] | **1.0%** | **1.0%** |
| **Total (excluding PRA buffer)[3]** | **11.0%** | **16.8%** |

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

(2) The UK countercyclical capital buffer (CCyB) may be set between 0% and 2.5%. On 28 November 2018 the UK CCyB increased from 0.5% to 1.0%. At its October 2019 meeting, the FPC maintained the UK CCyB rate at 1%, noting the underlying vulnerabilities (excluding Brexit) that can amplify economic shocks have not changed materially since the November 2018 Financial Stability Report and remain at a standard level overall in the UK.

(3) The Group may be subject to a PRA buffer as set by the PRA but is not permitted to disclose the level of any buffer. A PRA buffer can consist of two components:

- a risk management and governance buffer that is set as a scalar of the Pillar 1 and Pillar 2A requirements; and
- a buffer relating to the results of the BoE stress tests.

Underlying capital generation by the core divisions post additional AT1 distribution was 77bps, largely driven by strong underlying profits more than offsetting asset growth and investment spending. After absorbing the net impact of costs associated with restructuring, the acquisition of Virgin Money Holdings (UK) plc and legacy conduct issues, the Group's CET1 ratio was 13.3%.

# Financial risk

In August 2019, Virgin Money Holdings (UK) plc successfully received investor consent to transfer obligations on its outstanding AT1 (£230m) and Senior Notes (£350m) to Virgin Money UK PLC (formerly named CYBG PLC). All of the Group's regulatory capital and MREL instruments are now issued out of Virgin Money UK PLC, consistent with the single point of entry resolution model. This also removed the previous need to adjust for non-controlling interests in the Group's capital calculations.

**Dividend**

As disclosed in the Business and financial review, the Board has recommended not to pay a final dividend for the financial year ending 30 September 2019.

**Leverage**

| Leverage ratio (unaudited) | 2019 £M | REPORTED 2018 £M |
|---|---|---|
| **TOTAL TIER 1 CAPITAL FOR THE LEVERAGE RATIO** | | |
| Total CET1 capital | **3,204** | 2,113 |
| AT1 capital | **915** | 450 |
| **Total Tier 1** | **4,119** | 2,563 |
| **EXPOSURES FOR THE LEVERAGE RATIO** | | |
| Total assets as per published financial statements | **90,999** | 43,456 |
| Adjustment for off-balance sheet items | **2,728** | 1,763 |
| Adjustment for derivative financial instruments | **(35)** | (134) |
| Adjustment for securities financing transactions (SFTs) | **1,934** | 1,468 |
| Other regulatory adjustments | **(882)** | (613) |
| **Leverage ratio exposure** | **94,744** | 45,940 |

| | 2019 £M | PRO FORMA 2018 £M | REPORTED 2018 £M |
|---|---|---|---|
| **CRD IV leverage ratio**[(1)] | **4.3%** | 4.6% | 5.6% |
| **UK leverage ratio**[(2)] | **4.9%** | 5.1% | 6.5% |

(1) IFRS 9 transitional capital arrangements have been applied to the leverage ratio calculation as at 30 September 2019.

(2) The Group's leverage ratio on a modified basis as at 30 September 2019, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017.

The UK leverage ratio framework, which came into force on 1 January 2016, is relevant to PRA regulated banks and building societies with consolidated retail deposits equal to or greater than £50bn. The Group is currently excluded from the full reporting requirements of the UK leverage ratio framework but will be required to comply in the first reporting period following the date at which this threshold is breached, which is 31 December 2019.

The leverage ratio is monitored against a Board approved RAS, with responsibility for managing the ratio delegated to the Group's Asset and Liability Committee (ALCO), which monitors it on a monthly basis.

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

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

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

The Group's leverage ratio is 4.3% (30 September 2018 pro forma: 4.6%) which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018, and the UK minimum ratio of 3.60% (3.25% plus 0.35% countercyclical leverage buffer.)

# Financial risk

## Funding and liquidity risk

Funding risk occurs where the Group is unable to raise or maintain funds of sufficient quantity and quality to support the delivery of the business plan or sustain lending commitments. Prudent funding risk management reduces the likelihood of liquidity risks occurring, increases the stability of funding sources, minimises concentration risks and controls future balance sheet growth. Liquidity risk occurs when the Group is unable to meet its current and future financial obligations as they fall due or at acceptable cost, or when the Group reduces liquidity resources below internal or regulatory stress requirements.

### Liquid assets

The quantity and quality of the Group's liquid assets are calibrated to the Board's view of liquidity risk appetite and remain at a prudent level above regulatory requirements. The Group was compliant with all internal and regulatory liquidity metrics at 30 September 2019 (30 September 2018: compliant). The LCR moved from 137% to 152% during the year.

The liquid asset portfolio provides a buffer against sudden and potentially sharp outflows of funds. Liquid assets must therefore be of a high quality so they can be realised for cash and cannot be encumbered for any other purpose (e.g. to provide collateral for payments systems). The liquid asset portfolio is primarily comprised of cash at BoE, UK government securities (gilts) and listed securities (e.g. bonds issued by supra-nationals and AAA-rated covered bonds).

| Liquid asset portfolio[1] | 2019 (AUDITED) £M | PRO FORMA 2018 (UNAUDITED) £M | REPORTED 2018 (AUDITED) £M | CHANGE (AUDITED) % | AVERAGE 2019 (AUDITED) £M | AVERAGE 2018 (AUDITED) £M |
|---|---|---|---|---|---|---|
| **LEVEL 1** | | | | | | |
| Cash and balances with central banks | **7,469** | 7,979 | 3,942 | 89.5% | **7,266** | 3,405 |
| UK government treasury bills and gilts | **1,076** | 908 | 513 | 109.7% | **870** | 568 |
| Other debt securities | **2,867** | 2,180 | 943 | 204.0% | **2,604** | 913 |
| **Total level 1** | **11,412** | 11,067 | 5,398 | 111.4% | **10,740** | 4,886 |
| **LEVEL 2[2]** | **29** | 175 | – | – | **103** | – |
| **Total LCR eligible assets** | **11,441** | 11,242 | 5,398 | 111.9% | **10,843** | 4,886 |

(1) Excludes encumbered assets.
(2) Includes Level 2A and Level 2B.

### Encumbered assets by asset category

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

**Encumbered assets by asset category (audited)**

| | | | | | OTHER ASSETS | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | ASSETS ENCUMBERED WITH NON-CENTRAL BANK COUNTERPARTIES | | | | | ASSETS NOT POSITIONED AT THE CENTRAL BANK | | | | |
| **September 2019** | COVERED BONDS £M | SECURI-TISATIONS £M | OTHER £M | TOTAL £M | POSITIONED AT THE CENTRAL BANK (INCLUDING ENCUMBERED) £M | READILY AVAILABLE FOR ENCUMBRANCE £M | OTHER ASSETS CAPABLE OF BEING ENCUMBERED £M | CANNOT BE ENCUMBERED £M | TOTAL £M | TOTAL £M |
| Loans and advances to customers | **2,896** | **8,571** | **–** | **11,467** | **19,929** | **19,933** | **18,589** | **3,430** | **61,881** | **73,348** |
| Cash and balances with central banks | **–** | **–** | **–** | **–** | **3,219** | **7,077** | **–** | **–** | **10,296** | **10,296** |
| Due from other banks | **156** | **550** | **171** | **877** | **–** | **–** | **131** | **10** | **141** | **1,018** |
| Derivative financial instruments | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **366** | **366** | **366** |
| Financial instruments at fair value through other comprehensive income | **41** | **34** | **555** | **630** | **–** | **3,697** | **–** | **1** | **3,698** | **4,328** |
| Other assets | **–** | **–** | **409** | **409** | **–** | **–** | **173** | **1,061** | **1,234** | **1,643** |
| Total assets | **3,093** | **9,155** | **1,135** | **13,383** | **23,148** | **30,707** | **18,893** | **4,868** | **77,616** | **90,999** |

| September 2018 | Assets encumbered with non-central bank counterparties: Covered bonds £m | Securitisations £m | Other £m | Total £m | Other assets: Positioned at the central bank (including encumbered) £m | Assets not positioned at the central bank: Readily available for encumbrance £m | Other assets capable of being encumbered £m | Cannot be encumbered £m | Total £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|---|
| Loans and advances to customers | 1,393 | 5,243 | – | 6,636 | 6,940 | 5,016 | 11,322 | 2,830 | 26,108 | 32,744 |
| Cash and balances with central banks | – | – | – | – | 2,809 | 3,764 | – | – | 6,573 | 6,573 |
| Due from other banks | 161 | 299 | 163 | 623 | – | – | 70 | – | 70 | 693 |
| Derivatives | – | – | – | – | – | – | – | 262 | 262 | 262 |
| Financial assets – available for sale | – | – | 36 | 36 | 46 | 1,468 | 5 | 7 | 1,526 | 1,562 |
| Other financial assets | – | – | – | – | – | – | 362 | – | 362 | 362 |
| Other assets | – | – | 143 | 143 | – | – | 95 | 1,022 | 1,117 | 1,260 |
| Total assets | 1,554 | 5,542 | 342 | 7,438 | 9,795 | 10,248 | 11,854 | 4,121 | 36,018 | 43,456 |

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

| | 3 months or less £m | 3 to 12 months £m | 1 to 5 years £m | Over 5 years £m | Total 2019 | Total 2018 |
|---|---|---|---|---|---|---|
| Covered bonds | **–** | **10** | **599** | **1,303** | **1,912** | 742 |
| Securitisation | **574** | **928** | **3,549** | **–** | **5,051** | 2,956 |
| Medium term notes | **–** | **311** | **298** | **1,288** | **1,897** | 796 |
| Subordinated debt | **–** | **9** | **722** | **–** | **731** | 479 |
| **Total debt securities in issue** | **574** | **1,258** | **5,168** | **2,591** | **9,591** | 4,973 |
| Of which issued by Virgin Money UK PLC | **–** | **18** | **1,016** | **1,223** | **2,257** | 1,276 |

# Financial risk

### External credit ratings

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

| | OUTLOOK AS AT | AS AT | |
|---|---|---|---|
| MATERIAL RISK FOR THE GROUP | 30 SEP 2019[1] | 30 SEP 2019 | 30 SEP 2018 |
| **VIRGIN MONEY UK PLC** | | | |
| Moody's | Positive | Baa3 | Not rated |
| Fitch | Rating Watch Negative | BBB+ | BBB+ |
| Standard & Poor's | Stable | BBB- | BBB- |
| **CLYDESDALE BANK PLC** | | | |
| Moody's[2] | Positive | Baa1 | Baa1 |
| Fitch | Rating Watch Negative | A- | BBB+ |
| Standard & Poor's | Stable | BBB+ | BBB+ |
| **VIRGIN MONEY HOLDINGS (UK) PLC** | | | |
| Moody's | Stable | Baa3 | Baa3 |
| Fitch | Rating Watch Negative | BBB+ | BBB+ |
| **VIRGIN MONEY PLC** | | | |
| Moody's | Positive | Baa1 | Baa2 |
| Fitch | Rating Watch Negative | A- | BBB+ |

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

On 1 March 2019, due to a reassessment of the probability of a no-deal/disruptive Brexit scenario, Fitch placed all of the Group's long-term Issuer Default Ratings (IDR) on Rating Watch Negative (along with 19 UK banks in total). None of the Group's other ratings or its 'anchor' Viability Rating have been impacted.

On 3 June 2019, Fitch upgraded the long-term ratings of Clydesdale Bank PLC and Virgin Money PLC to A-. The upgrades followed an increase in the junior debt buffer at Clydesdale Bank PLC.

On 21 October 2019, Fitch and Moody's withdrew the long-and short-term ratings of Virgin Money Holdings (UK) PLC and Virgin Money PLC following completion of the FSMA Part VII transfer. None of the Group's other ratings was impacted by the FSMA Part VII transfer.

As at 27 November 2019, there have been no other changes to the Group's long-term credit ratings or outlooks since the report date, with the exception of the outlook on the Virgin Money UK PLC and Clydesdale Bank PLC Moody's ratings, which were moved from 'positive' to 'stable' on 12 November 2019. This followed a revision in Moody's outlook for the UK Sovereign from 'stable' to 'negative'. This was as a result of Moody's view that UK institutions have weakened and the UK's economic and fiscal strength are likely to be weaker going forward. Subsequently, Moody's adjusted the ratings outlook for 15 UK banks, including the Group.

# Directors' responsibility statement in respect of the Annual Report and Accounts

The responsibility statement below has been prepared in connection with the Company's full Annual Report and Accounts for the year ending 30 September 2019. Certain parts thereof are not included within this announcement.

The Directors confirm that to the best of their knowledge:

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

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

**David Duffy**
Chief Executive Officer
27 November 2019

# Consolidated income statement

| FOR THE YEAR ENDED 30 SEPTEMBER | NOTE | 2019 £M | 2018 £M |
|---|---|---|---|
| Interest income | | **2,420** | 1,098 |
| Other similar interest | | **13** | 15 |
| Interest expense and similar charges | | **(919)** | (262) |
| **Net interest income** | 2.2 | **1,514** | 851 |
| Gains less losses on financial instruments at fair value | | **(17)** | (3) |
| Other operating income | | **252** | 159 |
| **Non-interest income** | 2.3 | **235** | 156 |
| **Total operating income** | | **1,749** | 1,007 |
| **Operating and administrative expenses before impairment losses** | 2.4 | **(1,729)** | (1,130) |
| **Operating profit/(loss) before impairment losses** | | **20** | (123) |
| Impairment losses on credit exposures | 3.2 | **(252)** | (41) |
| **Loss on ordinary activities before tax** | | **(232)** | (164) |
| Tax credit | 2.5 | **38** | 19 |
| **Loss for the year** | | **(194)** | (145) |
| | | | |
| **Attributable to:** | | | |
| Ordinary shareholders | | **(268)** | (181) |
| Other equity holders | | **41** | 36 |
| Non-controlling interests | | **33** | – |
| **Loss for the year** | | **(194)** | (145) |
| Basic loss per share (pence) | 2.6 | **(17.9)** | (19.7) |
| Diluted loss per share (pence) | 2.6 | **(17.9)** | (19.7) |

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

The notes on pages 48 to 105 form an integral part of these financial statements.

# Consolidated statement of comprehensive income

| FOR THE YEAR ENDED 30 SEPTEMBER | NOTE | 2019 £M | 2018 £M |
|---|---|---|---|
| **Loss for the year** | | **(194)** | (145) |
| | | | |
| **ITEMS THAT MAY BE RECLASSIFIED TO THE INCOME STATEMENT** | | | |
| *Change in cash flow hedge reserve* | | | |
| Gains/(losses) during the year | | **73** | (58) |
| Transfers to the income statement | | **(57)** | 9 |
| Taxation thereon – deferred tax (charge)/credit | | **(9)** | 11 |
| Taxation thereon – current tax credit | | **6** | – |
| | | **13** | (38) |
| *Change in FVOCI reserve* | | | |
| Gains during the year | | **13** | – |
| Transfers to the income statement | | **(4)** | – |
| Taxation thereon – deferred tax charge | | **(2)** | – |
| | | **7** | – |
| **Total items that may be reclassified to the income statement** | | **20** | (38) |
| | | | |
| **ITEMS THAT WILL NOT BE RECLASSIFIED TO THE INCOME STATEMENT** | | | |
| *Change in asset revaluation reserve* | 3.9 | **–** | – |
| Taxation thereon – deferred tax (charge)/credit | | **(1)** | 1 |
| | | | |
| *Remeasurement of defined benefit pension plans* | 3.12 | **110** | (9) |
| Taxation thereon – deferred tax (charge)/credit | | **(56)** | 3 |
| Taxation thereon – current tax credit | | **7** | – |
| | | **61** | (6) |
| **Total items that will not be reclassified to the income statement** | | **60** | (5) |
| | | | |
| **Other comprehensive income/(losses), net of tax** | | **80** | (43) |
| **Total comprehensive losses for the year, net of tax** | | **(114)** | (188) |
| | | | |
| **Attributable to:** | | | |
| Ordinary shareholders | | **(188)** | (224) |
| Other equity holders | | **41** | 36 |
| Non-controlling interests | | **33** | – |
| **Total comprehensive losses for the year, net of tax** | | **(114)** | (188) |

The notes on pages 48 to 105 form an integral part of these financial statements.

# Consolidated balance sheet

| AS AT 30 SEPTEMBER | NOTE | 2019 £M | 2018[2] £M |
|---|---|---|---|
| **ASSETS** | | | |
| *Financial assets at amortised cost* | | | |
| Loans and advances to customers | 3.1 | **73,095** | 32,748 |
| Cash and balances with central banks | 3.4 | **10,296** | 6,573 |
| Due from other banks | | **1,018** | 693 |
| *Financial assets at fair value through profit or loss* | | | |
| Loans and advances to customers | 3.5 | **253** | 362 |
| Derivative financial instruments | 3.6 | **366** | 262 |
| Other financial assets | 3.5 | **14** | – |
| Financial assets at fair value through other comprehensive income[1] | 3.7 | **4,328** | – |
| Financial assets available for sale[1] | 3.8 | **–** | 1,562 |
| Property, plant and equipment | 3.9 | **145** | 88 |
| Intangible assets and goodwill | 3.10 | **516** | 412 |
| Current tax assets | | **13** | – |
| Deferred tax assets | 3.11 | **322** | 206 |
| Defined benefit pension assets | 3.12 | **396** | 212 |
| Other assets | | **237** | 338 |
| **Total assets** | | **90,999** | 43,456 |
| **LIABILITIES** | | | |
| *Financial liabilities at amortised cost* | | | |
| Customer deposits | 3.13 | **64,000** | 28,904 |
| Debt securities in issue | 3.14 | **9,591** | 4,973 |
| Due to other banks | 3.15 | **8,916** | 3,088 |
| *Financial liabilities at fair value through profit or loss* | | | |
| Customer deposits | 3.5 | **4** | 15 |
| Derivative financial instruments | 3.6 | **273** | 361 |
| Deferred tax liabilities | 3.11 | **201** | 77 |
| Provisions for liabilities and charges | 3.16 | **459** | 331 |
| Other liabilities | 3.17 | **2,534** | 2,521 |
| **Total liabilities** | | **85,978** | 40,270 |
| **EQUITY** | | | |
| Share capital and share premium | 4.1 | **146** | 89 |
| Other equity instruments | 4.1 | **915** | 450 |
| Capital reorganisation reserve | 4.1 | **(839)** | (839) |
| Merger reserve | 4.1 | **2,128** | 633 |
| Other reserves | 4.1 | **10** | (20) |
| Retained earnings | 4.1 | **2,661** | 2,873 |
| **Total equity** | | **5,021** | 3,186 |
| **Total liabilities and equity** | | **90,999** | 43,456 |

(1) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to notes 1.9 and 5.4.
(2) The comparative year has been restated in line with the current year presentation. Refer to note 1.10.

The notes on pages 48 to 105 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 27 November 2019 and were signed on its behalf by:

David Duffy — Chief Executive Officer

Ian Smith — Group Chief Financial Officer

Virgin Money UK PLC, Registered number: 09595911

# Consolidated statement of changes in equity

| | | | | | OTHER RESERVES | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | SHARE CAPITAL AND SHARE PREMIUM £M | CAPITAL REORG' RESERVE £M | MERGER RESERVE £M | OTHER EQUITY INSTRU-MENTS £M | OWN SHARES HELD £M | DEFERRED SHARES RESERVE £M | EQUITY BASED COMP' RESERVE £M | ASSET REVAL RESERVE £M | AVAILABLE FOR SALE RESERVE[1] £M | FVOCI RESERVE[1] £M | CASH FLOW HEDGE RESERVE £M | RETAINED EARNINGS £M | NON CONTROL-LING INTEREST £M | TOTAL EQUITY £M |
| NOTE | 4.1.1 | 4.1.3 | 4.1.4 | 4.1.2 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | | 4.1.6 | |
| **As at 1 October 2017** | 88 | (839) | 633 | 450 | – | – | 8 | 1 | 7 | – | (1) | 3,055 | – | 3,402 |
| Loss for the year | – | – | – | – | – | – | – | – | – | – | – | (145) | – | (145) |
| Other comprehensive income/(losses), net of tax | – | – | – | – | – | – | – | 1 | – | – | (38) | (6) | – | (43) |
| Total comprehensive income/(losses) for the year | – | – | – | – | – | – | – | 1 | – | – | (38) | (151) | – | (188) |
| Dividends paid to ordinary shareholders | – | – | – | – | – | – | – | – | – | – | – | (9) | – | (9) |
| AT1 distribution paid (net of tax) | – | – | – | – | – | – | – | – | – | – | – | (29) | – | (29) |
| Transfer from equity based compensation reserve | – | – | – | – | – | – | (7) | – | – | – | – | 7 | – | – |
| Ordinary shares issued | 1 | – | – | – | – | – | – | – | – | – | – | – | – | 1 |
| Equity based compensation expensed | – | – | – | – | – | – | 9 | – | – | – | – | – | – | 9 |
| **As at 30 September 2018** | 89 | (839) | 633 | 450 | – | – | 10 | 2 | 7 | – | (39) | 2,873 | – | 3,186 |
| Changes on adoption of IFRS 9 and IFRS 15 (note 5.4) | – | – | – | – | – | – | – | – | (7) | 4 | – | (18) | – | (21) |
| **As at 1 October 2018** | 89 | (839) | 633 | 450 | – | – | 10 | 2 | – | 4 | (39) | 2,855 | – | 3,165 |
| Loss for the year | – | – | – | – | – | – | – | – | – | – | – | (194) | – | (194) |
| Other comprehensive (losses)/income net of tax | – | – | – | – | – | – | – | (1) | – | 7 | 13 | 61 | – | 80 |
| Total comprehensive (losses)/income for the year | – | – | – | – | – | – | – | (1) | – | 7 | 13 | (133) | – | (114) |
| Acquisition of Virgin Money Holdings (UK) PLC | 54 | – | 1,495 | – | (5) | 23 | – | – | – | – | – | – | 422 | 1,989 |
| Dividends paid to ordinary shareholders | – | – | – | – | – | – | – | – | – | – | – | (45) | – | (45) |
| AT1 distribution paid (net of tax) | – | – | – | – | – | – | – | – | – | – | – | (33) | – | (33) |
| Distributions to non-controlling interests (net of tax) | – | – | – | – | – | – | – | – | – | – | – | (26) | – | (26) |
| Transfer from equity based compensation reserve | – | – | – | – | – | – | (8) | – | – | – | – | 8 | – | – |
| Equity based compensation expensed | – | – | – | – | – | – | 4 | – | – | – | – | – | – | 4 |
| Settlement of Virgin Money Holdings (UK) PLC share awards | 3 | – | – | – | 4 | (4) | – | – | – | – | – | 1 | – | 4 |
| AT1 issuance | – | – | – | 465 | – | – | – | – | – | – | – | – | – | 465 |
| Capital note redemption | – | – | – | – | – | – | – | – | – | – | – | 34 | (422) | (388) |
| **As at 30 September 2019** | **146** | **(839)** | **2,128** | **915** | **(1)** | **19** | **6** | **1** | **–** | **11** | **(26)** | **2,661** | **–** | **5,021** |

(1) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to notes 1.9 and 5.4.

The notes on pages 48 to 105 form an integral part of these financial statements.

# Consolidated statement of cash flows

| FOR THE YEAR ENDED 30 SEPTEMBER | NOTE | 2019 £M | 2018 £M |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Loss on ordinary activities before tax | | **(232)** | (164) |
| *Adjustments for:* | | | |
| Non-cash or non-operating items included in loss before tax | 5.2 | **(1,035)** | (715) |
| Changes in operating assets | 5.2 | **(2,211)** | (1,059) |
| Changes in operating liabilities | 5.2 | **2,635** | (122) |
| Interest received | | **2,320** | 1,108 |
| Interest paid | | **(745)** | (173) |
| Tax paid | | **(8)** | – |
| **Net cash provided by/(used in) operating activities** | | **724** | (1,125) |
| | | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Interest received | | **27** | 12 |
| Cash acquired on acquisition of Virgin Money Holdings (UK) PLC | | **4,106** | – |
| Proceeds from maturity of financial assets at FVOCI | | **659** | – |
| Proceeds from maturity of available for sale investments | | **–** | 245 |
| Proceeds from sale of financial assets at FVOCI | | **352** | – |
| Proceeds from sale of available for sale investments | | **–** | 822 |
| Purchase of financial assets at FVOCI | | **(1,647)** | – |
| Purchase of available for sale investments | | **–** | (593) |
| Proceeds from sale of 50% (less one share) consideration in UTM | | **45** | – |
| Proceeds from sale of property, plant and equipment | | **3** | 9 |
| Purchase of property, plant and equipment | | **(20)** | (22) |
| Purchase and development of intangible assets | | **(130)** | (144) |
| **Net cash provided by investing activities** | | **3,395** | 329 |
| | | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Interest received | | **–** | 1 |
| Interest paid | | **(81)** | (94) |
| Proceeds from issuance of other equity instruments | | **247** | – |
| Repayment of AT1 classified as non-controlling interest | | **(160)** | – |
| Redemption and principal repayment on RMBS and covered bonds | | **(2,003)** | (1,372) |
| Issuance of RMBS and covered bonds | | **2,227** | 1,049 |
| Issuance of medium-term notes/subordinated debt | | **642** | 497 |
| Amounts drawn down under the TFS | | **–** | 1,250 |
| Amounts repaid under the TFS | | **(1,295)** | (900) |
| Ordinary dividends paid | | **(45)** | (9) |
| AT1 distributions | | **(41)** | (36) |
| Distributions to non-controlling interests | | **(33)** | – |
| **Net cash (used in)/provided by financing activities** | | **(542)** | 386 |
| **Net increase/(decrease) in cash and cash equivalents** | | **3,577** | (410) |
| Cash and cash equivalents at the beginning of the year | | **6,542** | 6,952 |
| **Cash and cash equivalents at the end of the year** | 5.2 | **10,119** | 6,542 |

# Consolidated statement of cash flows

| Reconciliation of movements to liabilities from cash flows arising from financing activities | TERM FUNDING SCHEME £M | DEBT SECURITIES IN ISSUE £M | TOTAL £M |
|---|---|---|---|
| **At 1 October 2018** | 2,254 | 4,973 | 7,227 |
| **CASH FLOWS:** | | | |
| Issuances | – | 2,869 | 2,869 |
| Redemptions | – | (2,003) | (2,003) |
| Repayment | (1,295) | – | (1,295) |
| **NON-CASH FLOWS:** | | | |
| Acquisition of TFS and debt securities in issue | 6,389 | 3,548 | 9,937 |
| Fair value adjustments and associated unwind on acquired TFS and debt securities in issue | (48) | 8 | (40) |
| Movement in accrued interest | 8 | 7 | 15 |
| Unrealised foreign exchange movements | – | 45 | 45 |
| Unamortised costs | – | 6 | 6 |
| Other movements | – | 138 | 138 |
| **At 30 September 2019** | **7,308** | **9,591** | **16,899** |

The notes on pages 48 to 105 form an integral part of these financial statements.

# Notes to the consolidated financial statements

## Section 1: Basis of preparation

**Overview**

This section sets out the Group's accounting policies that relate to the consolidated financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates. This section also shows new accounting standards, amendments and interpretations which are relevant to the Group, and whether they are effective in 2019 or later years. We explain how these changes are expected to impact the financial position and performance of the Group.

### 1.1 General information

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

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

### 1.2 Basis of accounting

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

The financial information has been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment properties, and certain other financial assets and liabilities at fair value through profit or loss and other comprehensive income. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

### 1.3 Presentation of risk, offsetting and maturity disclosures

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

### 1.4 Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Strategic report contained within the Group's Annual report and accounts. In addition, the Risk report included within the Group's Annual report and accounts includes the Group's risk management objectives and the Group's objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2019, the Directors have considered a number of factors, including the current balance sheet position, the principal and emerging risks which could impact the performance of the Group, the Group's strategic and financial plan and the impact of the acquisition of Virgin Money Holdings (UK) PLC. The assessment concluded that, for the foreseeable future, the Group has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that performance will continue to improve as the Group's strategy is executed.

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

### 1.5 Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. An assessment of control is performed on an ongoing basis.

Controlled entities are consolidated from the date on which control is established by the Group until the date that control ceases. The acquisition method of accounting is used to account for business combinations other than those under common control. A non-controlling interest is recognised by the Group in respect of any portion of the total assets less total liabilities of an acquired entity or entities that is not owned by the Group. Post-acquisition, income received and expenses incurred by the entity or entities acquired are included in the consolidated income statement on a line-by-line basis in accordance with the accounting policies set out herein. Balances and transactions between entities within the Group and any unrealised gains and losses arising from those transactions are eliminated in full upon consolidation.

The Group's interests in joint venture entities are accounted for using the equity method and then assessed for impairment in the relevant company's financial statements.

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

# Section 1: Basis of preparation continued

## 1.6 Foreign currency

### Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates, the 'functional currency'. The consolidated financial statements are presented in pounds sterling (GBP), which is also the Group's presentation currency, rounded to the nearest million pounds sterling (£m) unless otherwise stated.

### Transactions and balances

The Group records an asset, liability, expense or revenue arising from a transaction using the closing exchange rate between the functional and foreign currency on the transaction date. At each subsequent reporting date, the Group translates foreign currency monetary items at the closing rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the year in which the gains or losses arise.

Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction, with those measured at fair value translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby the associated gains or losses are recognised in the income statement, are also recognised in the income statement.

## 1.7 Financial assets and liabilities

### Recognition and derecognition

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

The Group derecognises a financial asset when the contractual cash flows from the asset expire or it transfers the right to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred. Financial liabilities are derecognised when the Group has discharged its obligation to the contract, or the contract is cancelled or expires.

### Classification and measurement

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

### Financial assets

Subsequent accounting for a financial asset is determined by the classification of the asset depending on the underlying business model and contractual cash flow characteristics. This results in classification within one of the following categories:

i. Amortised cost

A financial asset is measured at amortised cost when (1) the asset is held within a business model whose objective is achieved by collecting contractual cash flows; and (2) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding.

ii. Fair value through other comprehensive income

A financial asset is measured at fair value through other comprehensive income (FVOCI) when (1) the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and (2) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding, unless the financial asset is designated at fair value through profit or loss on initial recognition.

iii. Fair value through profit or loss

A financial asset is measured at fair value through profit or loss (FVTPL) if it (1) does not fall into one of the business models described above; (2) is specifically designated as FVTPL on initial recognition in order to eliminate or significantly reduce a measurement mismatch; or (3) is classified as held for trading.

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

### Financial liabilities

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

### Offsetting

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

# Notes to the consolidated financial statements

## Section 1: Basis of preparation continued

### 1.8 Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The Group considers the most significant use of accounting estimates and judgements relate to the following areas:

- impairment provisions on credit exposures (note 3.2);
- effective interest rate (note 2.2);
- deferred tax (note 3.11);
- PPI redress provision and other conduct related matters (note 3.16); and
- retirement benefit obligations (note 3.12).

The valuation of the Group's portfolio of loans and advances held at fair value through profit or loss is no longer considered a critical accounting estimate. While unobservable inputs such as the future expectation of credit losses will continue to impact the value of the portfolio, the balance has reduced to a level such that these are no longer considered to be critical to the Group's results.

### 1.9 New accounting standards and interpretations

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

**IFRS 9 'Financial Instruments'**
IFRS 9 'Financial Instruments' was issued in July 2014 and effective for financial periods beginning on or after 1 January 2018. IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement' in accounting for financial instruments and introduces changes to the classification and measurement of financial instruments and the impairment of financial assets. IFRS 9 also introduces new requirements for hedge accounting but includes an accounting policy choice for entities to continue to follow the hedge accounting requirements under IAS 39 until the IASB has an agreed strategy for macro hedge accounting. Consequently, the Group has decided to exercise the available accounting policy option and has chosen not to adopt the hedge accounting requirements of IFRS 9 at this time. There is no change to the Group's policy on financial liabilities, which are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss.

Financial assets are classified under IFRS 9 using a two-step process: (i) a business model assessment, and (ii) an assessment of whether the contractual terms of the financial asset give rise to cash flows which are consistent with that of solely payments of principal and interest.

The accounting policies for loans and advances to customers (note 3.1), impairment provisions on credit exposures (note 3.2) and financial assets at fair value through profit or loss (note 3.5), have been revised, and an accounting policy for the new category of financial assets 'financial assets at fair value through other comprehensive income' introduced (note 3.7).

The accounting policy for financial assets available for sale (note 3.8) is no longer relevant as this financial asset category has been removed with the introduction of IFRS 9. All accounting policies for financial assets under IAS 39 that were applicable for the Group up to and including 30 September 2018 have not been replicated in this results announcement but can be found in the Group's 2018 Annual Report and Accounts.

On transition and as permitted by IFRS 9, the Group has not restated comparative figures, with the impact of adopting IFRS 9 adjusted through retained earnings. Further detail on the transitional impact of IFRS 9 can be found in note 5.4.

**IFRS 15 'Revenues from Contracts with Customers'**
IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014 and effective for financial periods beginning on or after 1 January 2018. IFRS 15 replaces IAS 11 'Construction Contracts' and IAS 18 'Revenue' as the accounting standard on revenue recognition.

IFRS 15 requires revenue to be reflected as a transfer of goods or services to customers in an amount that recognises the consideration to which the Group expects to be entitled. This is satisfied by following a principles based five-step model for revenue recognition.

The majority of the Group's revenue is interest income generated from financial instruments, with the recognition criteria covered in IFRS 9 and not as part of IFRS 15. Interest income generated from lease contracts is also out of scope for IFRS 15. Fees and commissions together with certain elements of non-interest income are in scope of IFRS 15, with the Group's existing accounting policy materially consistent with the expectations under IFRS 15.

On transition and as permitted by IFRS 15, the Group has not restated comparative figures, with the impact of adopting IFRS 15 adjusted through retained earnings. Further detail on the transitional impact of IFRS 15 can be found in note 5.4.

# Section 1: Basis of preparation continued

**1.9 New accounting standards and interpretations** continued

**Other accounting standards and interpretations**

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

- amendments to IFRS 2: 'Classification and Measurement of Share-based Payment Transactions' issued in June 2016 and effective for financial years beginning on or after 1 January 2018. The amendments provide guidance on the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; classification of share-based payments with a net settlement feature for withholding tax obligations; and accounting for modifications to a share-based payment that change the classification from cash-settled to equity-settled;
- 'Annual Improvements to IFRS Standards 2014-2016 Cycle', issued December 2016 and effective for financial years beginning on or after 1 January 2018. The amendment relates to IAS 28: 'Investments in Associates and Joint Ventures' and the measurement of an associate or joint venture at fair value;
- IFRIC interpretation 22: 'Foreign Currency Transactions and Advance Consideration', issued December 2016 and effective for financial years beginning on or after 1 January 2018. The new interpretation provides requirements on which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance; and
- amendments to IFRS 9: 'Prepayment Features with Negative Compensation' issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendments allow companies to measure particular prepayable financial assets with negative compensation at amortised cost or fair value through other comprehensive income if a specified condition is met, instead of these being measured at fair value through profit or loss. The Group early adopted this amendment with effect from 1 October 2018 in line with the adoption of IFRS 9.

**New accounting standards and interpretations not yet adopted**

IFRS 16 'Leases' was issued in January 2016 and is effective for financial years beginning on or after 1 January 2019. A separate update on the Group's implementation of this new standard can be found at the end of this section.

There are a number of other standards, interpretations and amendments that have not been applied by the Group in preparing these financial statements as they are either not available for adoption in the EU or are not mandatory for the Group as at 30 September 2019. The pronouncements, while relevant to the Group, are not anticipated to have a material impact and include:

- IFRIC interpretation 23: 'Uncertainty over Income Tax Treatments', issued June 2017 and effective for financial years beginning on or after 1 January 2019. The new interpretation applies to any situation in which there is uncertainty as to whether an income tax treatment is acceptable under tax law and is not limited to actual ongoing disputes;
- 'Annual Improvements to IFRS Standards 2015-2017 Cycle'(1), issued December 2017 and effective for financial years beginning on or after 1 January 2019. The IASB has made amendments to the following standards: IFRS 3 'Business Combinations'; IFRS 11 'Joint arrangements'; IAS 12 'Income Taxes'; and IAS 32 'Borrowing Costs'. The amendment clarifies that the income tax consequences of distributions on financial instruments classified as equity should be recognised alongside the past transactions or events that generated the distributable profits. The Group has assessed that, on adoption of this amendment, the taxation impacts of distributions relating to AT1 securities would be recognised within 'Tax expense' in the income statement. Currently these taxation impacts are recognised directly in 'Retained earnings' within equity. As the amendment impacts only the presentation of taxation impacts but not their calculation, adoption will not result in any change to the Group's net assets but will result in an increase in 'Profit for the year attributable to equity owners' compared to existing practice. If the Group had applied the amendment in these financial statements, the Profit for the year attributable to equity owners would have been £15m (2018: £7m) higher than that disclosed in the income statement, with an equivalent reduction in 'Tax expense';
- amendment to IAS 19: 'Plan amendment, curtailment or settlement'(1) issued in February 2018 and effective prospectively for financial years beginning on or after 1 January 2019. The amendments clarify that after a plan event companies should use these updated assumptions to measure current service cost and net interest for the remainder of the reporting period;
- amendments to references to the 'Conceptual Framework in IFRS Standards'(1), issued in March 2018 and effective for financial years beginning on or after 1 January 2020. The amendments were issued following the IASB's publication of a revised version of its Conceptual Framework for Financial Reporting and updates the references in IFRS standards to previous versions of the Conceptual Framework;
- amendment to IAS 28: 'Long-term Interests in Associates and Joint Ventures' issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendment clarifies that an entity applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests);
- amendments to IAS 1: 'Presentation of Financial Statements' and IAS 8: 'Accounting Policies, Changes in Accounting Estimates and Errors'(1) issued in October 2018 and effective prospectively for financial years beginning on or after 1 January 2020. The amendments provide clarification on the definition of 'material';
- amendments to IFRS 3: 'Business Combinations'(1) issued in October 2018 and effective prospectively for financial years beginning on or after 1 January 2020. The amendment assists in the determination of whether an acquired set of activities and assets meets the test of being classed as a business; and
- Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)(1) issued in September 2019 and effective for financial years beginning on or after 1 January 2020. The amendments provide temporary reliefs which enable hedge accounting to continue during the period of uncertainty before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate (an RFR). The Group is working through the implications of the amendment ahead of implementation from 1 October 2020.

(1) Not yet endorsed by the EU.

# Section 1: Basis of preparation continued

**1.9 New accounting standards and interpretations** continued

**Update on IFRS 16: 'Leases'**
IFRS 16 'Leases' was issued in January 2016 and replaces IAS 17 'Leases', IFRIC 4 'Determining whether an Arrangement contains a Lease', SIC-15 'Operating Leases-Incentives' and SIC-27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. IFRS 16 is effective for annual periods beginning on or after 1 January 2019 and was EU endorsed on 31 October 2017. The Group will apply the standard from 1 October 2019.

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and will result in most leases for lessees being brought on to the balance sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged.

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to restore the underlying asset, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the incremental borrowing rate is used for the discount rate.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in amount expected to be payable under a residual value guarantee, or if there is a change in the assessment of whether a purchase, extension or termination option will be exercised.

When a lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-to-use asset or is recorded in the income statement if the carrying amount of the right-of-use asset has been reduced to zero.

**Transition approach and use of practical expedients**
The Group will elect to apply the practical expedient to grandfather the assessment of which transactions are leases. It will apply IFRS 16 only to contracts that were previously identified as leases by IAS 17. Contracts that were not identified as leases under IAS 17 and IFRIC 4 will not be reassessed. Therefore, the definition of a lease under IFRS 16 will only be applied to contracts entered into or changed on or after 1 October 2019.

The Group will also elect to apply the recognition exemptions for short-term leases (with a remaining lease term of less than 12 months) and low value leases. Lease payments associated with these leases will be recognised as an expense on a straight line basis over the term of the lease.

The Group will apply IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings as at 1 October 2019 and comparatives are not restated.

Under the modified approach, at transition, lease liabilities will be measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as at 1 October 2019.

For the purposes of applying the modified retrospective approach, the Group will elect to:

- measure the right-of-use asset at an amount equal to the lease liability at the date of initial application adjusted by the amount of any prepaid or accrued lease payments;
- apply the exemption not to recognise right-of-use assets and liabilities for leases with less than 12 months of lease term; and
- apply the practical expedient to rely on its assessment whether the lease was onerous under IAS 37 and therefore adjust the right-of-use asset at the date of initial application by the onerous lease provision rather than conduct an impairment test.

**Key accounting judgements**
The Group undertook a technical assessment of IFRS 16. The two key accounting judgements in relation to IFRS 16 are the determination of the discount rates and lease term.

When measuring the lease liability, lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the incremental borrowing rate is used for the discount rate. Under the modified retrospective approach, the Group will use its incremental borrowing rate at the date of initial application as the discount rate. Judgement will be required to determine an appropriate incremental borrowing rate.

When determining lease term, an assessment is required of whether an extension or termination option will be exercised. This is reassessed if there is a significant event or significant change in circumstances within the Group's control. Judgement is required when making this assessment.

**Impact of transition to IFRS 16**
On transition to IFRS 16, the Group estimates it will recognise right-of-use assets of approximately £196m and lease liabilities of approximately £207m, with no material impact to retained earnings. The Group will not restate comparative periods.

The Group continues to refine, monitor and validate certain elements of the IFRS 16 model and related controls ahead of full reporting of IFRS 16 impacts later in 2020.

The standard is not expected to have any significant impact on lessor accounting by the Group.

# Notes to the consolidated financial statements

## Section 1: Basis of preparation continued

### 1.10 Prior period comparatives

The prior period comparatives in the balance sheet have been restated in line with the current year presentation. £34m of derivative collateral in relation to clearing houses has been reclassified between other liabilities and due to other banks and £143m has been reclassified between other assets and due from other banks. In addition, certain line items within assets and liabilities which are not material have been aggregated with other similar line items.

## Section 2: Results for the year continued

### 2.1 Segment information

The Group's operating segments are operating units engaged in providing different products or services and whose operating results and overall performance are regularly reviewed by the Group's Chief Operating Decision Maker, the Executive Leadership Team.

Following the acquisition of Virgin Money Holdings (UK) PLC and up until 30 September 2019, the business has been assessed and reported to the Group's Chief Operating Decision Maker as a single segment, with decisions being made on the performance of the Group on that basis.

With effect from 1 October 2019, the business has been aligned to a three operating segments model: Business, Personal and Mortgages. Reporting on this segmental basis will be included in the 2020 Interim Results.

**Summary income statement**

| | 2019<br>£M | 2018<br>£M |
|---|---|---|
| Net interest income | **1,514** | 851 |
| Non-interest income | **235** | 156 |
| Total operating income | **1,749** | 1,007 |
| Operating and administrative expenses | **(1,729)** | (1,130) |
| Impairment losses on credit exposures | **(252)** | (41) |
| Segment loss before tax | **(232)** | (164) |
| | | |
| Average interest earning assets | **86,362** | 39,417 |

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

# Section 2: Results for the year continued

## 2.2 Net interest income

### Accounting policy

Interest income is reflected in the income statement using the effective interest method which discounts the estimated future cash payments or receipts over the expected life of the financial instrument to the gross carrying amount of the non-credit impaired financial asset. Interest expense is reflected in the income statement using the same effective interest method on the amortised cost of the financial liability.

When calculating the effective interest rate, cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses. The calculation includes all amounts paid or received that are an integral part of the effective interest rate such as transaction costs and all other premiums or discounts. Where it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination and commitment fees are recognised within the effective interest rate calculation. Non-utilisation of a commitment fee is recognised as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Interest income on financial assets in impairment Stages 1 and 2 is recognised on the unwind of the discount from the initial recognition of the expected credit loss (ECL) using the original effective rate of interest. Once a financial asset or group of similar financial assets has been categorised as credit-impaired (Stage 3), interest income is recognised on the net carrying value (after the ECL allowance) using the asset's original effective interest rate. The interest income for purchase or originated credit impaired financial assets is calculated using the credit-adjusted effective interest rate applied to the amortised cost of the financial asset from initial recognition. The Group recognises and presents the reversal of expected credit losses following the curing of a credit impaired financial asset as a reversal of impairment losses.

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

Interest income and expense on derivatives economically hedging interest bearing financial assets or liabilities (but not designated as hedging instruments) and other financial assets and liabilities held at fair value through profit or loss (either mandatory or by election) are also recognised within net interest income. With effect from 1 October 2018, IAS 1 'Presentation of financial statements' prohibits the inclusion of such interest within 'Interest income'. Therefore interest income or expense on these items is now presented within 'Other similar interest'. Comparatives have been restated.

### Critical accounting estimates and judgements

*Effective interest rate (EIR)*

Following the acquisition of Virgin Money Holdings (UK) PLC, the Group considered the application of EIR in relation to its reported amounts of assets, liabilities, revenues and expenses. The Group has concluded that sufficient judgement is now exercised on EIR for it to be included within its disclosures on critical accounting estimates and judgements.

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

### Mortgages

The main accounting judgement when assessing the cash flows within the Group's secured lending EIR model is the product life (including assumptions based on observed historic customer behaviour when in a standard variable rate (SVR) period) and the early repayment charge income receivable. The Group currently assumes that 83% of customers will have fully repaid or re-mortgaged within two months of reverting to SVR. If this were to increase to 90%, the loans and advances to customers balance would reduce by £20m with the adjustment recognised in net interest income.

### Credit cards

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

The EIR of new business written in the current year is 5.26% while that on acquired portfolios nearing the end of their promotional periods is 8.22% (this excludes those which were out of their promotional periods at the date of acquisition and therefore do not form part of the EIR modelling). Revisions to the estimates of future cash flows (compared to the original assumptions) that would have resulted in the EIR across all cohorts being reduced by 25bps, would lead to a £16m decrease in the loans and advances to customers balance. This present value adjustment would be recognised in interest income.

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

# Section 2: Results for the year continued

### 2.2 Net interest income continued

| | 2019 £M | 2018 £M |
|---|---|---|
| **INTEREST INCOME** | | |
| Loans and advances to customers | **2,320** | 1,057 |
| Loans and advances to other banks | **72** | 26 |
| Financial assets at fair value through other comprehensive income | **27** | – |
| Financial assets available for sale | **–** | 12 |
| Other interest income | **1** | 3 |
| **Total interest income** | **2,420** | 1,098 |
| **OTHER SIMILAR INTEREST** | | |
| Financial assets at fair value through profit or loss | **21** | 29 |
| Financial liabilities at fair value through profit or loss | **–** | (1) |
| Derivatives economically hedging interest bearing assets | **(8)** | (13) |
| **Total other similar interest** | **13** | 15 |
| **LESS: INTEREST EXPENSE AND SIMILAR CHARGES** | | |
| Customer deposits | **(580)** | (148) |
| Debt securities in issue | **(185)** | (94) |
| Due to other banks | **(144)** | (18) |
| Other interest expense | **(10)** | (2) |
| **Total interest expense and similar charges** | **(919)** | (262) |
| **Net interest income** | **1,514** | 851 |

# Notes to the consolidated financial statements

## Section 2: Results for the year continued

### 2.3 Non-interest income

**Accounting policy**

**Gains less losses on financial instruments at fair value**

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

- derivatives classified as held for trading – the full change in fair value of trading derivatives is recognised inclusive of interest income and expense arising on those derivatives except when economically hedging other assets and liabilities at fair value as outlined in note 2.2;
- other financial assets and liabilities designated at fair value through profit or loss – these relate principally to the Group's fixed interest rate loan portfolio and related term deposits (note 3.5), which were designated at inception as fair value through profit or loss. The fair value of these loans is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. The valuation technique used is reflective of current market practice; and
- hedged assets, liabilities and derivatives designated in hedge relationships – fair value movements are recognised on both the hedged item and hedging derivative in a fair value hedge relationship, the net of which represents hedge ineffectiveness, and hedge ineffectiveness on cash flow hedge relationships (note 3.6).

**Fees and commissions**

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

**Income from insurance, protection and investments**

This includes management fees generated from the sale of and management of funds, Stocks and Shares Individual Savings Accounts ('ISAs') and pensions to retail investors. The contractual performance obligations to investors are aligned to the obligations required of UK authorised fund managers.

In return for providing these continuous services, a management charge (expressed on an annualised basis to customers) is levied on investors' funds under management. This charge is accrued by the products via adjustment to the closing unit prices of investors' holdings on a daily basis.

| | 2019<br>£M | 2018<br>£M |
|---|---|---|
| **GAINS LESS LOSSES ON FINANCIAL INSTRUMENTS AT FAIR VALUE** | | |
| Held for trading derivatives | **16** | 16 |
| Financial assets and liabilities at fair value[(1)] | **3** | (13) |
| Ineffectiveness arising from fair value hedges (note 3.6) | **(22)** | – |
| Ineffectiveness arising from cash flow hedges (note 3.6) | **(14)** | (6) |
| | **(17)** | (3) |
| **OTHER OPERATING INCOME** | | |
| Net fee and commission income | **195** | 141 |
| Margin on foreign exchange derivative brokerage | **19** | 18 |
| Gain on sale of financial assets at fair value through other comprehensive income | **3** | – |
| Gain on sale of Virgin Money Unit Trust Managers Limited[(2)] | **35** | – |
| Share of joint venture results | **(1)** | – |
| Other income | **1** | – |
| | **252** | 159 |
| **Total non-interest income** | **235** | 156 |

# Notes to the consolidated financial statements

## Section 2: Results for the year continued

### 2.3 Non-interest income continued

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

| | 2019 £M | 2018 £M |
|---|---|---|
| Current account and debit card fees | **117** | 114 |
| Credit cards | **42** | 13 |
| Insurance, protection and investments | **37** | 13 |
| Non-banking and other fees[3] | **31** | 32 |
| Total fee and commission income | **227** | 172 |
| Total fee and commission expense | **(32)** | (31) |
| **Net fee and commission income** | **195** | 141 |

(1) A credit risk gain on other assets and liabilities at fair value of £2m has been recognised in the current year (2018: £3m gain).

(2) The Group ceased generating management fees directly from the sale and management of funds products from 31 July 2019 when it sold 50% (less one share) of its shareholding in Virgin Money Unit Trust Managers Limited (UTM) to Aberdeen Standard Investments. A gain on sale of £35m was recorded on the partial disposal. Consequently, UTM became a joint venture and is accounted for under the equity method from the date of disposal.

(3) Non-banking and other fees include mortgages, invoice and asset finance and ATM fees.

### 2.4 Operating and administrative expenses before impairment losses

**Accounting policy**

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

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

The Group's accounting policies on pension expenses and equity based compensation are included in notes 3.12 and 4.2 respectively.

| | 2019 £M | 2018 £M |
|---|---|---|
| Personnel expenses | **421** | 223 |
| Depreciation and amortisation expense (notes 3.9, 3.10) | **108** | 89 |
| Other operating and administration expenses | **1,200** | 818 |
| **Total operating and administrative expenses** | **1,729** | 1,130 |

Personnel expenses comprise the following items:

| | 2019 £M | 2018 £M |
|---|---|---|
| Salaries, wages and non-cash benefits and social security costs | **256** | 139 |
| Defined contribution pension expense | **47** | 33 |
| Defined benefit pension expense (note 3.12) | **9** | 2 |
| Equity based compensation (note 4.2) | **4** | 9 |
| Other personnel expenses | **105** | 40 |
| **Personnel expenses** | **421** | 223 |

On 26 October 2018, the High Court delivered a judgement confirming that defined benefit schemes should equalise pension benefits for men and women in relation to GMP and concluded on the methods that were appropriate. The estimated increase in the Scheme liabilities at the date of the judgement was £11m, which was based on a number of assumptions and the actual impact may be different. This has been reflected as a past service cost within the defined benefit pension expense above, and in the closing net accounting surplus of the Scheme (note 3.12).

# Notes to the consolidated financial statements

## Section 2: Results for the year continued

### 2.4 Operating and administrative expenses before impairment losses continued

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

| | 2019 NUMBER | 2018 NUMBER |
|---|---|---|
| Managers | **2,989** | 2,161 |
| Clerical staff | **5,714** | 3,608 |
| | **8,703** | 5,769 |

The average monthly number of employees was 9,787 (2018: 6,461).

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

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

| | 2019 £M | 2018 £M |
|---|---|---|
| Restructuring costs | **154** | – |
| Consent solicitation | **18** | – |
| Legacy restructuring and separation | **5** | 46 |
| Virgin Money Holdings (UK) PLC transaction costs | **11** | 37 |
| SME transformation | **30** | 16 |
| Intangible asset write-off | **127** | – |
| PPI redress expense (note 3.16) | **415** | 352 |
| Other conduct expenses (note 3.16) | **18** | 44 |
| Operating lease charges | **35** | 26 |

Restructuring costs represents the Group's integration costs as it embarks upon a three year programme to fully integrate both banks. The legacy restructuring and separation costs relate to the Sustain programme and demerger from NAB, both of which completed in the current period.

Incidental to the integration programme, a £127m charge was recognised in the year following a review of the Group's software estate, which identified a number of core assets (including £70m in relation to the Virgin Money Digital Bank asset) that are no longer of value to the Group's future strategy and therefore required to be written down.

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

| | 2019 £'000 | 2018 £'000 |
|---|---|---|
| Fees payable to the Company's auditor for the audit of the Company's financial statements | **21** | 21 |
| Fees payable to the Company's auditor for the audit of the Company's subsidiaries(1) | **2,967** | 1,593 |
| Total audit fees | **2,988** | 1,614 |
| Audit related assurance services | **436** | 120 |
| Other assurance services | **289** | 700 |
| Total non-audit fees | **725** | 820 |
| Fees payable to the Company's auditor in respect of associated pension schemes | **88** | 84 |
| Total fees payable to the Company's auditor | **3,801** | 2,518 |

(1) Includes the audit of the Group's structured entities, and the audit of Virgin Money Holdings (UK) PLC subsidiaries for the year ending 31 December 2019.

Non-audit services of £725k (2018: £820k) performed by the auditor during the year included the review of the Interim Financial Report; PRA Written Auditor Reporting; agreed upon procedures under the Conduct Indemnity arrangement with NAB; comfort letters for the global medium-term note programme and AT1 issuance; and client money reviews. The decrease in the year is principally due to reporting accountant procedures in relation to the acquisition of Virgin Money Holdings (UK) PLC.

In addition to the above, out of pocket expenses of £161k (2018: £49k) were borne by the Group, principally related to reimbursement of travel expenses incurred by staff when performing the above services.

# Notes to the consolidated financial statements

## Section 2: Results for the year continued

### 2.5 Taxation

**Accounting policy**

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it is related to items recognised directly in equity, in which case the tax is also recognised in equity.

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

| | 2019 £M | 2018 £M |
|---|---|---|
| **CURRENT TAX** | | |
| Current year | **20** | 8 |
| Adjustment in respect of prior years | **(5)** | 8 |
| | **15** | 16 |
| **DEFERRED TAX (NOTE 3.11)** | | |
| Current year | **(56)** | (1) |
| Adjustment in respect of prior years | **3** | (34) |
| | **(53)** | (35) |
| **Tax credit for the year** | **(38)** | (19) |

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

| | 2019 £M | 2018 £M |
|---|---|---|
| Loss on ordinary activities before tax | **(232)** | (164) |
| Tax credit based on the standard rate of corporation tax in the UK of 19% (2018: 19%) | **(44)** | (31) |
| *Effects of:* | | |
| Disallowable expenses | **50** | 42 |
| Conduct indemnity adjustment | **10** | (5) |
| Deferred tax assets recognised | **(49)** | (8) |
| Non-taxable gain on partial disposal of UTM (note 2.3) | **(7)** | – |
| Bank levy | **1** | – |
| Impact of rate changes | **3** | 9 |
| Adjustments in respect of prior years | **(2)** | (26) |
| **Tax credit for the year** | **(38)** | (19) |

Disallowable expenses represent, in the main, conduct charges that are not deductible in computing taxable profits, and non-deductible transaction costs predominantly in relation to the acquisition of Virgin Money Holdings (UK) PLC.

The increase in the conduct indemnity adjustment reflects a change in anticipated quantum and timing of the use of historic indemnified losses, following the acquisition of Virgin Money Holdings (UK) PLC.

Deferred tax assets recognised represent previously unrecognised historic losses that are now brought onto the balance sheet in accordance with the Group's established methodology.

# Section 2: Results for the year continued

## 2.6 Earnings per share (EPS)

### Accounting policy

**Basic earnings per share**
Basic earnings per share is calculated by taking the profit attributable to ordinary shareholders of the parent company, deducting the weighted-average of the Group's holdings of its own shares, and then dividing this by the weighted-average number of ordinary shares outstanding during the period.

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

The Group presents basic and diluted loss per share data in relation to the ordinary shares of Virgin Money UK PLC.

| | 2019 £M | 2018 £M |
|---|---|---|
| Loss attributable to ordinary shareholders | **(268)** | (181) |
| Tax relief on AT1 distribution attributable to ordinary equity holders | **8** | 7 |
| Tax relief on non-controlling interest distributions attributable to ordinary equity holders | **7** | – |
| Loss attributable to ordinary equity holders for the purposes of basic and diluted EPS | **(253)** | (174) |

| | 2019 NUMBER OF SHARES (MILLION) | 2018 NUMBER OF SHARES (MILLION) |
|---|---|---|
| Weighted-average number of ordinary shares in issue | | |
| – Basic | **1,414** | 885 |
| – Diluted | **1,414** | 885 |
| Basic loss per share (pence) | **(17.9)** | (19.7) |
| Diluted loss per share (pence) | **(17.9)** | (19.7) |

Basic earnings per share has been calculated after deducting 1m (2018: Nil) ordinary shares representing the weighted-average of the Group's holdings of its own shares. The calculation of the diluted earnings per share excludes conditional awards of over 1m (2018: 1m) ordinary shares made under equity based compensation schemes. These are considered anti-dilutive due to the Group making a loss in both the current and the prior year.

# Section 3: Assets and liabilities

### 3.1 Loans and advances to customers

**Accounting policy**

Loans and advances to customers arise when the Group provides money directly to a customer and includes mortgages, term lending, overdrafts, credit card lending, lease finance and invoice financing. They are recognised initially at fair value and are subsequently measured at amortised cost, using the effective interest method, adjusted for expected credit losses (note 3.2). They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The leased asset is not held on the Group balance sheet; instead, a finance lease is recognised representing the minimum lease payments receivable under the terms of the lease, discounted at the rate of interest implicit in the lease. Interest income is recognised in interest receivable, allocated to accounting periods to reflect a constant periodic rate of return.

In certain limited circumstances, the Group has elected to apply the fair value through profit or loss measurement option to some debt instruments that would otherwise be classified at amortised cost (note 3.5).

| | 2019 £M | 2018[(1)] £M |
|---|---|---|
| Gross loans and advances to customers | **73,246** | 32,943 |
| Impairment provisions on credit exposures (note 3.2) | **(362)** | (195) |
| Fair value hedge adjustment | **211** | – |
| | **73,095** | 32,748 |

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

The Group has a portfolio of fair valued business loans of £253m (2018: £362m) which are classified separately as financial assets at fair value through profit or loss on the balance sheet (note 3.5). Combined with the above, this is equivalent to total loans and advances of £73,348m (2018: £33,110m).

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

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

**Lease finance**
The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The cost of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £38m (2018: £20m) and £408m (2018: £399m) respectively.

**Finance lease and hire purchase receivables**

| | 2019 £M | 2018 £M |
|---|---|---|
| **GROSS INVESTMENT IN FINANCE LEASE AND HIRE PURCHASE RECEIVABLES** | | |
| Due within 1 year | **276** | 269 |
| Due within 1 to 5 years | **386** | 376 |
| Due after more than 5 years | **23** | 15 |
| | **685** | 660 |
| Unearned income | **(36)** | (32) |
| **Net investment in finance lease and hire purchase receivables** | **649** | 628 |

The total receivables from finance leases and hire purchase contracts were £60m (2018: £32m) and £589m (2018: £596m) respectively.

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.2 Impairment provisions on credit exposures

**Accounting policy**

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

**ECL methodology**

The ECL methodology is based upon the combination of probability of default (PD), loss given default (LGD) and exposure at default (EAD) estimates that consider a range of factors which have a direct bearing on credit risk and consequently the required level of impairment loss provisioning.

The future cash flows used within the ECL calculation are estimated based on the contractual cash flows of the assets, adjusted for the probability of default occurring and taking account of historical loss experience. In addition, the Group uses reasonable and supportable forecasts of future economic conditions to estimate the ECL allowance. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process which does not impact reliability. The methodology and assumptions are reviewed regularly and updated as necessary.

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

*Collectively assessed:* these assets are assessed and provided for on a group or a pooled basis due to the existence of shared risk characteristics. Financial assets with shared risk characteristics are assessed in the sense that assets with similar characteristics at a given point in time will tend to display a similar PD profile but only for as long as they retain those similar characteristics. In particular, movement between stages will tend to occur when individual assets have deteriorated, rather than because a proportion of a pool is presumed to have deteriorated.

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

It is not possible for an asset to have both an individual and a collectively assessed ECL provision. Regardless of the calculation basis, the Group generates an allowance at the individual financial instrument level.

**Significant increase in credit risk assessment**

The impairment loss allowance is calculated as either a 12-month or lifetime ECL depending on whether the financial asset has exhibited a significant increase in credit risk (SICR) since origination or has otherwise become credit impaired as at the reporting date.

The Group uses a PD threshold curve (distinct for each portfolio) to assess for a SICR and also utilises the 30 days past due and 90 days past due backstops for recognising SICR and credit impairment effectively.

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

**Impairment staging**

Financial assets where a 12-month ECL is recognised are classified as Stage 1; financial assets which are considered to have experienced a SICR are classified as Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are classified as Stage 3. The Group adopts the backstop position that a financial asset has experienced a SICR (and therefore falls into Stage 2) when it reaches 30 days past due, and that a financial asset becomes credit impaired (and therefore falls into Stage 3) when it reaches 90 days past due.

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

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

**Write-offs and recoveries**

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

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

**Critical accounting estimates and judgements**

The use of an ECL methodology under IFRS 9 requires the Group to apply estimates and exercise judgement when calculating an impairment allowance for credit exposures. The most significant of these are detailed below.

# Section 3: Assets and liabilities continued

### 3.2 Impairment provisions on credit exposures continued

**Accounting policy** continued

**Accounting estimates**

*Asset lifetimes*

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

Shortening the Group's credit card portfolio lifetime assumption by three months would equate to an ECL decrease of £1m.

*Economic scenarios*

The Group relies on three economic scenarios over a five-year forecast period when calculating the ECL allowance: base case, mild upside and severe downside. These contain a number of key economic assumptions such as unemployment rates, base rates and inflation, which ensure that non-linear relationships between different forward-looking scenarios and their associated credit losses do not materially impact the ECL calculation. The base case used by the Group for IFRS 9 modelling is also used for the Group's internal planning purposes.

The Group sources forward-looking scenarios and a range of macroeconomic conditions over the forecast period from a third-party provider. The Group considers that the resulting 'mild upside' and 'severe downside' scenarios provide a balance in reaching an ECL calculation that is free from bias and addresses concerns around the potential for non-linearity of the ECL calculation. The Group applied the following weightings to the chosen scenarios:

| | 30 SEPTEMBER 2019 | 1 OCTOBER 2018 |
|---|---|---|
| Mild upside | **20%** | 25% |
| Base case | **60%** | 60% |
| Severe downside | **20%** | 15% |

The scenario weightings are considered and debated by an internal review panel and then recommended and approved for use in the IFRS 9 models by ALCO. The slight increase in the weightings towards the mild upside scenario on adoption of IFRS 9 reflected the relative conservatism in the Group's base case, which was closer to the chosen downside scenario. The weightings applied at 30 September 2019 were revised to reflect a general deterioration in future economic outlook relative to the base case.

The calculation of the Group's impairment provision is sensitive to changes in the chosen weightings, with the effect on the closing impairment allowance of £362m as a result of applying a 100% weighting separately to each scenario producing the following: Base case – an ECL reduction of £11m; Mild upside – an ECL reduction of £27m; and Severe downside – an ECL increase of £65m.

**Accounting judgements**

*Significant increase in credit risk*

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

Indicators of a significant increase in credit risk include deterioration of the residual lifetime PD by set thresholds which are unique to each product portfolio, non-default forbearance programmes, and watch list status. The Group adopts the backstop position that a significant increase in credit risk will have taken place when the financial asset reaches 30 days past due.

Changes to these set thresholds can impact staging, driving accounts into higher stages. If a further 10% of the business population in Stage 1 were to move Stage leading to an increase in ECL held by approximately £13m. In contrast, if a further 10% of the credit card population in Stage 1 were to experience a non-default related forbearance issue and migrate to Stage 2, the level of ECL held would increase by £52m. In mortgages this would increase by £7m. Introducing a PD stress, which increased PDs upwards by 20% for all portfolios, would result in an overall increase in ECLs of £54m.

*Definition of default*

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

*Post Model Adjustments (PMAs)*

The ECL provision is further impacted by management judgements in the form of PMAs, which were also a feature of impairment provisioning under IAS 39. These are judgements that increase the collectively assessed modelled output where management consider that not all of the risks identified in a particular product segment have been, or are capable of being, accurately reflected within those models. This can be the case when modelled inputs are not sufficiently sensitive to sudden changes in economic conditions e.g. Brexit. PMAs can also be applied when assessing potential recoveries on individually assessed provisions where factors such as customer and economic specific conditions need to be considered.

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.2 Impairment provisions on credit exposures continued

**Movement in impairment provisions on credit exposures**

| | 2019 £M | 2018 £M |
|---|---|---|
| Opening balance at 30 September | **195** | 210 |
| IAS 39 restatement | **(195)** | – |
| IFRS 9 adoption | **224** | – |
| Charge for the year | **252** | 41 |
| Amounts written off | **(142)** | (68) |
| Recoveries of amounts written off in previous years | **28** | 13 |
| Other | **–** | (1) |
| **Closing balance** | **362** | 195 |

Following the adoption of IFRS 9 on 1 October 2018, the Group impairment provision is classified by stage allocation as follows:

| | 2019 £M | 2018 £M |
|---|---|---|
| Stage 1 | **79** | – |
| Stage 2 | **168** | – |
| Stage 3 | **118** | – |
| POCI | **(3)** | – |
| | **362** | – |

The transitional stage allocation on adoption date of 1 October 2018 is presented in the Risk management section on page 27.

## Section 3: Assets and liabilities continued

### 3.3 Securitisation and covered bond programmes

**Accounting policy**

The Group sponsors the formation of structured entities, primarily for the purpose of facilitation of asset securitisation and covered bond transactions, the full details of which can be found in note 6.2 to the Company financial statements. The Group has no shareholding in these entities, but is exposed, or has rights, to variable returns and has the ability to affect those returns. The entities are consolidated in the Group's financial statements in accordance with note 1.5.

**Securitisation**

The Group has securitised a portion of its retail mortgage loan portfolio under both master trust (Lanark & Lannraig) and standalone (Gosforth) securitisation programmes. The securitised mortgage loans have been assigned at principal value to bankruptcy remote structured entities. The securitised debt holders have no recourse to the Group other than the principal and interest (including fees) generated from the securitised mortgage loan portfolio.

The externally held securitised notes in issue are included within debt securities in issue (note 3.14). There are a number of notes held internally by the Group which are used as collateral for repurchases and similar transactions or for credit enhancement purposes.

**Covered bond**

A subset of the Group's retail mortgage loan portfolio has been ring-fenced and assigned to bankruptcy remote limited liability partnerships, Clydesdale Covered Bond No 2 LLP and Eagle Place LLP, to provide a guarantee for the obligations payable on the covered bonds issued by the Group.

The covered bond partnerships are consolidated with the mortgage loans retained on the consolidated balance sheet and the covered bonds issued included within debt securities in issue (note 3.14). The covered bond holders have dual recourse: firstly, to the bond issuer on an unsecured basis; and secondly, to the appropriate LLP under the Covered Bond Guarantee secured against the mortgage loans.

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

**Significant restrictions**

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

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

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | LOANS AND ADVANCES SECURITISED £M | NOTES IN ISSUE £M | LOANS AND ADVANCES SECURITISED £M | NOTES IN ISSUE £M |
| **SECURITISATION PROGRAMMES** | | | | |
| Lanark Master Issuer | **5,009** | **4,597** | 5,479 | 4,536 |
| Lannraig Master Issuer | **1,032** | **838** | 933 | 899 |
| Gosforth 2014-1 | **372** | **385** | – | – |
| Gosforth 2015-1 | **707** | **630** | – | – |
| Gosforth 2016-1 | **1,142** | **1,048** | – | – |
| Gosforth 2016-2 | **701** | **579** | – | – |
| Gosforth 2017-1 | **934** | **852** | – | – |
| Gosforth 2018-1 | **1,353** | **1,267** | – | – |
| | **11,250** | **10,196** | 6,412 | 5,435 |
| Less held by the Group | | **(5,154)** | | (2,486) |
| | | **5,042** | | 2,949 |
| **COVERED BOND PROGRAMMES** | | | | |
| Clydesdale Covered Bond No 2 LLP | **1,253** | **776** | 1,389 | 732 |
| Eagle Place LLP | **2,622** | **1,126** | – | – |
| | **3,875** | **1,902** | 1,389 | 732 |

# Section 3: Assets and liabilities continued

### 3.3 Securitisation and covered bond programmes continued

The fair values of financial assets and associated liabilities relating to the securitisation programmes where the counterparty to the liabilities has recourse only to the financial assets were £11,329m and £5,085m respectively (2018: £6,284m and £2,948m).

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

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

**Securitisation programmes**
The Group provides credit support to the structured entities via reserve funds, which are partly funded through subordinated debt arrangements and by holding junior notes. Exposures totalled £100m in subordinated debt (2018: £23m) and £1,722m in junior notes held (2018: £971m). The Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities of £1,467m (2018: £1,074m).

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

**Covered bond programmes**
The nominal level of over-collateralisation was £699m (2018: £860m) in Clydesdale Covered Bond No 2 LLP and £1,490m in Eagle Place LLP. From time-to-time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

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

### 3.4 Cash and balances with central banks

**Accounting policy**

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

| | 2019 £M | 2018 £M |
|---|---|---|
| Cash assets | **1,574** | 1,656 |
| Balances with central banks (including EU payment systems) | **8,722** | 4,917 |
| | **10,296** | 6,573 |
| Less mandatory deposits with central banks[1] | **(183)** | (75) |
| Included in cash and cash equivalents (note 5.2) | **10,113** | 6,498 |

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

# Section 3: Assets and liabilities continued

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

**Accounting policy**

Financial assets and liabilities are designated at fair value through profit or loss, with gains and losses recognised in the income statement as they arise (note 2.3), when this reduces measurement or recognition inconsistencies (e.g. an accounting mismatch) or where the performance is evaluated on a fair value basis in accordance with risk management and investment strategies.

The Group's unlisted securities and other financial assets which were held under IAS 39 as 'available for sale' have been classified as FVTPL on adoption of IFRS 9, with the business model they are held under assessed as neither to hold and collect contractual cash flows nor to hold and collect contractual cash flows and to sell.

| | 2019 £M | 2018 £M |
|---|---|---|
| **FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS** | | |
| Loans and advances | **253** | 362 |
| Other financial assets[1] | **14** | – |
| | **267** | 362 |
| **FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS** | | |
| Customer deposits – term deposits | **4** | 15 |

(1) Included within other financial assets is £8m (2018: £Nil) of unlisted securities.

**Loans and advances**
Included in financial assets at fair value through profit or loss is a historical portfolio of loans (sales ceased in 2012). Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £253m (2018: £362m) including accrued interest receivable of £1m (2018: £2m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £4m (2018: £8m) and the change for the current year is a decrease of £4m (2018: decrease of £3m), of which £2m (2018: £3m) has been recognised in the income statement.

**Other financial assets**
This represents deferred consideration receivable and consists of the rights to future income.

Note 5.4 provides the transitional disclosures for IFRS 9.

Refer to note 3.18 for further information on the valuation methodology applied to financial assets held at fair value through profit or loss and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk management section.

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

The change in fair value attributable to changes in the Group's credit risk is £Nil (2018: £Nil). The Group is contractually obligated to pay £Nil (2018: £0.3m) less than the carrying amount at maturity to the deposit holder.

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.6 Derivative financial instruments

**Accounting policy**

The Group uses derivative financial instruments to manage exposure to interest rate and foreign currency risk. Interest rate risk arises when there is a mismatch between fixed interest rate and floating interest rates, and different repricing characteristics between assets and liabilities. Currency risk arises when assets and liabilities are not denominated in the functional currency of the entity. Derivatives are recognised on the balance sheet at fair value on trade date and are measured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The notional amount of a derivative contract is not recorded on the balance sheet but is disclosed as part of this note.

**Netting**

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

**Hedge accounting**

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

IFRS 9 replaces IAS 39 for annual periods beginning on or after 1 January 2018. The Group has elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39. The method of recognising the fair value gain or loss on a derivative depends on whether it is designated as a hedging instrument and the nature of the item being hedged. Certain derivatives are designated as either hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge); or hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge).

**Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. Specifically, the separate component of equity (note 4.1) is adjusted to the lesser of the cumulative gain or loss on the hedging instrument, and the cumulative change in fair value of the expected future cash flows on the hedged item from the inception of the hedge. Any remaining gain or loss on the hedging instrument is recognised in the income statement. The carrying value of the hedged item is not adjusted. Amounts accumulated in equity are transferred to the income statement in the period in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

**Fair value hedge**

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequently, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. This movement in the fair value of the hedged item is made as an adjustment to the carrying value of the hedged asset or liability.

Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement over the remaining life of the asset or liability.

**Hedge effectiveness**

The Group documents, at the inception of a transaction, the relationship between hedging instruments and the hedged items, and the Group's risk management objective and strategy for undertaking these hedge transactions. The documentation covers how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

**Derivatives held for trading**

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

# Section 3: Assets and liabilities continued

### 3.6 Derivative financial instruments continued

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

| | 2019 £M | 2018 £M |
|---|---|---|
| **FAIR VALUE OF DERIVATIVE FINANCIAL ASSETS** | | |
| Designated as hedging instruments | **315** | 203 |
| Designated as held for trading | **51** | 59 |
| | **366** | 262 |
| **FAIR VALUE OF DERIVATIVE FINANCIAL LIABILITIES** | | |
| Designated as hedging instruments | **191** | 259 |
| Designated as held for trading | **82** | 102 |
| | **273** | 361 |

Cash collateral on derivatives placed with banks totalled £55m (2018: £306m). Cash collateral received on derivatives totalled £149m (2018: £37m). These amounts are included within due from and due to other banks respectively. Collateral placed with clearing houses, which did not meet offsetting criteria, totalled £55m (30 September 2018: £143m) and is included within other assets. Similarly, collateral received from clearing houses is included in other liabilities and totalled £Nil (30 September 2018: £34m).

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

| **Total derivative contracts** | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | NOTIONAL CONTRACT AMOUNT £M | FAIR VALUE OF ASSETS £M | FAIR VALUE OF LIABILITIES £M | NOTIONAL CONTRACT AMOUNT £M | FAIR VALUE OF ASSETS £M | FAIR VALUE OF LIABILITIES £M |
| **DERIVATIVES DESIGNATED AS HEDGING INSTRUMENTS** | | | | | | |
| *Cash flow hedges* | | | | | | |
| Interest rate swaps (gross) | **25,023** | **105** | **121** | 24,570 | 88 | 111 |
| Less: net settled interest rate swaps[1] | **(14,513)** | **(47)** | **(75)** | – | – | – |
| Interest rate swaps (net)[2] | **10,510** | **58** | **46** | 24,570 | 88 | 111 |
| Cross currency swaps[2] | **1,446** | **162** | **–** | 690 | 70 | – |
| | **11,956** | **220** | **46** | 25,260 | 158 | 111 |
| *Fair value hedges* | | | | | | |
| Interest rate swaps (gross) | **25,492** | **146** | **526** | 2,180 | 45 | 148 |
| Less: net settled interest rate swaps[1] | **(23,872)** | **(60)** | **(389)** | – | – | – |
| Interest rate swaps (net)[2] | **1,620** | **86** | **137** | 2,180 | 45 | 148 |
| Cross currency swaps[2] | **808** | **9** | **8** | – | – | – |
| | **2,428** | **95** | **145** | 2,180 | 45 | 148 |
| **Total derivatives designated as hedging instruments** | **14,384** | **315** | **191** | 27,440 | 203 | 259 |
| **Derivatives designated as held for trading** | | | | | | |
| *Foreign exchange rate related contracts* | | | | | | |
| Spot and forward foreign exchange[2] | **728** | **16** | **15** | 1,788 | 26 | 23 |
| Cross currency swaps[2] | **1,123** | **11** | **9** | 455 | 10 | 10 |
| Options[2] | **2** | **–** | **–** | 11 | – | – |
| | **1,853** | **27** | **24** | 2,254 | 36 | 33 |
| *Interest rate related contracts* | | | | | | |
| Interest rate swaps (gross) | **1,159** | **24** | **53** | 811 | 15 | 59 |
| Less: net settled interest rate swaps[1] | **(363)** | **(5)** | **(2)** | – | – | – |
| Interest rate swaps (net)[2] | **796** | **19** | **51** | 811 | 15 | 59 |
| Swaptions[2] | **11** | **–** | **2** | 33 | – | – |
| Options[2] | **465** | **2** | **3** | 501 | 1 | 3 |
| | **1,272** | **21** | **56** | 1,345 | 16 | 62 |
| *Commodity related contracts* | **55** | **2** | **2** | 53 | 7 | 7 |
| *Equity related contracts* | **3** | **1** | **–** | | | |
| **Total derivatives designated as held for trading** | **3,183** | **51** | **82** | 3,652 | 59 | 102 |

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

# Section 3: Assets and liabilities continued

## 3.6 Derivative financial instruments continued

### Hedge accounting

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

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

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

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

### Portfolio fair value hedges

The Group applies macro fair value hedging to its fixed rate mortgages and fixed rate customer deposits. The Group determines hedged items by identifying portfolios of homogeneous loans or deposits based on their contractual maturity and other risk characteristics. Loans or deposits within the identified portfolios are allocated to repricing time buckets based on expected, rather than contractual, repricing dates. The hedging instruments are designated appropriately to those repricing time buckets. Hedge effectiveness is measured on a monthly basis, by comparing fair value movements of the designated proportion of the bucketed loans due to the hedged risk, against the fair value movements of the derivatives, to ensure that they are within an 80% to 125% range.

The aggregated fair value changes in the hedged loans and deposits are recognised on the Group's balance sheet as an asset and liability respectively. At the end of every month, in order to minimise the ineffectiveness from early repayments and accommodate new exposures, the Group voluntarily de-designates the hedge relationships and redesignates them as new hedges. At de-designation, the fair value hedge accounting adjustments are amortised on a straight line basis over the original hedged life. The Group has elected to commence amortisation at the date of de-designation.

### Micro fair value hedges

The Group uses this hedging strategy on GBP and foreign currency denominated fixed rate assets held at fair value through other comprehensive income (or available-for-sale fixed rate assets in the year to 30 September 2018) and GBP and foreign currency denominated fixed rate debt issuances by the Group.

### Portfolio cash flow hedges

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

### Micro cash flow hedges

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

### Hedge ineffectiveness

Hedge ineffectiveness can arise from:

- differences in timing of cash flows of hedged items and hedging instruments;
- changes in expected timings and amounts of forecast future cash flows;
- different interest rate curves applied to discount the hedged items and hedging instruments; and
- derivatives used as hedging instruments having a non-zero fair value at the time of designation.

Additionally, for portfolio fair value hedges of the Group's fixed rate mortgage portfolio, ineffectiveness also arises from the difference between forecast and actual prepayments (prepayment risk).

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.6 Derivative financial instruments continued

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

**30 September 2019**

| | 3 MONTHS OR LESS | 3 TO 12 MONTHS | 1 TO 5 YEARS | TOTAL |
|---|---|---|---|---|
| **CASH FLOW HEDGES** | | | | |
| **Foreign exchange risk** | | | | |
| Cross currency swap | | | | |
| Notional principal (£m) | 107 | 445 | 894 | 1,446 |
| Average GBP/EUR rate | 1.3459 | 1.3423 | 1.3680 | n/a |
| Average GBP/USD rate | 1.3263 | 1.3228 | 1.3089 | n/a |

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

| **30 September 2019** | NOTIONAL CONTRACT AMOUNT £M | CARRYING AMOUNT | | CHANGE IN FAIR VALUE OF HEDGING INSTRUMENT IN THE YEAR USED FOR INEFFECTIVENESS MEASUREMENT[2] £M |
|---|---|---|---|---|
| | | ASSETS £M | LIABILITIES £M | |
| **CASH FLOW HEDGES** | | | | |
| **Interest rate risk** | | | | |
| Interest rate swaps[1] | 25,023 | 105 | (121) | – |
| **Foreign exchange risk** | | | | |
| Cross currency swaps | 1,446 | 162 | – | 59 |
| **Total derivatives designated as cash flow hedges** | 26,469 | 267 | (121) | 59 |
| | | | | |
| **FAIR VALUE HEDGES** | | | | |
| **Interest rate risk** | | | | |
| Interest rate swaps[1] | 25,492 | 146 | (526) | (264) |
| **Foreign exchange and interest rate risk** | | | | |
| Cross currency swaps | 808 | 9 | (8) | 1 |
| **Total derivatives designated as fair value hedges** | 26,300 | 155 | (534) | (263) |

(1) As shown in the total derivatives contracts table on page 69, for centrally cleared derivatives, where the IAS 32 *'Financial Instruments: Presentation'* netting criteria is met, the derivative balances are offset within other assets. For all other derivatives, the derivative balances are presented within derivative financial instruments.

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

# Section 3: Assets and liabilities continued

### 3.6 Derivative financial instruments continued

**Summary of hedged items in designated hedge relationships**

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

| 30 September 2019 | CARRYING AMOUNT OF HEDGED ITEMS | | ACCUMULATED AMOUNT OF FAIR VALUE ADJUSTMENTS ON THE HEDGED ITEM[6] | CHANGE IN FAIR VALUE OF HEDGED ITEM IN THE YEAR USED FOR INEFFECTIVENESS MEASUREMENT | CASH FLOW HEDGE RESERVE | |
|---|---|---|---|---|---|---|
| | ASSETS £M | LIABILITIES £M | £M | £M | CONTINUING HEDGES £M | DISCONTINUED HEDGES £M |
| **CASH FLOW HEDGES** | | | | | | |
| **Interest rate risk** | | | | | | |
| Gross floating rate assets and gross floating rate liabilities[1] | | | | (14) | (15) | (20) |
| **Foreign exchange risk** | | | | | | |
| Floating rate currency issuances[2] | | | | (59) | – | – |
| **Total** | | | | (73) | (15) | (20) |
| | | | | | | |
| **FAIR VALUE HEDGES** | | | | | | |
| **Interest rate risk** | | | | | | |
| Fixed rate mortgages[3] | 16,436 | – | 211 | 209 | | |
| Fixed rate customer deposits[4] | – | (4,769) | (10) | (9) | | |
| Fixed rate FVOCI debt instruments[5] | 2,940 | – | 166 | 133 | | |
| Fixed rate issuances[2] | – | (2,368) | 122 | (92) | | |
| **Foreign exchange and interest rate risk** | | | | | | |
| Fixed rate currency FVOCI debt instruments[5] | 82 | – | 3 | 4 | | |
| Fixed rate currency issuances[2] | – | (530) | 1 | (4) | | |
| **Total** | 19,458 | (7,667) | 493 | 241 | | |

(1) Future highly probable cash flows arising from loans and advances to customers, due to customers and debt securities in issue.
(2) Hedged item is recorded in debt securities in issue.
(3) Hedged item and the cumulative fair value changes, are recorded in loans and advances to customers.
(4) Hedged item and the cumulative fair value changes, are recorded in due to customers.
(5) Hedged item is recorded in financial assets at fair value through other comprehensive income.
(6) Includes cumulative unamortised fair value hedge adjustments relating to hedges that have been discontinued and are being amortised to the income statement over the remaining life of the asset or liability.

# Section 3: Assets and liabilities continued

### 3.6 Derivative financial instruments continued

| Gains and losses from hedge accounting<br>30 September 2019 | HEDGE INEFFECTIVENESS RECOGNISED IN INCOME STATEMENT[1] £M | EFFECTIVE PORTION RECOGNISED IN OTHER COMPREHENSIVE INCOME £M | RECLASSIFIED INTO INCOME STATEMENT AS NET INTEREST INCOME £M | RECLASSIFIED INTO INCOME STATEMENT AS NON-INTEREST INCOME £M |
|---|---|---|---|---|
| **CASH FLOW HEDGES** | | | | |
| **Interest rate risk** | | | | |
| Gross floating rate assets and gross floating rate liabilities | (14) | 14 | – | – |
| **Foreign exchange risk** | | | | |
| Floating rate currency issuances | – | 59 | – | (57) |
| **Total (losses)/gains on cash flow hedges** | (14) | 73 | – | (57) |
| **FAIR VALUE HEDGES** | | | | |
| **Interest rate risk** | | | | |
| Fixed rate mortgages | (24) | | | |
| Fixed rate customer deposits | 4 | | | |
| Fixed rate FVOCI debt instruments | (2) | | | |
| Fixed rate issuances | (1) | | | |
| **Foreign exchange and interest rate risk** | | | | |
| Fixed rate currency FVOCI debt instruments | – | | | |
| Fixed rate currency issuances | 1 | | | |
| **Total losses on fair value hedges** | (22) | | | |

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

The ineffectiveness arising from cash flow and fair value hedges was:

| | 2019 £M | 2018 £M |
|---|---|---|
| Loss arising from cash flow hedges | | |
| Loss from cash flow hedges due to hedge ineffectiveness | **(14)** | (6) |
| | **(14)** | (6) |
| (Loss)/gain arising from fair value hedges | | |
| Hedging instrument | **(263)** | 14 |
| Hedged item attributable to the hedged risk | **241** | (14) |
| | **(22)** | – |
| Ineffectiveness arising from cash flow and fair value hedges | **(36)** | (6) |

Below is a schedule indicating, as at 30 September 2018, the periods when the hedged cash flows are expected to occur and when they are expected to affect profit or loss:

| | FORECAST RECEIVABLE CASH FLOWS 2018 £M | FORECAST PAYABLE CASH FLOWS 2018 £M |
|---|---|---|
| Within 1 year | 109 | 283 |
| Between 1 and 2 years | 130 | 366 |
| Between 2 and 3 years | 108 | 160 |
| Between 3 and 4 years | 63 | 5 |
| Between 4 and 5 years | 37 | 3 |
| Greater than 5 years | 60 | 10 |
| | 507 | 827 |

# Section 3: Assets and liabilities continued

### 3.7 Financial assets at fair value through other comprehensive income

**Accounting policy**

Fair value through other comprehensive income (FVOCI) is a new financial asset classification category introduced by IFRS 9 'Financial Instruments'. As permitted by IFRS 9, the Group has not restated its comparative financial statements, consequently no comparative is presented as at 30 September 2018. The Group's listed securities previously classified as 'available for sale' under IAS 39 (note 3.8) have been assessed as meeting the criteria to be classified as FVOCI.

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

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

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

| | 2019 £M | 2018 £M |
|---|---|---|
| Listed securities | **4,328** | – |
| Total financial assets at fair value through other comprehensive income | **4,328** | – |

Refer to note 3.18 for further information on the valuation methodology applied to financial assets at FVOCI at 30 September 2019 and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk management section.

Note 5.4 provides the transitional disclosures for IFRS 9.

### 3.8 Financial assets available for sale

**Accounting policy**

The available for sale classification category for financial assets ceased to apply from 1 October 2018 on the adoption of IFRS 9.

The Group's listed securities have been assessed as meeting the criteria to be classified as fair value through other comprehensive income under IFRS 9 (note 3.7). Unlisted securities and other financial assets have been classified as fair value through profit or loss (note 3.5).

| | 2019 £M | 2018 £M |
|---|---|---|
| Listed securities | **–** | 1,551 |
| Unlisted securities | **–** | 5 |
| Other financial assets | **–** | 6 |
| Total financial assets available for sale | **–** | 1,562 |

Refer to note 3.18 for further information on the valuation methodology applied to financial assets available for sale at 30 September 2018 and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk management section.

Note 5.4 provides the transitional disclosures for IFRS 9.

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.9 Property, plant and equipment

**Accounting policy**

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by the Directors, taking account of advice received from independent valuers. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors, including adjustments to observable market inputs reflecting any specific characteristics of the land and buildings. Directors' valuations are performed annually in July, with the independent valuations carried out on a three-year cycle on an open market basis.

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

With the exception of freehold and long-term leasehold land, all items of property, plant and equipment are depreciated or amortised using the straight line method, at rates appropriate to their estimated useful life to the Group. The annual rates of depreciation or amortisation are:

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

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

| | FREEHOLD LAND AND BUILDINGS £M | LONG-TERM LEASEHOLD LAND AND BUILDINGS £M | BUILDING IMPROVEMENTS £M | FIXTURES AND EQUIPMENT £M | TOTAL £M |
|---|---|---|---|---|---|
| **COST OR VALUATION** | | | | | |
| At 1 October 2017 | 5 | 3 | 143 | 102 | 253 |
| Additions | – | – | 9 | 13 | 22 |
| Disposals | (2) | – | (3) | (1) | (6) |
| At 30 September 2018 | 3 | 3 | 149 | 114 | 269 |
| Acquisition of Virgin Money Holdings (UK) PLC | 36 | 3 | 11 | 15 | 65 |
| Additions | – | – | 12 | 8 | 20 |
| Disposals | (1) | – | (4) | – | (5) |
| **At 30 September 2019** | **38** | **6** | **168** | **137** | **349** |
| **ACCUMULATED DEPRECIATION** | | | | | |
| At 1 October 2017 | 1 | – | 88 | 78 | 167 |
| Charge for the year | – | – | 10 | 8 | 18 |
| Disposals | – | – | (3) | (1) | (4) |
| At 30 September 2018 | 1 | – | 95 | 85 | 181 |
| Charge for the year (note 2.4) | 3 | – | 11 | 11 | 25 |
| Disposals | – | – | (2) | – | (2) |
| **At 30 September 2019** | **4** | **–** | **104** | **96** | **204** |
| Net book value | | | | | |
| **At 30 September 2019** | **34** | **6** | **64** | **41** | **145** |
| At 30 September 2018 | 2 | 3 | 54 | 29 | 88 |

**Valuations**

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

| | 2019 £M | 2018 £M |
|---|---|---|
| Carrying value as included under the revaluation basis | **40** | 5 |
| Carrying value if the historical cost basis had been used | **40** | 5 |

# Section 3: Assets and liabilities continued

### 3.10 Intangible assets and goodwill

**Accounting policy**

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

Identifiable and directly associated external and internal costs of acquiring and developing software are capitalised where the software is controlled by the Group, and where it is probable that future economic benefits that exceed its cost will flow from its use over more than one year. Costs associated with maintaining software are recognised as an expense as incurred. Capitalised software costs are amortised on a straight line basis over their expected useful lives, usually between three and ten years. Impairment losses are recognised in the income statement as incurred.

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

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, which typically arises when the benefits associated with the software were substantially reduced from what had originally been anticipated or the asset has been superseded by a subsequent investment. In such situations, an impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the higher of its fair value less costs of disposal or its value in use.

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

| | CAPITALISED SOFTWARE £M | GOODWILL £M | CORE DEPOSIT INTANGIBLE £M | TOTAL £M |
|---|---|---|---|---|
| **COST** | | | | |
| At 1 October 2017 | 589 | – | – | 589 |
| Additions | 144 | – | – | 144 |
| **At 30 September 2018** | 733 | – | – | 733 |
| Acquisition of Virgin Money Holdings (UK) PLC | 172 | 11 | 6 | 189 |
| Additions | 130 | – | – | 130 |
| Write-off | (85) | – | – | (85) |
| **At 30 September 2019** | **950** | **11** | **6** | **967** |
| **ACCUMULATED AMORTISATION** | | | | |
| At 1 October 2017 | 250 | – | – | 250 |
| Charge for the year | 71 | – | – | 71 |
| **At 30 September 2018** | 321 | – | – | 321 |
| Charge for the year (note 2.4) | 82 | – | 1 | 83 |
| Impairment (note 2.4) | 115 | – | – | 115 |
| Write-off | (68) | – | – | (68) |
| **At 30 September 2019** | **450** | – | **1** | **451** |
| **NET BOOK VALUE** | | | | |
| **At 30 September 2019** | **500** | **11** | **5** | **516** |
| At 30 September 2018 | 412 | – | – | 412 |

£31m (2018: £1m) of the £130m (2018: £144m) software additions do not form part of internally generated software projects.

A £127m charge (comprising impairment of £115m and write-offs with a net book value of £12m) was recognised in the year following a review of the Group's software estate following the acquisition of Virgin Money Holdings (UK) PLC, which identified a number of core assets (including £70m in relation to the Virgin Money Digital Bank asset) that are no longer of value to the Group's future strategy and therefore required to be written down (note 2.4).

# Section 3: Assets and liabilities continued

### 3.11 Deferred tax

**Accounting policy**

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. A deferred tax asset is recognised for unused tax losses and unused tax credits only if it is probable that future taxable amounts will arise against which those temporary differences and losses may be utilised.

**Critical accounting estimates and judgements**

The Group has deferred tax assets of £322m (2018: £206m), the principal components of which are tax losses, capital allowances and acquisition accounting adjustments.

Tax losses carried forward of £146m (2018: £99m) have increased due to the recognition of historic losses and a re-evaluation of the rate at which they are expected to unwind.

The Group has assessed the recoverability of these deferred tax assets at 30 September 2019 and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised over the corporate planning horizon.

At 30 September 2019, the Group had an unrecognised deferred tax asset of £114m (2018: £157m) representing trading losses with a gross value of £668m (2018: £926m). Although there is no prescribed period after which losses expire, a deferred tax asset has not been recognised in respect of these losses as the Directors have insufficient certainty over their recoverability in the foreseeable future.

**Movement in net deferred tax asset**

| | 2019<br>£M | 2018<br>£M |
|---|---|---|
| At 30 September | **129** | 79 |
| IFRS 9 adjustment recognised in equity (note 5.4) | **7** | – |
| At 1 October | **136** | 79 |
| Recognised in the income statement (note 2.5) | **53** | 35 |
| Recognised directly in equity | **(68)** | 15 |
| **At 30 September** | **121** | 129 |

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.11 Deferred tax continued

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

| | 2019 £M | 2018 £M |
|---|---|---|
| **DEFERRED TAX ASSETS** | | |
| Tax losses carried forward | **146** | 99 |
| Capital allowances | **91** | 88 |
| Cash flow hedge reserve | **3** | 12 |
| Acquisition accounting adjustments | **44** | – |
| Transitional adjustment – IFRS 9 | **16** | – |
| Transitional adjustment – available for sale reserve | **1** | 1 |
| Employee equity based compensation | **5** | 3 |
| Unamortised issue costs | **4** | – |
| Pension spreading | **11** | – |
| Other | **1** | 3 |
| | **322** | 206 |
| **DEFERRED TAX LIABILITIES** | | |
| Defined benefit pension scheme surplus | **(139)** | (74) |
| Acquisition accounting adjustments | **(51)** | – |
| Gains on unlisted financial instruments at fair value through other comprehensive income | **(6)** | (3) |
| Intangible assets | **(4)** | – |
| Other | **(1)** | – |
| | **(201)** | (77) |
| **Net deferred tax asset** | **121** | 129 |

Payments to the pension scheme were greater than 210% of 2018 contributions and therefore in accordance with the legislation, tax relief is spread over four years giving rise to the pension spreading deferred tax asset of £11m. The current and deferred tax impact of pension contributions, and pension spreading, are reflected in the consolidated statement of comprehensive income.

The accounting adjustments relating to the acquisition of Virgin Money Holdings (UK) PLC (note 3.19) resulted in a net deferred tax liability of £22m on the date of acquisition, which has subsequently unwound in line with the related unwind of the fair value adjustments to a net deferred tax liability of £7m at 30 September 2019. The constituent parts of the net liability have been shown as deferred tax assets of £44m and deferred tax liabilities of £51m as they are not expected to unwind at the same time.

In accordance with legislation, the tax relief on the IFRS 9 opening adjustment (note 5.4) is spread evenly over 10 years and will unwind through entity corporation tax computations across the Group. The IFRS 9 deferred tax asset balance of £16m represents the combination of the Group's transitional position as presented in note 5.4 and the IFRS 9 transitional element remaining of the Virgin Money Holdings (UK) PLC adoption of IFRS 9 on 1 January 2018.

The European Securities and Markets Authority (ESMA) issued a Public Statement relating to IAS 12 'Income Taxes' in July 2019. The publication covered considerations on the recognition of deferred tax assets arising from the carry-forward of unused tax losses. As the Group's deferred tax asset, including the element relating to tax losses carried forward, is material, the Group has assessed the content of the ESMA Public Statement and will look to incorporate any potential further disclosure requirements arising from the statement in the financial statements in future reporting periods.

# Section 3: Assets and liabilities continued

## 3.12 Retirement benefit obligations

### Accounting policy

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

**Defined contribution pension scheme**
The Group recognises its obligation to make contributions to the scheme as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

**Defined benefit pension scheme**
A liability or asset is recognised on the balance sheet in respect of the defined benefit scheme and is measured as the difference between the present value of the defined benefit obligation less the fair value of the defined benefit scheme assets at the reporting date. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the defined benefit obligation. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the scheme. In assessing whether a surplus is recoverable, the Group considers its current right to obtain a refund or a reduction in future contributions and does not anticipate any future acts by other parties that could change the amount of the surplus that may be ultimately recovered.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, net interest on the net defined benefit obligation/asset, past service cost resulting from a scheme amendment or curtailment, gains or losses on settlement and administrative costs incurred. Where actuarial remeasurements arise, the Group recognises such amounts directly in equity through the statement of comprehensive income in the period in which they occur. Actuarial remeasurements arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in actuarial assumptions.

The following table summarises the present value of the defined benefit obligation and fair value of plan assets for the Scheme as at 30 September:

| | 2019 £M | 2018 £M |
|---|---|---|
| Active members' defined benefit obligation | **(30)** | (24) |
| Deferred members' defined benefit obligation | **(2,537)** | (2,131) |
| Pensioner and dependant members' defined benefit obligations | **(1,744)** | (1,591) |
| Total defined benefit obligation | **(4,311)** | (3,746) |
| Fair value of Scheme assets | **4,707** | 3,958 |
| **Net defined benefit pension asset** | **396** | 212 |
| **Post-retirement medical benefits obligations[1]** | **(3)** | (3) |

(1) Post-retirement medical benefits obligations are included within other liabilities (note 3.17).

**The Group's pension arrangements**
The Group operates both defined benefit and defined contribution arrangements. The Group's principal trading subsidiary, Clydesdale Bank PLC, is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). The current version of the Scheme was established under trust on 30 September 2009 with the assets held in a trustee administered fund. The Trustee is responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

The Scheme is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, sets out the framework for funding defined benefit occupational pension plans in the UK.

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

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependant relatives for which provision has been made on a basis consistent with the methodology applied to the defined benefit pension scheme. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. The obligation in respect of this scheme was £3m at 30 September 2019 (2018: £3m) and is included within other liabilities in note 3.17.

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

**3.12 Retirement benefit obligations** continued

**Scheme valuations**

There are a number of means of measuring liabilities in the defined benefit schemes, with the ultimate aim of the Trustee being that the Scheme is 100% funded on an agreed self-sufficiency basis(1). The two bases used by the Group to value its obligations are (i) an IAS 19 accounting basis; and (ii) a Trustee's Technical Provision basis.

*(i) IAS 19 accounting basis*

The valuations of the Scheme assets and obligations are calculated on an accounting basis in accordance with the applicable accounting standard IAS 19 which provides the basis for the accounting framework and methodology for entries in the income statement, balance sheet and capital reporting. The principal purpose of this valuation is to allow comparison of pension obligations between companies. The obligation under an accounting valuation can be higher or lower than those under a Trustee's Technical Provision valuation.

The rate used to discount the obligation on an IAS 19 basis is a key driver of any potential volatility and is based on yields on AA rated high-quality corporate bonds, regardless of how the Trustee of the Scheme invests the assets. The accounting valuation under IAS 19 can therefore move adversely because of low rates and narrowing credit spreads which are not fully matched by the Scheme assets. Inflation is another key source of volatility and arises as a result of member benefits having an element of index linking, which causes the obligation to increase in line with rises in long-term inflation assumptions. In practice however, over the long term, the relationship between interest and inflation rates tends to be negatively correlated resulting in a degree of risk offset.

*(ii) Trustee's Technical Provision basis*

This valuation basis reflects how much money the Trustee considers is required now in order to provide for the promised benefits as they come up for payment in the future. The Trustee is responsible for ensuring that the calculation is conducted prudently on an actuarial basis, taking into account factors including the Scheme's investment strategy and the relative financial strength of the sponsoring employer.

A key aspect of this valuation is the investment strategy the Trustee proposes to follow as part of the policy for meeting the Scheme's obligations. Because there are no guarantees about investment returns over long periods, legislation requires the Trustee to consider carefully how much of their expected future investment returns it would be prudent for them to account for in advance.

The last Scheme funding valuation was conducted in accordance with Scheme data and market conditions as at 30 September 2016 and resulted in a reported deficit of £290m(2). The Group agreed to eliminate this deficit through making contributions as agreed in the recovery plan dated 31 July 2017 and a revised schedule of contributions dated 31 January 2018. The following scheduled contributions of £184m remain to be made over the period to March 2023:

- equal monthly contributions totalling £50m per annum until 31 March 2022; and
- £55m in the year to 31 March 2023.

The next triennial funding valuation is currently in progress and will be calculated with reference to the Scheme data and market conditions as at 30 September 2019. The Group expects this valuation to be agreed with the Trustee of the Scheme by the end of 2020.

Scheme assets are not subject to the same valuation differences as Scheme obligations and are consistently valued at current market value.

(1) This is where the Scheme is essentially self-funded and does not need to call on the Group for any additional funding.

(2) The IAS 19 valuation as at 30 September 2016 reported a Scheme deficit of £75m.

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.12 Retirement benefit obligations continued

**IAS 19 position**
The Scheme movements in the year are as follows:

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | PRESENT VALUE OF OBLIGATION £M | FAIR VALUE OF PLAN ASSETS £M | TOTAL £M | CUMULATIVE LOSS IN OCI £M | PRESENT VALUE OF OBLIGATION £M | FAIR VALUE OF PLAN ASSETS £M | TOTAL £M | CUMULATIVE LOSS IN OCI £M |
| **Balance sheet surplus at 1 October** | (3,746) | 3,958 | 212 | | (3,974) | 4,181 | 207 | |
| | | | | (704) | | | | (695) |
| **TOTAL EXPENSE** | | | | | | | | |
| Current service cost | – | – | – | | (1) | – | (1) | |
| Past service cost | (11) | – | (11) | | (2) | – | (2) | |
| Interest (expense)/income | (100) | 107 | 7 | | (104) | 109 | 5 | |
| Administrative costs | – | (5) | (5) | | – | (6) | (6) | |
| **Total (expense)/income recognised in the consolidated income statement** | (111) | 102 | (9) | | (107) | 103 | (4) | |
| **REMEASUREMENTS** | | | | | | | | |
| Return on Scheme assets greater than discount rate | – | 772 | 772 | 772 | – | 27 | 27 | 27 |
| *Actuarial:* | | | | | | | | |
| Loss – experience adjustments | (9) | – | (9) | (9) | (35) | – | (35) | (35) |
| Gain – demographic assumptions | 30 | – | 30 | 30 | 19 | – | 19 | 19 |
| Loss – financial assumptions | (683) | – | (683) | (683) | (20) | – | (20) | (20) |
| **Remeasurement (losses)/gains recognised in other comprehensive income** | (662) | 772 | 110 | 110 | (36) | 27 | (9) | (9) |
| **CONTRIBUTIONS AND PAYMENTS** | | | | | | | | |
| Employer contributions | – | 83 | 83 | | – | 18 | 18 | |
| Benefit payments | 96 | (96) | – | | 93 | (93) | – | |
| Transfer payments | 112 | (112) | – | | 278 | (278) | – | |
| | 208 | (125) | 83 | | 371 | (353) | 18 | |
| **Balance sheet surplus at 30 September** | (4,311) | 4,707 | 396 | | (3,746) | 3,958 | 212 | |
| | | | | (594) | | | | (704) |

The past service cost included within the income statement charge for the current year of £11m relates to GMP equalisation, which is detailed further below. In the prior year, the Group incurred a past service cost of £2m in relation to enhanced early retirement entitlements on redundancy, which was fully offset in the income statement by a corresponding release from the restructuring provision.

The expected contributions and benefit payments for the year ending 30 September 2020 are £56m (2019: £77m) and £108m (2019: £98m) respectively.

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

**GMP equalisation**
On 26 October 2018, the High Court handed down a judgement concluding that defined benefit schemes should equalise pension benefits for men and women in relation to GMP and concluded on the methods that were appropriate. The estimated increase in the Scheme obligations at the date of the judgement was £11m which is based on a number of assumptions, therefore the actual impact may be different. An allowance for GMP equalisation has been reflected in the income statement and in the closing net accounting surplus of the Scheme.

# Section 3: Assets and liabilities continued

### 3.12 Retirement benefit obligations continued

**Maturity of Scheme liabilities**
The estimated maturity period of Scheme obligations on an IAS 19 accounting basis is provided within the Group annual report and accounts.

The discounted mean term of the defined benefit obligation at 30 September 2019 is 20 years (2018: 19 years).

**Scheme assets**
In order to meet the obligations of the Scheme, the Trustee invests in a diverse portfolio of assets, with the level and volatility of asset returns being a key factor in the overall investment strategy. The investment portfolio is subject also to a range of risks typical of the types of assets held, such as: equity risk; credit risk on bonds; currency risk; interest rate and inflation risk; and exposure to the property market. The Trustee's investment strategy (including physical assets and derivatives) seeks to reduce the Scheme's exposure to these risks. In managing interest rate and inflation risks, the investment strategy seeks to hold portfolios of matching assets (including derivatives) that enable the Scheme's assets to better match movements in the value of liabilities due to changes in interest rates and inflation.

As at 30 September 2019, both the interest rate and inflation rate hedge ratios were around 85% and 75% respectively (2018: 81% and 71%) of the obligation when measured on a self-sufficiency basis. This strategy reflects the Scheme's obligation profile and the Trustee's and the Group's attitude to risk. The Trustee monitors the investment objectives and asset allocation policy on a regular basis.

The Trustee's investment strategy involves two main categories of investments:

- matching assets – a range of investments that provide a match to changes in obligation values; and
- return seeking assets – a range of investments designed to provide specific, planned and consistent returns.

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

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | QUOTED £M | UNQUOTED £M | TOTAL £M | % | QUOTED[3] £M | UNQUOTED[3] £M | TOTAL £M | % |
| **BONDS** | | | | | | | | |
| Fixed government | **569** | **–** | **569** | | 478 | – | 478 | |
| Index linked government | **1,757** | **–** | **1,757** | | 1,539 | – | 1,539 | |
| Global sovereign | **20** | **1** | **21** | | 23 | 1 | 24 | |
| Corporate and other | **531** | **305** | **836** | | 412 | 294 | 706 | |
| | **2,877** | **306** | **3,183** | **68%** | 2,452 | 295 | 2,747 | 70% |
| **EQUITIES[1]** | | | | | | | | |
| Global equities | **–** | **503** | **503** | | – | 555 | 555 | |
| Emerging market equities | **–** | **50** | **50** | | – | 58 | 58 | |
| UK equities | **–** | **32** | **32** | | – | 37 | 37 | |
| | **–** | **585** | **585** | **12%** | – | 650 | 650 | 16% |
| **OTHER** | | | | | | | | |
| Secured income alternatives | **–** | **358** | **358** | | – | 336 | 336 | |
| Derivatives[2] | **–** | **219** | **219** | | – | 172 | 172 | |
| Repurchase agreements | **–** | **(534)** | **(534)** | | – | (836) | (836) | |
| Property | **–** | **129** | **129** | | – | 132 | 132 | |
| Alternative credit | **–** | **409** | **409** | | – | 260 | 260 | |
| Infrastructure | **–** | **352** | **352** | | – | 255 | 255 | |
| Cash | **–** | **1** | **1** | | – | 238 | 238 | |
| Equity options | **5** | **–** | **5** | | 4 | – | 4 | |
| | **5** | **934** | **939** | **20%** | 4 | 557 | 561 | 14% |
| **Total Scheme assets** | **2,882** | **1,825** | **4,707** | **100%** | 2,456 | 1,502 | 3,958 | 100% |

(1) Equity investments are classified as unquoted reflecting the nature of the funds in which the Scheme invests directly. The underlying investments within those funds are, however, mostly quoted.

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

(3) The split of plan assets between quoted and unquoted in the prior year has been restated to reflect their nature.

At 30 September 2019, the Scheme had employer-related investments within the meaning of Section 40 (2) of the Pensions Act 1995 totalling £2m (2018: nil).

# Section 3: Assets and liabilities continued

### 3.12 Retirement benefit obligations continued

**Actuarial assumptions**

The following assumptions were used in arriving at the IAS 19 defined benefit obligation:

| | 2019 % P.A. | 2018 % P.A. |
|---|---|---|
| **FINANCIAL ASSUMPTIONS** | | |
| Discount rate | **1.77** | 2.75 |
| Inflation (RPI) | **3.20** | 3.30 |
| Inflation (CPI) | **2.20** | 2.30 |
| Career average revalued earnings (CARE) revaluations: | | |
| Pre 31 March 2012 benefits (RPI) | **3.20** | 3.30 |
| Post 31 March 2012 benefits (CPI capped at 5% per annum) | **2.20** | 2.30 |
| Pension increases (capped at 2.5% per annum) | **2.10** | 2.13 |
| Pension increases (capped at 5% per annum) | **3.07** | 3.15 |
| Rate of increase for pensions in deferment | **2.20** | 2.30 |

**Demographic assumptions**

| | 2019 YEARS | 2018 YEARS |
|---|---|---|
| **POST-RETIREMENT MORTALITY:** | | |
| Current pensioners at 60 – male | **28.0** | 28.2 |
| Current pensioners at 60 – female | **29.6** | 29.8 |
| Future pensioners at 60 – male | **29.1** | 29.3 |
| Future pensioners at 60 – female | **30.8** | 31.0 |

**Critical accounting estimates and judgements**

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

*discount rate applied:* this is set with reference to market yields at the end of the reporting period on high quality corporate bonds in the currency and with a term consistent with the Scheme's obligations. The average duration of the Scheme's obligations is approximately 20 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate;

*inflation assumptions:* this is set with reference to market expectations of the RPI measure of inflation for a term consistent with the Scheme's obligations, based on data published by the BoE. Other measures of inflation (such as CPI, or inflation measures subject to an annual cap) are derived from this assumption; and

*mortality assumptions:* the cost of the benefits payable by the Scheme will also depend upon the life expectancy of the members. The assumptions for mortality rates are based on standard mortality tables (as adjusted to reflect the characteristics of Scheme members) which allow for future improvements in life expectancies.

The table below sets out the sensitivity and impact on the balance sheet surplus position of the Scheme, the defined benefit obligation and pension cost to changes in the key actuarial assumptions:

| Assumption change | | Balance sheet surplus £m | Obligation £m | Pension cost £m |
|---|---|---|---|---|
| **Discount rate** | + 0.25% | **(6)** | **(205)** | **(5)** |
| | - 0.25% | **8** | **220** | **4** |
| **Inflation** | + 0.25% | **(9)** | **145** | **3** |
| | - 0.25% | **(9)** | **(137)** | **(2)** |
| **Life expectancy** | +1 year | **(169)** | **169** | **3** |
| | -1 year | **164** | **(164)** | **(3)** |

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, changes in some of the assumptions may be correlated.

# Section 3: Assets and liabilities continued

### 3.13 Customer deposits

| | 2019 £M | 2018 £M |
|---|---|---|
| Interest bearing demand deposits | **38,551** | 19,895 |
| Term deposits | **22,239** | 6,192 |
| Non-interest bearing demand deposits | **3,002** | 2,756 |
| Other wholesale deposits | **1** | 1 |
| | **63,793** | 28,844 |
| Accrued interest payable | **207** | 60 |
| | **64,000** | 28,904 |

### 3.14 Debt securities in issue

**Accounting policy**

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

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

The breakdown of debt securities in issue is shown below:

| 2019 | MEDIUM-TERM NOTES £M | SUBORDINATED DEBT £M | SECURITISATION £M | COVERED BONDS £M | TOTAL £M |
|---|---|---|---|---|---|
| Carrying value | **1,838** | **722** | **5,040** | **1,828** | **9,428** |
| Fair value hedge adjustments | **47** | **–** | **2** | **74** | **123** |
| Total debt securities | **1,885** | **722** | **5,042** | **1,902** | **9,551** |
| Accrued interest payable | **12** | **9** | **9** | **10** | **40** |
| | **1,897** | **731** | **5,051** | **1,912** | **9,591** |

| 2018 | MEDIUM-TERM NOTES £M | SUBORDINATED DEBT £M | SECURITISATION £M | COVERED BONDS £M | TOTAL £M |
|---|---|---|---|---|---|
| Carrying value | 794 | 476 | 2,949 | 698 | 4,917 |
| Fair value hedge adjustments | (1) | – | – | 34 | 33 |
| Total debt securities | 793 | 476 | 2,949 | 732 | 4,950 |
| Accrued interest payable | 3 | 3 | 7 | 10 | 23 |
| | 796 | 479 | 2,956 | 742 | 4,973 |

The acquisition of Virgin Money Holdings (UK) PLC on 15 October 2018 resulted in recognition of the following debt securities (excluding accrued interest), which are included within the above balances as at 30 September 2019:

| | MEDIUM-TERM NOTES £M | SUBORDINATED DEBT £M | SECURITISATION £M | COVERED BONDS £M | TOTAL £M |
|---|---|---|---|---|---|
| Fair value of acquired balances | 647 | – | 2,909 | – | 3,556 |

# Section 3: Assets and liabilities continued

### 3.14 Debt securities in issue continued

The following tables provide a breakdown of the medium-term notes and subordinated debt by instrument as at 30 September:

**Medium-term notes (excluding accrued interest)**

| | 2019 £M | 2018 £M |
|---|---|---|
| CYBG 3.125% fixed-to-floating rate callable senior notes due 2025 | **298** | 298 |
| CYBG 4% fixed rate reset callable senior notes due 2026 | **523** | 495 |
| CYBG 3.375% fixed rate reset callable senior notes due 2025 | **366** | – |
| CYBG 4% fixed rate reset callable senior notes due 2027 | **397** | – |
| VM PLC 2.25% fixed rate senior notes due 2020 | **301** | – |
| | **1,885** | 793 |

**Subordinated debt (excluding accrued interest)**

| | 2019 £M | 2018 £M |
|---|---|---|
| CYBG 5% fixed rate reset callable subordinated notes due 2026 | **476** | 476 |
| CYBG 7.875% fixed rate reset callable subordinated notes due 2028 | **246** | – |
| | **722** | 476 |

Details of securitisation and covered bond issuances are included in note 3.3.

During the year, the Group issued £400m of medium-term notes and £250m of subordinated notes. The Group also issued £1,102m in Sterling and US Dollar denominations and redeemed £769m in Sterling denominations from the securitisation programmes, and issued £1,132m in Sterling and Euro denominations from the Eagle Place covered bond programme.

### 3.15 Due to other banks

**Accounting policy**

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

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

| | 2019 £M | 2018[1] £M |
|---|---|---|
| Secured loans | **7,308** | 2,254 |
| Securities sold under agreements to repurchase[2] | **1,554** | 802 |
| Transaction balances with other banks | **12** | 29 |
| Deposits from other banks | **42** | 3 |
| | **8,916** | 3,088 |

(1) The prior year comparative has been restated in line with the current year presentation. £34m of derivative collateral in relation to clearing houses has been reclassified between other liabilities and due to other banks (note 1.10).
(2) The underlying securities sold under agreements to repurchase have a carrying value of £2,324m (2018: £1,172m).

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

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.16 Provisions for liabilities and charges

**Accounting policy**

Provisions for liabilities and charges are recognised when a legal or constructive obligation exists as a result of past events, it is probable that an outflow of economic benefits will be necessary to settle the obligation, and the obligation can be reliably estimated. Provisions for liabilities and charges are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

**Critical accounting estimates and judgements**

*PPI redress provision and other conduct related matters*

With the FCA's deadline on PPI complaints now passed the level of uncertainty in determining the quantum of PPI related liability has reduced. However, owing to the significant volumes received in the weeks preceding the time bar there continues to be significant judgement required to determine the key assumptions used to estimate the quantum of the provision, including the level of conversion rate if information requests convert into complaints, uphold rates (how many claims are, or may be, upheld in the customer's favour), and redress costs (the average payment made to customers). The provision, therefore, continues to be subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2019, consequently the provision calculated may be subject to change in the future if outcomes differ to those currently assumed. Sensitivity analysis indicating the impact of reasonably possible changes in key assumptions on the PPI provision is presented within this note.

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

| | 2019<br>£M | 2018<br>£M |
|---|---|---|
| **PPI REDRESS PROVISION** | | |
| Opening balance | **275** | 422 |
| Charge to the income statement (note 2.4) | **415** | 352 |
| Charge reimbursed under Conduct Indemnity | **–** | 148 |
| Utilised | **(311)** | (647) |
| Closing balance | **379** | 275 |
| **CUSTOMER REDRESS AND OTHER PROVISIONS** | | |
| Opening balance | **41** | 109 |
| Virgin Money Holdings (UK) PLC provision on acquisition | **11** | – |
| Charge to the income statement (note 2.4) | **18** | 44 |
| Utilised | **(45)** | (112) |
| Closing balance | **25** | 41 |
| **RESTRUCTURING PROVISION** | | |
| Opening balance | **15** | 23 |
| Virgin Money Holdings (UK) PLC provision on acquisition | **2** | – |
| Charge to the income statement | **64** | 15 |
| Utilised | **(26)** | (23) |
| Closing balance | **55** | 15 |
| **Total provisions for liabilities and charges** | **459** | 331 |

# Notes to the consolidated financial statements

## Section 3: Assets and liabilities continued

### 3.16 Provisions for liabilities and charges continued

**PPI redress**

In common with the wider UK retail banking sector, the Group has continued to deal with complaints and redress issues arising out of historic sales of PPI. During the year, the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £415m was required due to the significant volume of information requests received, mainly from claims management companies ahead of the August 2019 industry deadline. It also incorporates a reassessment of the costs of processing cases and the impact of experience adjustments. The total provision raised to date in respect of PPI is £3,055m (30 September 2018: £2,640m), with £379m of this remaining (30 September 2018: £275m) for closing out the remaining stock of complaints and information requests including costs of administration.

To 30 September 2019, the Group has received 629,000 complaints (30 September 2018: 483,000) and has allowed for 86,000 further complaints converted from information requests received prior to the time bar (30 September 2018: 83,000).

The overall provision is based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including: (i) the number of PPI claims arising from the volume of information requests submitted prior to the time bar; (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; and (iv) the costs of administration.

As such, the factors discussed above mean there is a risk that existing provisions for PPI customer redress may not cover all potential costs. In light of this, the eventual costs of PPI redress and complaint handling may therefore differ materially from that estimated and further provision could be required.

The table below sets out the key assumptions and the effect on the provision at 30 September 2019 of future, potential, changes in key assumptions:

**Assumptions**

| | CHANGE IN ASSUMPTION | SENSITIVITY[1] |
|---|---|---|
| Number of expected complaints converted from the stock of information requests at 30 September 2019 | +/-5% | £44m |
| Uphold rate on stock of complaints at 30 September 2019 and expected converted complaints from information requests | +/-1% | £5m |
| Average redress costs[2] | +/-1% | £2m |

(1) There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged.

(2) Sensitivity to a change in average redress across customer initiated complaints.

**Customer redress and other provisions**

Other provisions include amounts in respect of a number of non-PPI conduct related matters, legal proceedings, and claims arising in the ordinary course of the Group's business. Over the course of the year, the Group has raised further provisions of £18m in relation to non-PPI conduct matters (note 2.4). The ultimate cost to the Group of these customer redress matters is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. The matters are at varying stages of their life cycle and in certain circumstances, usually early in the life of a potential issue, elements of the potential exposure are contingent. These factors could result in the total cost of review and redress varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required.

**Conduct Indemnity Deed**

The Group's economic exposure to the impact of historic conduct related liabilities was mitigated by a Capped Indemnity of £1.7bn from NAB. The full amount of the Capped Indemnity was drawn down in the year to 30 September 2018. Details of this matter can be found in note 3.14 of the 2018 Annual Report and Accounts.

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

### 3.16 Provisions for liabilities and charges continued

**Restructuring provision**

Restructuring of the business is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. During the year £64m (2018: £15m) was provided for in accordance with the requirements of IAS 37. £26m (2018: £23m) of the total provision was utilised in the year.

Included within the restructuring provision is an amount for committed rental expense on surplus lease space consistent with the expected exposure on individual leases where the property is unoccupied. This element of the provision will be utilised over the remaining life of the leases, or until the leases are assigned, and is measured at present values by discounting anticipated future cash flows.

# Section 3: Assets and liabilities continued

### 3.17 Other liabilities

| | 2019 £M | 2018[1] £M |
|---|---|---|
| Notes in circulation | **2,277** | 2,254 |
| Accruals and deferred income | **130** | 125 |
| Other[2] | **127** | 142 |
| | **2,534** | 2,521 |

(1) The prior year comparative has been restated in line with the current year presentation. £34m of derivative collateral in relation to clearing houses has been reclassified between other liabilities and due to other banks (note 1.10).

(2) Other includes £3m (2018: £3m) of post retirement medical benefit obligations (note 3.12).

### 3.18 Fair value of financial instruments

**Accounting policy**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. Where no such active market exists for the particular asset or liability, the Group uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions where possible, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. In doing so, fair value is estimated using a valuation technique that makes maximum possible use of market inputs and that places minimal possible reliance upon entity-specific inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, which represents the fair value of the consideration paid or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits or losses on the transaction date.

In certain limited circumstances, the Group applies the fair value measurement option to financial assets including loans and advances where the inherent market risks (principally interest rate and option risk) are individually hedged using appropriate interest rate derivatives. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement and therefore avoid an accounting mismatch. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value and recognised in the income statement.

Analysis of the fair value disclosures uses a hierarchy that reflects the significance of inputs used in measuring fair value. The level in the fair value hierarchy within which a fair value measurement is categorised is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The fair value hierarchy is as follows:

Level 1 fair value measurements – quoted prices (unadjusted) in active markets for an identical financial asset or liability;

Level 2 fair value measurements – inputs other than quoted prices within Level 1 that are observable for the financial asset or liability, either directly (as prices) or indirectly (derived from prices); and

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

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

# Section 3: Assets and liabilities continued

### 3.18 Fair value of financial instruments continued

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

The tables show a comparison of the carrying amounts of financial assets and liabilities measured at amortised cost, and their fair values, where these are not approximately equal.

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

| | 30 SEPTEMBER 2019 | | 30 SEPTEMBER 2018 | |
|---|---|---|---|---|
| | CARRYING VALUE £M | FAIR VALUE £M | CARRYING VALUE £M | FAIR VALUE £M |
| **FINANCIAL ASSETS** | | | | |
| Loans and advances to customers(1) | **73,095** | **73,119** | 32,748 | 32,307 |
| **FINANCIAL LIABILITIES** | | | | |
| Due to other banks(2) | **8,916** | **8,874** | 3,122 | 3,057 |
| Customer deposits(2) | **64,000** | **64,166** | 28,904 | 28,968 |
| Debt securities in issue(3) | **9,591** | **9,667** | 4,973 | 5,052 |

(1) Loans and advances to customers are categorised as Level 3 in the fair value hierarchy with the exception of £1,513m (2018: £1,110m) of overdrafts which are categorised as Level 2.

(2) Categorised as Level 2 in the Fair Value Hierarchy.

(3) Categorised as Level 2 in the Fair Value Hierarchy with the exception of £2,606m of listed debt (2018: £1,279m) which is categorised as Level 1.

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

*(a) Loans and advances to customers* – The fair values of loans and advances are determined by firstly segregating them into portfolios of similar characteristics. Contractual cash flows are then adjusted for expected credit losses and expectations of customer behaviour based on observed historic data. The cash flows are then discounted using current market rates for instruments of similar terms and maturity to arrive at an estimate of their fair value.

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

*(c) Customer deposits* – The fair value of deposits is determined using a replacement cost method which assumes alternative funding is raised in the most advantageous market. The contractual cash flows have been discounted using a funding curve with credit spreads reflecting the tenor of each deposit.

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

# Section 3: Assets and liabilities continued

### 3.18 Fair value of financial instruments continued

**(b) Fair value of financial instruments recognised on the balance sheet at fair value**
The following tables provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, using the fair value hierarchy described above.

| | FAIR VALUE MEASUREMENT AS AT 30 SEPTEMBER 2019 | | | | FAIR VALUE MEASUREMENT AS AT 30 SEPTEMBER 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | LEVEL 1 £M | LEVEL 2 £M | LEVEL 3 £M | TOTAL £M | LEVEL 1 £M | LEVEL 2 £M | LEVEL 3 £M | TOTAL £M |
| **FINANCIAL ASSETS** | | | | | | | | |
| Financial assets at fair value through other comprehensive income[1] | **4,328** | **–** | **–** | **4,328** | – | – | – | – |
| AFS investments[1] | **–** | **–** | **–** | **–** | 1,551 | – | 11 | 1,562 |
| Financial assets at fair value through profit or loss | **–** | **253** | **–** | **253** | – | 362 | – | 362 |
| Other financial assets | **–** | **–** | **14** | **14** | – | – | – | – |
| Derivative financial assets | **–** | **366** | **–** | **366** | – | 262 | – | 262 |
| **Total financial assets at fair value** | **4,328** | **619** | **14** | **4,961** | 1,551 | 624 | 11 | 2,186 |
| **FINANCIAL LIABILITIES** | | | | | | | | |
| Financial liabilities at fair value | **–** | **4** | **–** | **4** | – | 15 | – | 15 |
| Derivative financial liabilities | **–** | **273** | **–** | **273** | – | 361 | – | 361 |
| **Total financial liabilities at fair value** | **–** | **277** | **–** | **277** | – | 376 | – | 376 |

(1) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to notes 1.9 and 5.4.

There were no transfers between Level 1 and 2 in the current or prior year.

The Group's valuations for financial instruments that are measured subsequent to initial recognition at fair value are based on the following methodologies and assumptions:

*(a) Derivative financial assets and liabilities* – The fair values of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from discounted cash flow models or option pricing models as appropriate.

*(b) Fair value through other comprehensive income* – The fair values of listed investments are based on quoted closing market prices[1].

*(c) Financial assets and liabilities at fair value through profit or loss:*

- *Loans and advances to customers and term deposits* (Level 2) – The fair values are derived from data or valuation techniques based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument.
- *Financial assets at fair value through profit or loss* (Equity investment, Level 3) – Primarily represents £6m of Visa Inc. preferred stock received as partial consideration for the sale of the Group's share in Visa Europe (note 2.3). The preferred stock is convertible into Visa Inc. common stock or its equivalent at a future date, subject to potential reduction for certain litigation losses that may be incurred by Visa Europe. The fair value of the preference shares has been calculated by taking the period end New York Stock Exchange share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity investments, the Group's share of the net asset value or the transaction price respectively is considered the best representation of the exit price and is the Group's best estimate of fair value[1].
- *Financial assets at fair value through profit or loss* (Debt investment, Level 3) – Primarily represents £5m of deferred consideration receivable and consists of the rights to future commission. The valuation is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management[1]. For other unlisted debt investments, the transaction price is considered the best estimate of the exit price and is the Group's best estimate of fair value.

(1) These balances were disclosed under available for sale in 2018 and were reclassified as a result of IFRS 9 (note 1.9).

# Section 3: Assets and liabilities continued

### 3.18 Fair value of financial instruments continued

**Level 3 movement analysis:**

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | FINANCIAL ASSETS AVAILABLE FOR SALE £M | FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS £M | FINANCIAL LIABILITIES AT FAIR VALUE £M | FINANCIAL ASSETS AVAILABLE FOR SALE £M | FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS £M | FINANCIAL LIABILITIES AT FAIR VALUE £M |
| Balance at the beginning of the year | **11** | **–** | **–** | 10 | 477 | (26) |
| Transfer to Level 2[1] | **–** | **–** | **–** | – | (477) | 26 |
| Reclassification on adoption of IFRS 9[2] | **(11)** | **11** | **–** | – | – | – |
| Fair value gains/(losses) recognised[3] | | | | | | |
| In profit or loss – unrealised | **–** | **1** | **–** | 1 | – | – |
| In profit or loss – realised | **–** | **3** | **–** | (1) | – | – |
| In available for sale – unrealised | **–** | **–** | **–** | 1 | – | – |
| Purchases | **–** | **3** | **–** | – | – | – |
| Settlements | **–** | **(4)** | **–** | – | – | – |
| **Balance at the end of the year** | **–** | **14** | **–** | 11 | – | – |

(1) The financial assets at fair value comprise a portfolio of loans which are no longer on sale. The continued run-off of these loans has resulted in the unobservable credit risk inputs no longer being significant to their fair value. As such, in the prior year, the loans (and associated liabilities) were reclassified to Level 2 in the fair value hierarchy. In accordance with the Group's accounting policy, the transfer was deemed to have occurred at the beginning of the reporting period.

(2) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to notes 1.9 and 5.4.

(3) Net gains or losses were recorded in non-interest income, or available for sale reserve as appropriate.

**Quantitative information about significant unobservable inputs in Level 3 valuations**

The table below lists key unobservable inputs to Level 3 financial instruments and provides the range of those inputs as at 30 September 2019.

| | FAIR VALUE £M | VALUATION TECHNIQUE | UNOBSERVABLE INPUTS | LOW RANGE | HIGH RANGE |
|---|---|---|---|---|---|
| **OTHER FINANCIAL ASSETS AT FVTPL** | | | | | |
| Equity investments | 8 | Discounted cash flow | Contingent litigation risk | 0% | 100% |
| Debt investments | 6 | Discounted cash flow | Funds under management attrition rate | 10% | 20% |

**Sensitivity of Level 3 fair value measurements to reasonably possible alternative assumptions**

Where valuation techniques use non-observable inputs that are significant to a fair value measurement in its entirety, changing these inputs will change the resultant fair value measurement.

The most significant input impacting the carrying value of the FVTPL-debt investment is the 'Funds Under Management attrition' rate. The Group currently assumes an annual 15% attrition rate. If this rate was 20% the fair value would reduce by £1m; if it was 10% the fair value would increase by £2m.

Other than these significant Level 3 measurements, the Group has a limited remaining exposure to Level 3 fair value measurements and changing one or more of the inputs for fair value measurements in Level 3 to reasonable alternative assumptions would not change the fair value significantly with respect to profit or loss, total assets, total liabilities or equity on these remaining Level 3 measurements.

### 3.19 Acquisition of Virgin Money Holdings (UK) PLC

On 15 October 2018, the Group acquired all the voting rights in Virgin Money Holdings (UK) PLC by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1,532m. This comprised the fair value of approximately 541m new CYBG PLC ordinary shares in exchange for all Virgin Money Holdings (UK) PLC shares at a ratio of 1.2125 CYBG shares for each Virgin Money Holdings (UK) PLC share. Immediately following completion, Virgin Money Holdings (UK) PLC shareholders owned approximately 38% of the Combined Group (on a fully diluted basis).

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

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

# Section 3: Assets and liabilities continued

### 3.19 Acquisition of Virgin Money Holdings (UK) PLC continued

The table below sets out the fair values of the identifiable net assets and liabilities acquired.

| | BOOK VALUE AT 15 OCTOBER 2018 £M | FAIR VALUE ADJUSTMENTS £M | FAIR VALUE AT 15 OCTOBER 2018 £M |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with central banks | 4,146 | – | 4,146 |
| Due from other banks | 598 | – | 598 |
| Financial assets at fair value through other comprehensive income[(1)(2)] | 2,028 | – | 2,028 |
| Other financial assets at fair value through profit or loss | 1 | – | 1 |
| Derivative financial instruments | 71 | – | 71 |
| Loans and advances to customers[(3)] | 37,840 | 34 | 37,874 |
| Property, plant and equipment | 73 | (7) | 66 |
| Intangible assets | 172 | 6 | 178 |
| Deferred tax assets | 23 | 22 | 45 |
| Other assets | 93 | – | 93 |
| **Total assets** | 45,045 | 55 | 45,100 |
| **LIABILITIES** | | | |
| Due to other banks[(3)] | 7,171 | (114) | 7,057 |
| Derivative financial instruments | 41 | – | 41 |
| Customer deposits | 32,111 | 10 | 32,121 |
| Debt securities in issue | 3,548 | 8 | 3,556 |
| Deferred tax liabilities | – | 44 | 44 |
| Other liabilities | 337 | 1 | 338 |
| **Total liabilities** | 43,208 | (51) | 43,157 |
| **Net assets** | 1,837 | 106 | 1,943 |
| **Fair value of net assets acquired** | | | 1,943 |
| **Fair value of non-controlling interests[(4)]** | | | (422) |
| **Goodwill arising on acquisition** | | | 11 |
| **Total consideration[(2)(5)]** | | | 1,532 |

(1) Under IFRS 9 'Financial Instruments', debt investments which would previously have been classified in the available for sale category are reclassified to the new fair value through other comprehensive income category.
(2) Adjusted to remove the CYBG debt securities held by Virgin Money Holdings (UK) PLC.
(3) Included within Loans and advances to customers and Due to other banks is c£300m of fair value assets which will unwind through the income statement over the next 3 to 5 years.
(4) At the acquisition date, Virgin Money Holdings (UK) PLC had in issue Fixed Rate Resettable AT1 securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these were classified as equity instruments. The Group did not acquire the AT1 securities which remained in issue to third parties, consequently these represented a non-controlling interest. As the AT1 instruments were actively traded, the fair value of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018.
(5) Includes 'shares to be issued' in the future relating to employee share plans in regard to the settlement of the outstanding Virgin Money Holdings (UK) PLC share awards partially offset by the purchase of 'own shares' (note 4.1.5).

At acquisition date, the contractual amount of loans and advances receivable from customers was £37,664m. The best estimate of the amounts not expected to be collected was £123m. The goodwill arising on the acquisition of Virgin Money Holdings (UK) PLC is mainly attributable to expected cash flows from new customers and significant synergies which are expected to be realised. The goodwill arising on acquisition is not expected to be deductible for tax purposes.

The amounts of net interest income and profit before tax contributed to the Group's consolidated income statement for the year ended 30 September 2019 from the acquired Virgin Money Holdings (UK) PLC business were £559m and £149m respectively. If the acquisition had occurred on 1 October 2018, the Group's total net interest income for the year would have increased by £22m to £1,536m and the loss before tax would have increased by £33m to £265m.

Transaction costs of £48m were incurred by CYBG PLC in relation to the acquisition.

# Section 4: Capital

### 4.1 Equity

**Accounting policy**

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

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

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

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

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

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

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

### 4.1.1 Share capital and share premium

| | 2019 £M | 2018 £M |
|---|---|---|
| Share capital | **143** | 89 |
| Share premium | **3** | – |
| **Share capital and share premium** | **146** | 89 |

| | 2019 NUMBER OF SHARES | 2018 NUMBER OF SHARES | 2019 £M | 2018 £M |
|---|---|---|---|---|
| **Ordinary shares of £0.10 each – allotted, called up and fully paid** | | | | |
| Opening ordinary share capital | **886,079,959** | 883,606,066 | **89** | 88 |
| Share for share exchange | **540,856,644** | – | **54** | – |
| Issued under employee share schemes | **7,549,086** | 2,473,893 | **–** | 1 |
| **Closing ordinary share capital** | **1,434,485,689** | 886,079,959 | **143** | 89 |

**Acquisition of Virgin Money Holdings (UK) PLC**
On 15 October 2018, CYBG PLC issued 540,856,644 £0.10 ordinary shares in exchange for the acquisition of the entire share capital of Virgin Money Holdings (UK) PLC by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1.5bn. The nominal value of the shares issued was £54m and the balance of £1,495m was transferred to a merger reserve in accordance with Section 612 of the Companies Act.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Company. All shares in issue at 30 September 2019 rank equally with regard to the Company's residual assets.

During the year 7,549,086 (2018: 2,473,893) ordinary shares were issued under employee share schemes with a nominal value of £0.7m (2018: £0.2m).

A final dividend in respect of the year ended 30 September 2018 of 3.1p (2017: 1p) per ordinary share amounting to £45m (2017: £9m), was paid in February 2019. This dividend was deducted from retained profits in the current year. The Directors have recommended that no dividend will be paid in respect of the year ended 30 September 2019.

Share premium represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued ordinary shares.

# Section 4: Capital continued

**4.1 Equity** continued

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

**4.1.2 Other equity instruments**
Other equity instruments consist of the following Perpetual Contingent Convertible Notes.

- Perpetual securities (fixed 8% up to the first reset date) issued on 8 February 2016 with a nominal value of £450m and optional redemption on 8 December 2022.
- Perpetual securities (fixed 8.75% up to the first reset date) issued on 10 November 2016 with a nominal value of £230m and optional redemption on 10 November 2021. This was held by Virgin Money Holdings (UK) PLC on the date of acquisition and was originally recognised as a non-controlling interest (note 4.1.6). Following a change in obligor from Virgin Money Holdings (UK) PLC to CYBG PLC on 20 August 2019, this has been recognised within other equity.
- Perpetual securities (fixed 9.25% up to the first reset date) issued on 13 March 2019 with a nominal value of £250m and optional redemption on 8 June 2024.

The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £15m (2018: £Nil). AT1 distributions of £41m were made in the year, £33m net of tax (2018: £36m paid, £29m net of tax).

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

**4.1.4 Merger reserve**
A merger reserve of £633m was recognised on the issuance of CYBG PLC ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of CYBI. An additional £1,495m was recognised on the issuance of CYBG PLC ordinary shares in October 2018 in exchange for the acquisition of the entire share capital of Virgin Money Holdings (UK) PLC. The merger reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and the nominal value of the shares issued.

**4.1.5 Other reserves**
**Own shares held**
Virgin Money Holdings (UK) PLC established an Employee Benefit Trust (EBT) in 2011 in connection with the operation of its share plans. On the date of acquisition by CYBG PLC, the shares held in the EBT were converted to CYBG shares at a ratio of 1.2125 CYBG shares for each Virgin Money Holdings (UK) PLC share. The investment in own shares as at 30 September 2019 is £1m (2018: £Nil). The market value of the shares held in the EBT at 30 September 2019 was £1m (2018: £Nil).

**Deferred shares reserve**
The deferred share reserve comprises shares to be issued in the future relating to employee share plans in regard to the settlement of outstanding Virgin Money Holdings (UK) PLC share awards, which will be settled through the issuance of Virgin Money UK PLC shares at a future date in line with the vesting profile of the underlying plans.

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

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

**Available for sale (AFS) reserve**
The AFS reserve recorded the gains and losses arising from changes in the fair value of AFS financial assets prior to 1 October 2018. On adoption of IFRS 9 'Financial Instruments' with the removal of the AFS category for financial assets, part of the balance on the reserve was transferred to the FVOCI reserve with £3m released to retained earnings (note 5.4).

**Fair value through other comprehensive income (FVOCI ) reserve**
The FVOCI reserve records the unrealised gains and losses arising from changes in the fair value of financial assets at fair value through other comprehensive income. The movements in this reserve are detailed in the consolidated statement of comprehensive income. On adoption of IFRS 9 'Financial Instruments' with the removal of the AFS category for financial assets, £4m of the balance on the AFS reserve was transferred to the FVOCI reserve (note 5.4).

# Section 4: Capital continued

### 4.1.5 Other reserves continued

**Cash flow hedge reserve**

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

| | 2019 £M | 2018 £M |
|---|---|---|
| At 1 October | **(39)** | (1) |
| **AMOUNTS RECOGNISED IN OTHER COMPREHENSIVE INCOME:** | | |
| **Cash flow hedge – interest rate risk** | | |
| Effective portion of changes in fair value of interest rate swaps | **14** | (58) |
| Amounts transferred to the income statement | **–** | 9 |
| Taxation | **(3)** | 11 |
| **Cash flow hedge – Foreign exchange risk** | | |
| Effective portion of changes in fair value of cross currency swaps | **59** | – |
| Amounts transferred to the income statement | **(57)** | – |
| Taxation | **–** | – |
| **At 30 September** | **(26)** | (39) |

### 4.1.6 Non-controlling interests

At the acquisition date, Virgin Money Holdings (UK) PLC had in issue Fixed Rate Resettable AT1 securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these are classified as equity instruments. The Group did not acquire the AT1 securities which remained in issue to third parties, consequently these represented a non-controlling interest. As the AT1 instruments are actively traded, the fair value on acquisition of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018. Following the change in obligor from Virgin Money Holdings (UK) PLC to CYBG PLC on 20 August 2019, this has been recognised within other equity (note 4.1.2).

Distributions to non-controlling interests of £33m were made in the year, £26m net of tax (2018: £Nil).

### 4.2 Equity based compensation

**Accounting policy**

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

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

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

The equity settled share based payment charge for the year is £4m (2018: £9m).

# Section 4: Capital continued

**4.2 Equity based compensation** continued

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

| PLAN | ELIGIBLE EMPLOYEES | NATURE OF AWARD | VESTING CONDITIONS[1] | GRANT DATES[2] |
|---|---|---|---|---|
| DEP[3] | Selected employees | Conditional rights to shares | Continuing employment or leaving in certain limited circumstances | 2016, 2017 and 2018 |
| LTIP | Selected senior employees | Conditional rights to shares | Continuing employment or leaving in certain limited circumstances and achievement of delivery of the Group's strategic goals and growth in shareholder value | 2017 and 2018 |
| SIP | All employees | Non-conditional share award | Continuing employment | 2016 and 2017 |

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

Further detail on each plan is provided below:

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

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

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

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

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

# Section 4: Capital continued

**4.2 Equity based compensation** continued

**Awards/rights made during the year**

| PLAN | NUMBER OUTSTANDING AT 1 OCTOBER 2018 | NUMBER AWARDED | NUMBER FORFEITED | NUMBER RELEASED | NUMBER OUTSTANDING AT 30 SEPTEMBER 2019 | AVERAGE FAIR VALUE OF AWARDS AT GRANT PENCE |
|---|---|---|---|---|---|---|
| **DEP** | | | | | | |
| 2015 Demerger | 2,038,052 | – | (223,829) | (1,785,999) | **28,224** | 196.96 |
| 2015 Bonus | 54,953 | – | – | (54,953) | **–** | 195.17 |
| 2015 Commencement | 25,685 | – | – | (25,685) | **–** | 194.67 |
| 2016 Bonus | 21,403 | – | – | (10,700) | **10,703** | 266.03 |
| 2016 Commencement | 57,271 | – | – | (36,867) | **20,404** | 266.03 |
| 2017 Bonus | 592,807 | – | (31,943) | (329,794) | **231,070** | 313.20 |
| 2017 Commencement | 68,167 | – | (34,324) | (28,734) | **5,109** | 313.20 |
| 2018 Bonus | – | 1,634,582 | – | (1,462,777) | **171,805** | 192.35 |
| **LTIP** | | | | | | |
| 2016 LTIP | 2,232,391 | – | (203,923) | – | **2,028,468** | 266.03 |
| 2017 LTIP | 2,314,487 | – | (207,534) | – | **2,106,953** | 313.20 |
| 2018 LTIP | – | 5,857,259 | (61,455) | – | **5,795,804** | 190,47 |
| **SIP** | | | | | | |
| 2015 Demerger | 1,297,152 | – | (512) | (270,148)[1] | **1,026,492** | 194.67 |
| 2017 Free Share | 906,141 | – | (477) | (68,688) | **836,976** | 313.20 |
| 2019 Free Share | – | 2,343,888 | (84,870) | (48,216) | **2,210,802** | 202.53 |

(1) Shares withdrawn from SIP Trust on leaving the Group.

**Determination of grant date fair values**

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

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

# Section 5: Other notes

## 5.1 Contingent liabilities and commitments

**Accounting policy**

**Financial guarantees**

The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party and are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. The rating of the Group as a guarantee provider enhances the marketability of the paper issued by the counterparty in these circumstances. Financial guarantee contracts are initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary.

The expected credit loss requirements of IFRS 9 as set out in note 3.2 are equally applicable to loan commitments and financial guarantee contracts.

**Operating lease commitments**

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

**Contingent liabilities**

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless they are remote.

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

**Financial guarantees**

| | 2019 £M | 2018 £M |
|---|---|---|
| Guarantees and assets pledged as collateral security: | | |
| Due in less than 3 months | **24** | 26 |
| Due between 3 months and 1 year | **24** | 36 |
| Due between 1 year and 3 years | **6** | 10 |
| Due between 3 years and 5 years | **11** | 2 |
| Due after 5 years | **48** | 45 |
| | **113** | 119 |
| **OTHER CREDIT COMMITMENTS** | | |
| Undrawn formal standby facilities, credit lines and other commitments to lend at call | **15,158** | 7,016 |

The Group's loan commitments and financial guarantee contracts attracted expected credit losses of £5m at 30 September 2019. The balance calculated on adoption of IFRS 9 is disclosed in note 5.4.

# Section 5: Other notes continued

### 5.1 Contingent liabilities and commitments continued

**Capital commitments**
The Group had future capital expenditure which had been contracted for, but not provided for, at 30 September 2019 of £0.2m (2018: £1m).

**Operating lease commitments**

| | 2019 £M | 2018 £M |
|---|---|---|
| **LEASES AS LESSOR** | | |
| Future minimum lease payments under non-cancellable operating leases: | | |
| Within 1 year | **2** | 1 |
| Between 1 year and 5 years | **4** | 4 |
| Over 5 years | **1** | 1 |
| | **7** | 6 |
| **LEASES AS LESSEE** | | |
| Future minimum lease payments under non-cancellable operating leases: | | |
| Within 1 year | **35** | 29 |
| Between 1 year and 5 years | **135** | 96 |
| Over 5 years | **244** | 124 |
| | **414** | 249 |

**Other contingent liabilities**
**Conduct risk related matters**
There continues to be significant uncertainty and thus judgement is required in determining the quantum of conduct risk related liabilities, with note 3.16 reflecting the Group's current position in relation to redress provisions including those for PPI. The final amount required to settle the Group's potential liabilities for these, and other conduct related matters, is materially uncertain. Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated.

The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

**Legal claims**
The Group is named in and is defending a number of legal claims arising in the ordinary course of business. No material adverse impact on the financial position of the Group is expected to arise from the ultimate resolution of these legal actions.

# Section 5: Other notes continued

## 5.2 Notes to the statement of cash flows

| | 2019 £M | 2018 £M |
|---|---|---|
| **ADJUSTMENTS INCLUDED IN THE LOSS BEFORE TAX** | | |
| Interest receivable | **(2,432)** | (1,113) |
| Interest payable | **918** | 262 |
| Depreciation and amortisation (note 2.4) | **108** | 89 |
| Derivative financial instruments fair value movements | **17** | (3) |
| Impairment losses on credit exposures (note 3.2) | **252** | 41 |
| Software impairments and write-offs | **132** | – |
| Other non-cash movements | **1** | – |
| Gain on sale of 50% (less one share) consideration in Virgin Money UTM | **(35)** | – |
| Equity based compensation | **4** | 9 |
| | **(1,035)** | (715) |
| **CHANGES IN OPERATING ASSETS** | | |
| Net (increase)/decrease in: | | |
| Balances with supervisory central banks | **(20)** | (31) |
| Due from other banks | **274** | 339 |
| Derivative financial instruments | **64** | 18 |
| Financial instruments at fair value through other comprehensive income | **(33)** | – |
| Financial assets at fair value through profit or loss | **103** | 117 |
| Loans and advances to customers | **(2,663)** | (1,488) |
| Defined benefit pension assets | **(74)** | – |
| Other assets | **138** | (14) |
| | **(2,211)** | (1,059) |
| **CHANGES IN OPERATING LIABILITIES** | | |
| Net increase/(decrease) in: | | |
| Due to other banks | **(20)** | (1,053) |
| Derivative financial instruments | **(128)** | (16) |
| Financial liabilities at fair value through profit or loss | **(11)** | (11) |
| Customer deposits | **2,837** | 1,186 |
| Provisions for liabilities and charges | **128** | (223) |
| Defined benefit pension obligations | **–** | (14) |
| Other liabilities | **(171)** | 9 |
| | **2,635** | (122) |

# Section 5: Other notes continued

**5.2 Notes to the statement of cash flows** continued

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition. This includes cash and liquid assets and amounts due to other banks (to the extent less than 90 days).

| | 2019 £M | 2018 £M |
|---|---|---|
| Cash and balances with central banks (note 3.4) | **10,113** | 6,498 |
| Other assets | **43** | 86 |
| Due to other banks | **(20)** | (12) |
| Other liabilities | **(17)** | (30) |
| | **10,119** | 6,542 |

**5.3 Related party transactions**

Following the acquisition of Virgin Money Holdings (UK) PLC, the Group has a number of additional related entities. No comparative information is required where the entity only became a related party during the period.

**Assets with related entities**

| | 2019 £M | 2018 £M |
|---|---|---|
| **INVESTMENTS IN JOINT VENTURES AND ASSOCIATES** | | |
| Virgin Money Unit Trust Managers Limited[1] | **8** | – |
| **OTHER ASSETS** | | |
| Amounts due from Virgin Money Unit Trust Managers Limited[1] | **2** | – |
| **Total assets with related entities** | **10** | – |
| **LIABILITIES WITH RELATED ENTITIES** | | |
| **CUSTOMER DEPOSITS** | | |
| The Virgin Money Foundation | **1** | – |
| **OTHER LIABILITIES** | | |
| Group pension deposits[2] | **17** | 36 |
| Commissions and charges due to Virgin Atlantic Airways Limited[3] | **6** | – |
| Trademark licence fees due to Virgin Enterprises Limited[4] | **4** | – |
| **Total liabilities with related entities** | **28** | 36 |
| **NON-INTEREST INCOME** | | |
| Net fees and commissions to Virgin Atlantic Airways Limited | **(15)** | – |
| Share of post-tax result of Virgin Money Unit Trust Managers Limited[1] | **(1)** | – |
| Gain on sale of 50% (less one share) consideration in Virgin Money Unit Trust Managers Limited | **35** | – |
| **OPERATING AND ADMINISTRATIVE EXPENSES** | | |
| Trademark licence fees to Virgin Enterprises Limited[4] | **(11)** | – |
| Costs recharged to Virgin Money Unit Trust Managers Limited[1] | **2** | – |
| Donations to the Virgin Money Foundation[5] | **(2)** | – |
| **Total income statement** | **8** | – |

# Notes to the consolidated financial statements

## Section 5: Other notes continued

### 5.3 Related party transactions continued

(1) The Group entered into a joint venture with Aberdeen Standard Investments (ASI), under the terms of which ASI acquired 50% (less one share) of the Group's investments and pensions business. This new joint venture is Virgin Money Unit Trust Managers Limited.

(2) The Group and the Trustee to the pension scheme have entered into a contingent Security Arrangement which provides additional support to the Scheme by underpinning recovery plan contributions and some additional investment risk. The security is in the form of a pre-agreed maximum level of assets that are set aside for the benefit of the Pension Scheme in certain trigger events. These assets are held by Red Grey Square Funding LLP, an insolvency remote consolidated structured entity. The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.1m (2018: £0.3m), were charged to the Group sponsored scheme. Information on the pension schemes operated by the Group is provided in note 3.12. Pension contributions of £83m (2018: £18m) were made to the Scheme (note 3.12).

(3) The Group incurs credit card commissions and air mile charges with Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. £4m of cash costs payable to VAA have been deferred on the balance sheet.

(4) Licence Fees of £11m were payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark. This contract was previously held by Virgin Money Holdings (UK) plc. However, following the acquisition of Virgin Money Holdings (UK) PLC, the contract was renewed directly between CYBG plc and Virgin Enterprises Ltd.

(5) The Group has made donations to the Virgin Money Foundation to enable it to pursue its charitable objectives. The Group has also provided a number of support services to the Virgin Money Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.6m and is included in the total value disclosed above.

The Group paid £0.2m of ordinary dividends to Virgin Group Holdings Ltd.

**Compensation of key management personnel (KMP)**

KMP comprises Directors of the Company and members of the Executive Leadership Team.

| | 2019 £M | 2018 £M |
|---|---|---|
| Salaries and short-term benefits | **14** | 9 |
| Other long-term employee benefits | **–** | – |
| Termination benefits | **5** | – |
| Equity based compensation[(1)] | **2** | 1 |
| | **21** | 10 |

(1) Basis of the expense recognised in the year in accordance with IFRS 2 'Equity based compensations', including associated employers' NIC.

The following information regarding Directors' remuneration is presented in accordance with the Companies Act 2006.

| | 2019 £M | 2018 £M |
|---|---|---|
| Aggregate remuneration | **5** | 5 |

In addition to the above, £0.5m (2018: £0.4m) was expensed relating to LTIP. None of the Directors were members of the Group's defined contribution pension scheme during 2019 (2018: none). None of the Directors were members of the Group's defined benefit pension scheme during 2019 (2018: none). None of the Directors hold share options and none were exercised during the year (2018: none).

**Transactions with KMP**

KMP, their close family members and any entities controlled or significantly influenced by the KMP have undertaken the following transactions with the Group in the normal course of business. The transactions were made on the same terms and conditions as applicable to other Group employees, or on normal commercial terms.

| | 2019 £M | 2018 £M |
|---|---|---|
| Loans and advances | **4** | 2 |
| Deposits | **3** | 3 |

No provisions have been recognised in respect of loans provided to the KMP (2018: £Nil). There were no debts written-off or forgiven during the year to 30 September 2019 (2018: £Nil). Included in the above are four (2018: six) loans totalling £1m (2018: £2m) made to Directors. In addition to the above, there are guarantees of £Nil (2018: £Nil) made to Directors and their related parties.

## Section 5: Other notes continued

### 5.4 Transition to IFRS 9 'Financial Instruments' from IAS 39 'Financial Instruments: Recognition and Measurement' and the adoption of IFRS 15 'Revenue from Contracts with Customers'

**IFRS 9**

IFRS 9 replaced IAS 39 as the accounting standard for financial instruments and was adopted (except for the hedge accounting requirements) by the Group with effect from 1 October 2018. The requirements of IFRS 9 allow for the transitional adjustments to be reflected through the opening retained earnings line, without the need to produce comparative information on an IFRS 9 basis.

The following table summarises the locations of the policies and key judgement areas and impact on the Group's financial position of adopting IFRS 9 on 1 October 2018[(1)]:

| DETAIL | LOCATION |
|---|---|
| New accounting standards | Note 1.9 |
| Loans and advances to customers | Note 3.1 |
| Impairment provisions on credit exposures | Note 3.2 |
| Critical accounting estimates and judgements in relation to expected credit losses (ECL) | Note 3.2 |
| Financial assets and liabilities at fair value through profit or loss (FVTPL) | Note 3.5 |
| Financial assets at fair value through other comprehensive income (FVOCI) | Note 3.7 |
| Financial assets available for sale (AFS) | Note 3.8 – and only applicable for the year ended 30 September 2018 as this category for financial assets was removed with the introduction of IFRS 9 |
| Other relevant credit risk disclosures | Pages 144 to 157 of the Risk report contained in the Group's Annual Report and Accounts |

The carrying amount of the Group's financial assets and financial liabilities at 30 September 2018 under IAS 39 and at 1 October 2018 under IFRS 9 are as follows:

| | MEASUREMENT UNDER IAS 39 | MEASUREMENT UNDER IFRS 9 | IAS 39 CARRYING AMOUNT £M[(2)] | IFRS 9 CARRYING AMOUNT £M |
|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | |
| Cash and balances with central banks | Amortised cost | Amortised cost | 6,573 | 6,573 |
| Due from other banks | Amortised cost | Amortised cost | 693 | 693 |
| Financial assets available for sale[(3)] | Available for sale | Fair value through profit or loss | 1,562 | 11 |
| | | Fair value through other comprehensive income | n/a | 1,551 |
| Loans and advances to customers at fair value through profit or loss | Fair value through profit or loss | Fair value through profit or loss | 362 | 362 |
| Derivative financial instruments | Fair value through profit or loss | Fair value through profit or loss | 262 | 262 |
| Loans and advances to customers | Amortised cost | Amortised cost | 32,748 | 32,719 |
| **FINANCIAL LIABILITIES** | | | | |
| Other financial liabilities at fair value | Fair value through profit or loss | Fair value through profit or loss | 15 | 15 |

(1) The acquisition of Virgin Money Holdings (UK) PLC on 15 October 2018 has no impact or effect on the Group's disclosures on the transition to IFRS 9, which is based on the Group balance sheet position as at 30 September 2018 which was prior to the acquisition.

(2) The prior year comparative has been restated in line with the current year presentation (note 1.10).

(3) The Group's listed securities, comprising of UK Government Securities, and other listed securities (e.g. bonds issued by supra-nationals and AAA rated covered bonds), are held in a business model that is 'to hold to collect and sell' and classified at fair value through other comprehensive income. The Group's unlisted securities, and other financial assets held as available for sale have been classified at fair value through profit or loss.

The changes required (net of deferred tax) to the Group's financial assets and liabilities on adoption of IFRS 9 have been adjusted through the Group's retained earnings figure for 30 September 2018.

# Section 5: Other notes continued

**5.4 Transition to IFRS 9 'Financial Instruments' from IAS 39 'Financial Instruments: Recognition and Measurement' and the adoption of IFRS 15 'Revenue from Contracts with Customers'** continued

**Initial adoption approach**
The methodology and nature of the key judgements applied on the initial adoption of IFRS 9 were consistent with the Group policy as outlined in detail in note 3.2, and are therefore not repeated here.

Consistent with the Group's approach to the application of economic scenarios to the ECL calculation at 30 September 2019, similar scenarios fed into the ECL calculation at 1 October 2018. The Group applied the following weightings to the chosen scenarios at 1 October 2018:

| | |
|---|---|
| Mild upside | 25% |
| Base case | 60% |
| Severe downside | 15% |

Refer to note 3.2 for further detail regarding the approach and comparison of the weightings applied at 1 October 2018 and 30 September 2019.

**Future macroeconomic conditions**
A range of future macroeconomic conditions is used in the scenarios over a five-year forecast period and reflects the best estimates of future conditions under each scenario. The Group has identified the following key macroeconomic conditions as the most significant inputs for IFRS 9 modelling purposes: UK GDP growth, CPI inflation, house prices, bank rates, unemployment rates and CRE capital values. These are assessed and reviewed by an internal panel on a six-monthly basis to ensure appropriateness and relevance to the ECL calculation. Where model inputs are not reflective of the current market conditions at the date of the financial statements, the Group may reflect these through the use of temporary adjustments to the ECL calculation using expert credit judgement.

The simple forward-looking five-year averages for the key model inputs used in the ECL calculations at 1 October 2018 are:

| | UK GDP GROWTH % | CPI INFLATION % | HOUSE PRICES % | BANK RATE % | ILO UNEMPLOYMENT % |
|---|---|---|---|---|---|
| 1 October 2018 | | | | | |
| Mild upside | 2.6 | 2.4 | 4.9 | 2.5 | 3.3 |
| Base case | 2.1 | 1.9 | 4.3 | 1.1 | 4.2 |
| Severe downside | 0.6 | 0.8 | (1.7) | 0.1 | 6.2 |

The revised simple forward-looking five-year averages for the key model inputs used in the ECL calculations at 30 September 2019 are:

| | UK GDP GROWTH % | CPI INFLATION % | HOUSE PRICES % | BANK RATE % | ILO UNEMPLOYMENT % |
|---|---|---|---|---|---|
| 30 September 2019 | | | | | |
| Mild upside | **2.7** | **2.3** | **5.8** | **2.0** | **3.4** |
| Base case | **1.8** | **1.7** | **2.9** | **0.9** | **3.8** |
| Severe downside | **0.2** | **0.8** | **(4.6)** | **0.4** | **5.8** |

**IFRS 15**
The Group also adopted IFRS 15 'Revenue from Contracts with Customers' with effect from 1 October 2018.

The requirements of IFRS 15 allow for the transitional adjustments to be reflected through the opening retained earnings line, without the need to produce comparative information on an IFRS 15 basis.

The majority of the Group's income was either not in scope for IFRS 15 or was being recognised in a way that was consistent with the requirements of the new standard. The limited exception to this was income recognised in relation to the Group's rights to future commission on the deferred consideration receivable. This was held as an 'other' available for sale financial asset under IAS 39 and reclassified to FVTPL on transition to IFRS 9 as detailed in this note. As a result of this remeasurement, a further £1m of future commission income was recognised on transition to IFRS 15, which has been reflected in increases to both other assets and retained earnings on transition.

# Section 5: Other notes continued

### 5.4 Transition to IFRS 9 'Financial Instruments' from IAS 39 'Financial Instruments: Recognition and Measurement' and the adoption of IFRS 15 'Revenue from Contracts with Customers' continued

**Quantitative impact of IFRS 9 and IFRS 15 on adoption at 1 October 2018**
The change to the carrying amounts of the Group's assets, liabilities, reserves and retained earnings as at 30 September 2018 as a result of the IFRS 9 and IFRS 15 reclassifications and remeasurements required on 1 October 2018 are as follows:

| | IAS 39 CARRYING AMOUNT AS AT 30 SEPT 2018[1] £M | IFRS 9 – RECLASSIFICATIONS £M | IFRS 9 – REMEASUREMENT IN ECL £M | IFRS 9 – RELEASE OF AVAILABLE FOR SALE RESERVE £M | IFRS 15 REMEASUREMENT £M | CARRYING AMOUNT AS AT 1 OCT 2019 £M |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Financial assets available for sale | 1,562 | (1,562) | – | – | – | **–** |
| Financial assets at fair value through other comprehensive income | – | 1,551 | – | – | – | **1,551** |
| Other financial assets at fair value | 362 | 11 | – | – | – | **373** |
| Loans and advances to customers | 32,748 | – | (29) | – | – | **32,719** |
| Deferred tax | 206 | – | 7 | – | – | **213** |
| Other assets | 338 | – | – | – | 1 | **339** |
| **EQUITY** | | | | | | |
| Available for sale reserve | (7) | 4 | – | 3 | – | **–** |
| FVOCI reserve | – | (4) | – | – | – | **(4)** |
| Retained earnings | (2,873) | – | 22 | (3) | (1) | **(2,855)** |

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

The move to IFRS 9 has resulted in a net £19m decrease in retained earnings at 1 October 2018 primarily due to the change in the measurement in impairment losses, which are now calculated on an ECL basis as opposed to the incurred loss methodology used in IAS 39. The gross impairment loss adjustment of £29m as at 1 October 2018 includes £5m of ECLs calculated on the Group's loan commitments and financial guarantee contracts. In addition, while an ECL calculation is also performed on the Group's financial assets held at FVOCI, the resultant impairment provision is not material enough to be reported separately in the above tables.

### 5.5 Pillar 3 disclosures

**Basel III Capital Requirements Directive IV**
Pillar 3 disclosure requirements are set out in Part Eight of the CRR. The consolidated disclosures of the Group, for the 2019 financial year, will be issued concurrently with the Annual Report and Accounts and will be found at www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/.

### 5.6 Post balance sheet events

**FSMA Part VII transfer of trade and assets from Virgin Money PLC to Clydesdale Bank PLC**
On 26 September 2019, at a hearing in the Court of Session in Edinburgh, the Court approved a banking business transfer scheme under Part VII of the Financial Services and Markets Act 2000. The scheme effective date was 21 October 2019, and in accordance with the court approval, on this date the business of Virgin Money PLC was transferred to Clydesdale Bank PLC for a cash consideration of £10m. The transfer of the trade and assets is a business transfer under common control and has no impact on the consolidated Group financial results.

**Change in Company name**
CYBG PLC changed its name to Virgin Money UK PLC on 30 October 2019. The registered office address of the Company has changed from Merrion Way to Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

# Measuring financial performance – glossary

## Financial performance measures

As highlighted in the Annual Report and Accounts, the Group utilises a range of performance measures[1] to assess the Group's performance. These can be grouped under the following headings:

- profitability;
- asset quality; and
- capital optimisation.

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

### Statutory performance measures (S)

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

### Regulatory performance measures (R)

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

### Alternative performance measures (A)

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

Where a performance measure refers to an 'underlying' metric, the detail on how this measure is arrived at, along with management's reasoning for excluding the item from the Group's current underlying performance rationale, can be found on page 108, directly following this section. These adjustments to the Group's statutory results made by management are designed to provide a more meaningful underlying basis.

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

**Profitability:**

| TERM | TYPE | DEFINITION |
|---|---|---|
| Net interest margin (NIM) | A | Underlying net interest income as a percentage of average interest earning assets for a given period. Underlying net interest income of £1,433m (2018: £1,457m) is divided by average interest earning assets for a given period of £86,362m (2018: £81,934m) (which is then adjusted to exclude short-term repos used for liquidity management purposes, fair value adjustments, amounts received under the Conduct Indemnity and not yet utilised, and any associated income). As a result of the exclusions noted above, average interest earning assets used as the denominator have reduced by £Nil (2018: £187m) and the net interest income numerator has reduced by £Nil (2018: £3m). |
| Statutory return on tangible equity (RoTE) | A | Statutory profit/(loss) after tax attributable to ordinary equity holders as a percentage of average tangible equity (total equity less intangible assets, AT1 and non-controlling interests) for a given period. |
| Statutory return on assets | A | Statutory profit/(loss) after tax as a percentage of average total assets for a given period. |
| Statutory basic earnings per share (EPS) | S | Statutory profit/(loss) after tax attributable to ordinary equity shareholders including tax relief on any distributions made to other equity holders and non-controlling interests, divided by the weighted average number of ordinary shares in issue for a given period (excluding own shares held). |
| Underlying RoTE | A | Underlying profit after tax attributable to ordinary equity holders, including tax relief on any distributions made to other equity holders and non-controlling interests, as a percentage of average tangible equity (total equity less intangible assets, AT1 and non-controlling interests) for a given period. |
| Underlying CIR | A | Underlying operating and administrative expenses as a percentage of underlying total operating income for a given period. |
| Underlying return on assets | A | Underlying profit after tax as a percentage of average total assets for a given period. |
| Underlying basic EPS | A | Underlying profit after tax attributable to ordinary equity holders divided by the weighted average number of ordinary shares in issue for a given period. |
| Underlying profit after tax attributable to ordinary equity holders | A | Underlying profit before tax of £539m (2018: £581m) less tax charge of £77m (2018: £101m), less AT1 distributions (net of tax relief) of £33m (2018: £29m), less distributions to non-controlling interests (net of tax relief) of £26m (2018:£25m) and was equal to £403m (2018: £426m). The underlying tax charge is calculated by applying the statutory tax rate for the relevant period to the taxable items adjusted on the underlying basis. |

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

# Measuring financial performance – glossary

**Asset quality:**

| TERM | TYPE | DEFINITION |
|---|---|---|
| Impairment charge to average customer loans (cost of risk) | A | Impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances). |
| Total provision to customer loans | A | Total impairment provision on credit exposures as a percentage of total customer loans at a given date. |
| Indexed loan to value (LTV) of the mortgage portfolio | A | The mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices for the Clydesdale Bank PLC portfolio while the Virgin Money Holdings (UK) PLC portfolio is indexed using the Markit indices. |

**Capital optimisation:**

| TERM | TYPE | DEFINITION |
|---|---|---|
| Common Equity Tier 1 (CET1) ratio | R | CET1 capital divided by RWAs at a given date. |
| Tier 1 ratio | R | Tier 1 capital as a percentage of RWAs. |
| Total capital ratio | R | Total capital resources divided by RWAs at a given date. |
| CRD IV leverage ratio | R | This is a regulatory standard ratio proposed by Basel III as a supplementary measure to the risk-based capital requirements. It is intended to constrain the build-up of excess leverage in the banking sector and is calculated by dividing Tier 1 capital resources by a defined measure of on and off-balance sheet items plus derivatives. |
| UK leverage ratio | R | The Group's leverage ratio on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017. |
| Tangible net asset value (TNAV) per share | A | Tangible equity (total equity less intangible assets, AT1 and non-controlling interests) as at the period end divided by the number of ordinary shares in issue at the year end (excluding own shares held). |
| Pro forma tangible net asset value (TNAV) per share | A | Tangible equity (total equity less intangible assets, AT1 and non-controlling interests) as at the period end divided by the number of ordinary shares in issue at the period end. For comparative periods, the number of ordinary shares in issue used in the calculation is the number of ordinary shares in issue on 15 October 2018 following the acquisition of Virgin Money Holdings (UK) PLC (excluding own shares held). |
| Pro forma underlying basic earnings per share | A | Underlying profit after tax attributable to ordinary equity shareholders, including tax relief on any distributions made to other equity holders and non-controlling interests, divided by the weighted average number of ordinary shares in issue for a given period (excluding own shares held). The weighted average number of ordinary shares in issue assumes that the 540,856,644 shares issued on the acquisition of Virgin Money Holdings (UK) PLC, was completed on 1 October 2017. |
| Loan to deposit ratio (LDR) | R | Customer loans as a percentage of customer deposits at a given date. |
| Liquidity coverage ratio (LCR) | R | Measures the surplus (or deficit) of the Group's high quality liquid assets relative to weighted net stressed cash outflows over a 30-day period. It assesses whether the Group has sufficient liquid assets to withstand a short-term liquidity stress based on cash outflow assumptions provided by regulators. |
| Net stable funding ratio (NSFR) | R | The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The Group monitors the NSFR, based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions. |

# Measuring financial performance – glossary

## Underlying adjustments to the pro forma view of performance

On arriving at an underlying basis, the effects of certain items that do not promote an understanding of historical or future trends of earnings or cash flows are removed, as management consider that this presents more comparable results year-on-year. These items are all significant and are typically one-off in nature. Additional detail is provided below where considered necessary to further explain the rationale for their exclusion from underlying performance, in particular for new items in the current year or recurring non-underlying items:

| ITEM | 2019 £M | 2018 £M | REASON FOR EXCLUSION FROM THE GROUP'S CURRENT UNDERLYING PERFORMANCE |
|---|---|---|---|
| **Restructuring costs** | **(156)** | – | These are part of the Group's publicised three-year integration plan following the acquisition of Virgin Money Holdings (UK) PLC and comprise a number of one-off expenses that are required to realise the anticipated cost synergies. |
| **ACQUISITION COSTS:** | | | All costs incurred as a direct result of the acquisition of Virgin Money Holdings (UK) PLC have been removed from underlying performance due to the scale and nature of the transaction. Further information on the items is provided below to aid understanding. |
| Acquisition accounting | **(87)** | – | This consists principally of the unwind of the IFRS 3 fair value adjustments created on the acquisition of Virgin Money Holdings (UK) PLC in October 2018 (£23m gain) and the IFRS 9 impairment impact on acquired assets (£103m charge) with other smaller items amounting to £7m. These represent either one-off adjustments or are the scheduled reversals of the accounting adjustments that arose following the fair value exercise required by IFRS 3. These will continue to be treated as non-underlying adjustments over the expected three to five-year period until they have been fully reversed. |
| Intangible asset write-off | **(127)** | – | The charge for the software write-off is significant and has arisen in respect of software assets which are no longer considered to be of value relative to the Group's strategy following the acquisition of Virgin Money Holdings (UK) PLC. |
| Mortgage EIR adjustments | **80** | – | The alignment of accounting practices is a one-off exercise arising from the acquisition. |
| Virgin Money Holdings (UK) PLC transaction costs | **(55)** | (39) | These costs related directly to the transaction and comprised legal, advisory and other associated costs required to complete the transaction. |
| **Total acquisition costs** | **(189)** | (39) | |
| **Legacy conduct** | **(433)** | (396) | These costs are historical in nature and are not indicative of the Group's current practices. |
| **OTHER:** | | | |
| Consent solicitation | **(18)** | – | One-off costs relating to the change in obligor of senior debt from Virgin Money Holdings (UK) PLC to CYBG on 20 August 2019. |
| SME transformation | **(30)** | (16) | These costs are significant and considered to be one-off due to the unique growth opportunities currently available to the Group in respect of its Business lending. |
| Gain on sale of UTM | **35** | – | A one-off gain recognised on the disposal of 50% (less one share) of Virgin Money Unit Trust Managers Limited. |
| UTM transition costs | **(1)** | – | |
| GMP equalisation cost | **(11)** | – | A one-off charge for GMP equalisation in the Group's defined benefit scheme. |
| Legacy restructuring and separation | **(5)** | (46) | These legacy costs were significant in prior periods and related to the Sustain programme, and demerger from NAB, both of which completed in the current period. |
| Virgin Money digital bank termination costs | **–** | (3) | |
| Gain on disposal of VocaLink | **4** | – | |
| Gain on disposal of Visa C shares | **–** | 3 | |
| **Total other** | **(26)** | (62) | |

# Glossary

| TERM | DEFINITION |
|---|---|
| Additional Tier 1 (AT1) | Securities that are considered Additional Tier 1 capital in the context of CRD IV. |
| arrears | A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue. |
| average assets | Represents the average of assets over the year adjusted for any disposed operations. |
| B | The Group's digital application suite, offering retail customers money management capabilities across Web, Android and Apple platforms. |
| Bank | Clydesdale Bank PLC. |
| Basel II | The capital adequacy framework issued by the Basel Committee on Banking Supervision (BCBS) in June 2004. |
| Basel III | Reforms issued by the BCBS in December 2017 with subsequent revisions. |
| basis points (bps) | One hundredth of a percent (0.01%); meaning that 100 basis points is equal to 1%. This term is commonly used in describing interest rate movements. |
| Board | Refers to the Virgin Money UK PLC Board or the Clydesdale Bank PLC Board as appropriate. |
| Business lending | Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance. |
| Capped Indemnity | The indemnity from NAB in favour of the Group in respect of certain qualifying conduct costs incurred by the Group under the terms of the Conduct Indemnity Deed. |
| carrying value (also referred to as carrying amount) | The value of an asset or a liability in the balance sheet based on either amortised cost or fair value principles. |
| collateral | The assets of a borrower that are used as security against a loan facility. |
| collective impairment provision | Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment. |
| Combined Group | CYBG, now Virgin Money UK PLC, and its controlled entities following the acquisition of Virgin Money Holdings (UK) PLC. |
| commercial paper | An unsecured promissory note issued to finance short-term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date. |
| Common Equity Tier 1 capital (CET1) | The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments. |
| Company/CYBG | CYBG PLC up until 31 October 2019 and thereafter Virgin Money UK PLC. |
| Conduct Indemnity Deed | The deed between NAB and CYBG setting out the terms of:<br>the Capped Indemnity; and<br>certain arrangements for the treatment and management of Relevant Conduct Matters. |
| conduct risk | The risk of treating customers unfairly and/or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage. |
| counterparty | The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete. |
| Coverage ratio | Impairment allowance as at the period end shown as a percentage of gross loans and advances as at the period end. |
| covered bonds | A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group. |
| CRD IV | European legislation to implement Basel III. It replaces earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. CRD IV sets out capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also 'Basel III'. |
| Credit conversion factor (CCF) | Credit conversion factors are used in determining the exposure at default in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn and off-balance sheet commitments expected to be drawn down at the point of default. |
| Credit impaired financial assets | Financial assets that are in default or have an individually assessed provision. This is also referred to as a 'Stage 3' impairment loss and subject to a lifetime expected credit loss calculation. The Group considers 90 days past due as a backstop in determining whether a financial asset is credit impaired. |
| Credit risk mitigation (CRM) | Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set-off or netting. |

# Glossary

| TERM | DEFINITION |
|---|---|
| credit risk adjustment/credit valuation adjustment | An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty. |
| customer deposits | Money deposited by individuals and corporate entities that are not credit institutions, and can be either interest bearing, non-interest bearing or term deposits. |
| CYBI | CYB Investments Limited. |
| default | A customer is in default when either they are more than 90 DPD on a credit obligation to the Group, or are considered unlikely to pay their credit obligations in full without recourse to actions such as realisation of security (if held). |
| delinquency | See 'arrears'. |
| Demerger | The demerger of the Group from NAB pursuant to which all of the issued share capital of CYBI was transferred to CYBG by NAB in consideration for the issue and transfer of CYBG shares to NAB in part for the benefit of NAB (which NAB subsequently sold pursuant to the IPO) and in part for the benefit of NAB shareholders under a scheme of arrangement under part 5.1 of the Australian Corporations Act. |
| Demerger date | 8 February 2016. |
| derivative | A financial instrument that is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index. |
| earnings at risk (EaR) | A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates. |
| effective interest rate (EIR) | The carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument. |
| encumbered assets | Assets that have been pledged as security, collateral or legally 'ring-fenced' in some other way which prevents those assets being transferred, pledged, sold or otherwise disposed. |
| exposure | A claim, contingent claim or position which carries a risk of financial loss. |
| Exposure at default (EAD) | The estimate of the amount that the customer will owe at the time of default. |
| fair value | The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. |
| Financial Ombudsman Service | An independent body set up by the UK Parliament to resolve individual complaints between financial businesses and their customers. |
| Financial Services Compensation Scheme (FSCS) | The UK's compensation fund of last resort for customers of authorised financial services firms and is funded by the financial services industry. The FSCS may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default. |
| forbearance | The term generally applied to the facilities provided or changes to facilities provided to assist borrowers, who are experiencing, or are about to experience, a period of financial stress. |
| funding risk | A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required. |
| Group | CYBG, now Virgin Money UK PLC, and its controlled entities. |
| hedge ineffectiveness | Represents the extent to which the income statement is impacted by changes in fair value or cash flows of hedging instruments not being fully offset by changes in fair value or cash flows of hedged items. |
| IFRS 9 | The new financial instrument accounting standard which was adopted by the Group with effect from 1 October 2018. |
| impairment allowances | An expected credit loss provision held on the balance sheet for financial assets calculated in accordance with IFRS 9. The impairment allowance is calculated as either a 12-month or a lifetime expected credit loss. |
| impairment losses | The expected credit losses calculated in accordance with IFRS 9 and recognised in the income statement with the carrying value of the financial asset reduced by creating an impairment allowance. Impairment losses are calculated as either a 12-month or lifetime expected credit loss. |
| interest rate hedging products (IRHP) | This incorporates: (i) standalone hedging products identified in the Financial Services Authority (FSA) 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan (TBL) products; and (iii) the Group's secondary review of all fixed-rate tailored business loans (FRTBLs) complaints which were not in scope for the FSA notice. |
| Internal Capital Adequacy Assessment Process (ICAAP) | The Group's assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints. |
| Internal Liquidity Adequacy Assessment Process (ILAAP) | The Group's assessment and management of balance sheet risks relating to funding and liquidity. |

# Glossary

| TERM | DEFINITION |
|---|---|
| Internal Ratings-Based approach (IRB) | A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters. |
| investment grade | The highest possible range of credit ratings, from 'AAA' to 'BBB', as measured by external credit rating agencies. |
| Level 1 fair value measurements | Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets. |
| Level 2 fair value measurements | Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable. |
| Level 3 fair value measurements | Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable. |
| Lifetime expected credit loss | The expected credit loss calculation performed on financial assets where a significant increase in credit risk since origination has been identified. This can be either a 'Stage 2' or 'Stage 3' impairment loss depending on whether the financial asset is credit impaired. |
| Listing Rules | Regulations applicable to any company listed on a United Kingdom stock exchange, subject to the oversight of the UK Listing Authority (UKLA). The Listing Rules set out mandatory standards for any company wishing to list its shares or securities for sale to the public. |
| loan to value ratio (LTV) | A ratio that expresses the amount of a loan as a percentage of the value of the property on which it is secured. |
| Loss given default (LGD) | The estimate of the loss that the Group will suffer if the customer defaults (incorporating the effect of any collateral held). |
| medium-term notes | Debt instruments issued by corporates, including financial institutions, across a range of maturities. |
| Minimum Requirement for Own Funds and Eligible Liabilities (MREL) | MREL is a minimum requirement for institutions to maintain equity and eligible debt liabilities, to help ensure that when an institution fails the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business. |
| net interest income | The amount of interest received or receivable on assets, net of interest paid or payable on liabilities. |
| Net Promoter Score (NPS) | This is an externally collated customer loyalty metric that measures loyalty between a provider, who in this context is the Group, and a consumer. |
| operational risk | The risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events. |
| Overall Liquidity Adequacy Rule (OLAR) | An FCA and PRA rule that firms must at all times maintain liquidity resources which are adequate both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This is included in the Group's risk appetite and subject to approval by the Board as part of the ILAAP. |
| pension risk | The risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. |
| Personal lending | Lending to individuals rather than institutions and excludes mortgage lending which is reported separately. |
| PPI redress | Includes PPI customer redress and all associated costs excluding fines. |
| probability of default (PD) | The probability that a customer will default over either the next 12 months or lifetime of the account. |
| regulatory capital | The capital which the Group holds, determined in accordance with rules established by the PRA. |
| Relevant Conduct Matters | The legacy conduct issues covered by the Capped Indemnity, including certain conduct issues relating to PPI, standalone IRHP, voluntary scope TBLs and FRTBLs and other conduct matters in the period prior to the Demerger date whether or not known at the Demerger date. |
| residential mortgage-backed securities (RMBS) | Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal). |
| ring-fencing | A new regime of rules which require banks to change the way that they are structured by separating retail banking services from investment and international banking. This is to ensure the economy and taxpayers are protected in the event of any future financial crises. |
| risk appetite | The level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives. |
| risk weighted assets (RWA) | On and off-balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset. |
| sale and repurchase agreement ('repo') | A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counterparty (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo. |

# Glossary

| TERM | DEFINITION |
|---|---|
| Scheme | The Group's defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme. |
| secured lending | Lending in which the borrower pledges some asset (e.g. property) as collateral for the lending. |
| securitisation | The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically 'AAA' rated securities secured by the underlying financial asset. |
| Significant increase in credit risk | The assessment performed on financial assets at the reporting date to determine whether a 12-month or lifetime expected credit loss calculation is required. Qualitative and quantitative triggers are assessed in determining whether there has been a significant increase in credit risk since origination. The Group considers 30 days past due as a backstop in determining whether a significant increase in credit risk since origination has occurred. |
| specific impairment provision | A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs. |
| standardised approach | In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines. |
| stress testing | The term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds or liquidity which a bank holds. |
| structured entities (SE) | An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. May also be referred to as an SPV. |
| subordinated debt | Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation. |
| Term Funding Scheme (TFS) | Launched in 2016 by the BoE to allow banks and building societies to borrow from the BoE at rates close to base rate. This is designed to increase lending to businesses by lowering interest rates and increasing access to credit. |
| Tier 1 capital | A measure of a bank's financial strength defined by CRD IV. It captures CET1 capital plus other Tier 1 securities in issue, subject to deductions. |
| Tier 2 capital | A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV. |
| unaudited | Financial information that has not been subject to validation by the Group's external auditor. |
| underlying capital generation | The amount of capital generated by the business in basis points over a given period, before non-underlying items are included. |
| unsecured lending | Lending in which the borrower pledges no assets as collateral for the lending (such as credit cards and current account overdrafts). |
| value at risk (VaR) | A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence. |
| Virgin Money | Virgin Money UK PLC |
| Virgin Money Holdings | Virgin Money Holdings (UK) PLC |

# Abbreviations

| | |
|---|---|
| AIRB | Advanced internal ratings-based |
| ALCO | Asset and Liability Committee |
| API | Application programming interface |
| ASX | Australian Securities Exchange |
| AT1 | Additional Tier 1 |
| BCAs | Business current accounts |
| BCBS | Basel Committee on Banking Supervision |
| BoE | Bank of England |
| bps | Basis points |
| BTL | Buy-to-let |
| CAGR | Compound Annual Growth Rate |
| CCB | Capital Conservation Buffer |
| CCF | Credit conversion factor |
| CCyB | Countercyclical Capital Buffer |
| CET1 | Common Equity Tier 1 Capital |
| CIR | Cost to income ratio |
| CMA | Competition and Markets Authority |
| CPI | Consumer Price Index |
| CRD IV | Capital Requirements Directive IV |
| CRM | Credit risk mitigation |
| CRR | Capital Requirements Regulation |
| CSR | Corporate Social Responsibility |
| DEP | Deferred Equity Plan |
| DPD | Days past due |
| DTR | Disclosure and Transparency Rules |
| EAD | Exposure at default |
| EaR | Earnings at risk |
| EBA | European Banking Authority |
| ECL | Expected credit loss |
| EIR | Effective interest rate |
| EPS | Earnings per share |
| FCA | Financial Conduct Authority |
| FIRB | Foundation internal ratings-based |
| FPC | Financial Policy Committee |
| FRC | Financial Reporting Council |
| FSCS | Financial Services Compensation Scheme |
| FSMA | Financial Services and Markets Act 2000 |
| FTE | Full time equivalent |
| FVOCI | Fair value through other comprehensive income |
| FVTPL | Fair value through profit or loss |
| GDPR | General Data Protection Regulation |
| GHG | Greenhouse Gases |
| GMP | Guaranteed Minimum Pension |
| HMRC | Her Majesty's Revenue and Customs |
| HQLA | High Quality Liquid Assets |
| IAS | International Accounting Standard |
| IASB | International Accounting Standards Board |
| ICAAP | Internal Capital Adequacy Assessment Process |
| IFRS | International Financial Reporting Standard |
| ILAAP | Internal Liquidity Adequacy Assessment Process |
| ILO | International Labour Organisation |
| IPO | Initial Public Offering |
| IRB | Internal ratings-based |
| IRHP | Interest rate hedging products |
| IRRBB | Interest rate risk in the banking book |
| ISDA | International Swaps and Derivatives Association |
| JV | Joint venture |
| LCR | Liquidity coverage ratio |
| LDR | Loan to deposit ratio |
| LGD | Loss Given Default |
| LIBOR | London Interbank Offered Rate |
| LSE | London Stock Exchange |
| LTIP | Long-term incentive plan |
| LTV | Loan to value ratio |
| MREL | Minimum Requirement for Own Funds and Eligible Liabilities |
| MRT | Material Risk Takers |
| NAB | National Australia Bank Limited |
| NIM | Net interest margin |
| NPS | Net promoter score |
| NSFR | Net stable funding ratio |
| OLAR | Overall liquidity adequacy rule |
| PBT | Profit before tax |
| PCA | Personal current accounts |
| PD | Probability of Default |
| PILON | Payment in lieu of notice |
| POCI | Purchased or originated credit impaired |
| PPI | Payment protection insurance |
| PRA | Prudential Regulation Authority |
| RAS | Risk Appetite Statement |
| RMBS | Residential mortgage-backed securities |
| RMF | Risk Management Framework |
| RoTE | Return on Tangible Equity |
| RPI | Retail Price Index |
| RWA | Risk weighted assets |
| SICR | Significant increase in credit risk |
| SIP | Share Incentive Plan |
| SME | Small or medium sized enterprises |
| SRB | Systemic Risk Buffer |
| SVR | Standard variable rate |
| TCC | Transactional Credit Committee |
| TFS | Term Funding Scheme |
| TNAV | Tangible net asset value |
| TSA | Transitional Services Agreement |
| TSR | Total Shareholder Return |
| VAA | Virgin Atlantic Airways |
| VaR | Value at risk |

# Country by country reporting

The Capital Requirements (Country by Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's CRD IV. The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations.

The vast majority of entities that are consolidated within the Group's financial statements are UK registered entities. The activities of the Group are described in the Strategic report contained in the Group's Annual Report and Accounts.

| | 2019<br>UK |
|---|---|
| Average FTE employees (number) | **8,703** |
| Total operating income (£m) | **1,749** |
| Loss before tax (£m) | **232** |
| Corporation tax paid (£m) | **7** |
| Public subsidies received (£m) | **–** |

The only other non-UK registered entity of the Group is a Trustee company that is part of the Group's securitisation vehicles (Lanark and Lannraig). Lannraig Trustees Limited is registered in Jersey. This entity plays a part in the overall securitisation process by having the beneficial interest in certain mortgage assets assigned to it. This entity has no assets or liabilities recognised in its financial statements with the securitisation activity taking place in other UK registered entities of the structures. This entity does not undertake any external economic activity and has no employees. The results of this entity as well as those of the entire Lanark and Lannraig securitisation structures are consolidated in the financial statements of the Group.

# Other information

The financial information included in this results announcement does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 30 September 2019 were approved by the directors on 27 November 2019 and will be delivered to the Registrar of Companies following publication in December 2019. The auditor's report on those accounts was unqualified and did not include a statement under sections 498(2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 498(3) (failure to obtain necessary information and explanations) of the Companies Act 2006.