Annual report & consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2016

Company Number: SC001111

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Contents

Overview

Clydesdale Bank PLC ('the Bank'), together with its subsidiary undertakings (which together comprise 'the Group'), operate under the Clydesdale Bank, Yorkshire Bank and B brands. It offers a range of banking services for both retail and business customers through retail branches, Business Banking centres, direct and online banking, including B, and brokers. It is the main operating subsidiary of its immediate parent, CYBG PLC.

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.

The forward looking statements disclaimer can be found on page 156.

Officers and professional advisers

Directors	David Joseph Duffy Ian Stuart Smith Debbie Crosbie Clive Adamson (appointed 1 July 2016) David Jonathan Bennett (appointed 22 October 2015) David Alan Browne Paul Coby (appointed 1 June 2016) Adrian Thomas Grace Richard John Gregory OBE Fiona MacLeod (appointed 12 September 2016) James Neilson Pettigrew Dr Teresa Robson-Capps Timothy Wade (appointed 12 September 2016)
Secretary	Lorna Forsyth McMillan James Richard Peirson
Registered office	20 Merrion Way Leeds Yorkshire LS2 8NZ
Independent auditors	Ernst & Young LLP 25 Churchill Place London E14 5EY

Strategic Report

The Directors of the Bank with its subsidiary undertakings (which together comprise 'the Group') present their Strategic Report for the year ended 30 September 2016.

Principal activities

The Group operates a full service UK-focused retail and commercial banking business under the brand names 'Clydesdale Bank', 'Yorkshire Bank' and 'B' across its core regional markets (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. Clydesdale and Yorkshire Banks are strong, low risk retail-only banks focused on providing residential mortgages, personal and business current accounts, savings, personal loans and credit cards, loans for small and medium businesses, and payment and transaction services.

Business review

Financial analysis

The consolidated income statement is presented on an underlying basis which includes adjustments to present items that the Group believes are non-recurring, or not otherwise indicative of the underlying performance of the business.

Consolidated income statement – underlying basis	**2016 £m**	2015 £m	2016 vs 2015 %
Net interest income	**807**	789	2.3%
Non-interest income	**183**	172	6.4%
Total operating income	**990**	961	3.0%
Total operating and administrative expenses	**(726)**	(737)	(1.5)%
Operating profit before impairment losses	**264**	224	17.9%
Impairment losses on credit exposures (1)	**(39)**	(78)	(50.0)%
Underlying profit on ordinary activities before tax	**225**	146	54.1%
Conduct charges	**(484)**	(486)	
Restructuring expense	**(45)**	(17)	
Separation costs	**(11)**	(10)	
Net gain on capital and debt restructuring (2)	**1**	41	
Pension increase exchange gain	**-**	18	
Loss on impairment of intangible assets	**(45)**	-	
Gain on disposal of VISA share	**7**	-	
Statutory loss on ordinary activities before tax	**(352)**	(308)	
Tax (charge)/credit	**(206)**	59	
Statutory loss attributable to equity holders	**(558)**	(249)	

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to notes 15 and 16 to the financial statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in other assets and liabilities at fair value within non-interest income (refer to notes 6 and 13 to the financial statements).

(2) Includes a £1m gain on debt restructuring. The comparative period includes gains of £41m, and a loss of £2m, in relation to capital restructuring and a further £2m gain on debt restructuring (refer to notes 6, 7 and 11 to the financial statements).

Group underlying profit before tax of £225m increased from £146m for the year ended September 2015 primarily due to an increase in operating income, reflecting a reduction in funding costs across both retail deposits and wholesale funding, and a reduction in impairment losses as a result of strong credit performance.

The Group made a statutory loss after tax of £558m in the current year compared with the statutory loss after tax of £249m for the year to September 2015. The 2016 loss was primarily due to the additional conduct charges for the year and the write-off of deferred tax assets as a result of the enactment of Finance Bill 2016, reflecting the inherent uncertainty in the UK's approach to the taxation of Banking Groups. The 2016 result also included a charge of £45m for restructuring and £45m for impairment of intangible assets.

Strategic Report (continued)

Income analysis

Net interest income	2016 £m	2015 £m	2016 vs 2015 %
Interest income and similar income	**1,101**	1,110	(0.8)%
Interest expense and similar charges	**(294)**	(321)	(8.4)%
Total net interest income	**807**	789	2.3%

Net interest income increased by £18m (2.3%) from £789m to £807m. Gross interest income and similar income decreased in the year by £9m (0.8%) from £1,110m to £1,101m. Mortgage interest income grew due to the successful execution of our strategy to increase the size of the mortgage portfolio. The balance growth of 6.5% was well above system growth of 3.2%[1]. Interest income from SME lending fell marginally in the year due to lower average volumes reflecting the continued managed run-off of the non-core portfolio. SME lending returned to growth in the year driven by the core book which grew by 6.1%. Unsecured personal lending interest income also fell in the year as a result of the decline in both the size of the book and lower customer interest rates. The decline was largely driven by the personal loan book, in a highly competitive market environment, where for much of the year the returns on the overall book were unattractive to the Group.

Gross interest expense reduced in the year from £321m to £294m. The main driver behind this is the reduction in average wholesale balances replaced by growth in higher quality and lower cost customer funding, in particular savings accounts. In addition to this there was a continuation of the managed reduction in term deposit costs as more expensive term deposits were replaced at cheaper rates with volumes remaining broadly flat.

Structural hedges are used to minimise the volatility on income related to customer deposits and the Group's capital. Balances are hedged with interest rate swaps and the tenor is based on the expected life of the liabilities. During 2016, the notional size of the hedge increased to £14.4bn and covered approximately £8.3bn of non and low interest bearing liabilities, £2.7bn of administered deposits and £3.4bn of equity. Notional interest income from structural hedging was £86m (2015: £79m).

Non-interest income	2016 £m	2015 £m	2016 vs 2015 %
Gains less losses on financial instruments at fair value	**9**	2	Large
Fees and commission	**151**	144	4.5%
Other income	**23**	26	(11.5)%
Total underlying non-interest income	**183**	172	6.4%
Gain on capital and debt restructure	**1**	43	(97.7)%
Gain on disposal of VISA share	**7**	-	100.0%
Total statutory non-interest income	**191**	215	(11.2)%

Non-interest income reduced by £24m (11.2%) from £215m to £191m. The key driver in the reduction was the gain on capital and debt restructure in 2015 which was not repeated in 2016. Underlying non-interest income increased from £172m to £183m in 2016. Fees and commissions across the industry remain under pressure and have been impacted by the impact of European Interchange Fee Regulation which came into full effect from December 2015. Business lending non-interest income fell in the year in line with average balances, and also reflected the impact of the fee-free campaign for new business current account customers. Fees & commission income benefitted by £13m following the transfer of the UK intermediary business from NAB to the Group on 30 September 2015. This income primarily relates to commissions from third parties on the sales of insurance products to the Group's customers. The other income streams were broadly in line with the prior year.

[1] System growth is sourced from the BoE 'Mortgages outstanding by type of lender, UK (BOE)' report (MM4)

Strategic Report (continued)

Income statement analysis (continued)

Operating and administrative expenses

	2016 £m	2015 £m	2016 vs 2015 %
Personnel expenses	**280**	214	30.8%
Depreciation expense	**88**	20	Large
Other operating and administrative expenses:	**358**	503	(28.8)%
of which operating lease rentals	**30**	32	(6.3)%
of which other occupancy charges	**39**	38	2.6%
of which related entity charges	**5**	298	(98.3)%
of which other operating and administrative expenses	**284**	135	Large
Total underlying operating and administrative expenses	**726**	737	(1.5)%
Conduct charges	**484**	486	(0.4)%
Restructuring expense	**45**	17	164.7%
Separation costs	**11**	10	10.0%
Pension increase exchange gain	**-**	(18)	(100.0)%
Loss on impairment of intangible assets	**45**	-	Large
Loss on capital restructure	**-**	2	(100.0)%
Total statutory operating and administrative expenses	**1,311**	1,234	6.2%

Statutory operating and administrative expenses increased by £77m (6.2%) due to higher charges of a one-off nature, in particular higher restructuring and impairment of intangible asset charges. Total underlying expenses were broadly flat and moved from £737m in FY15 to £726m in FY16, delivered by strong cost control in the second half of the year. Personnel expenses have risen during the year following the acquisition of CYB Services Limited on 30 September 2015; these costs were previously included within related entity recharges. Other costs previously recharged to the Group are now recognised directly, resulting in an increase in other operating and administrative expenses. During the year the Group ran a voluntary severance programme which led to c. 150 Full Time Equivalent employees (FTEs) leaving from across the business. Core FTEs at 30 September 2016 were 6,313[1], being 535 lower than prior year.

Tax (expense)/credit	2016 £m	2015 £m	2016 vs 2015 %
Tax expense on underlying profit	**(47)**	(21)	123.8
Other tax expense	**(159)**	80	Large
Tax (expense)/credit on statutory loss	**(206)**	59	Large
UK Corporation tax rate	**20.0%**	20.5%	
Effective tax rate – Underlying profit	**20.9%**	14.4%	
Effective tax rate – Statutory profit	**58.5%**	19.2%	

The statutory effective tax rate of 58.5% in the current year is driven by the write-off of deferred tax assets on losses.

The material deferred tax charge is largely a result of the derecognition of tax losses valued at £237m following changes to tax legislation enacted in September 2016, which further restricted the Group's ability to offset tax losses. Further detail is provided in note 22.

The underlying profits of the Group were taxed at an effective rate of 20.9% (2015: 14.4%).

[1] Core FTEs excludes FTEs who are involved in legacy conduct remediation activities

Strategic Report (continued)

Balance sheet analysis

Customer loans (1)

	2016 £m	2015 £m
Mortgages	**21,836**	20,504
SME lending		
- Core	**6,358**	5,992
- Non-core	**800**	1,070
Unsecured personal lending	**1,153**	1,218
Total customer loans	**30,147**	28,784
Loans and advances to customers	**29,396**	27,687
Other financial assets at fair value	**747**	1,093
Due from customers on acceptances	**4**	4
Total customer loans	**30,147**	28,784

(1) Spot balances excluding accrued interest receivable, provisions for impairments, unearned income and deferred and unamortised fee income.

Customer loans increased by £1,363m from £28,784m at 30 September 2015 to £30,147m at 30 September 2016, driven by strong growth in mortgages. SME lending balances increased year on year, with strong growth in the Core SME book being partly offset by the continued run-off of the non-core book. Unsecured personal lending reduced in the period reflecting the competitive market environment for fixed rate personal loans, partly offset by a return to growth on credit cards.

Mortgages

Mortgages comprise the Group's largest asset portfolio and have a significant impact on its overall financial performance. The mortgage portfolio increased by 6.5% from £20,504m at 30 September 2015 to £21,836m at 30 September 2016. Gross origination in the year was £4,914m. This was higher than system growth of 3.2%[2]. The growth in the year reflected the strong performance in and our commitment to the intermediary market, alongside continued investment in the branch network

Growth slowed down in the second half of the year which was in part due to the impact of changes to Stamp Duty on BTL properties on 1 April 2016, which brought forward demand from the second half to the first half. Whilst in the second half the Group continued to grow above market rates, the overall market slowed; this has been attributed by some external commentators to the impacts of the UK referendum decision to withdraw from the European Union (EU).

The portion of BTL mortgages increased from 31% as at September 2015 to 34% as at September 2016 and included the impact of the surge in demand relating to the changes in Stamp Duty.

Growth continues to be predominantly through fixed rate mortgages, which accounted for 93% of mortgages drawn in the year.

[2] System growth is sourced from the BoE 'Mortgages outstanding by type of lender, UK (BOE)' report (MM4)

Strategic Report (continued)

Balance sheet analysis (continued)

SME lending

SME lending grew in the year from £7,062m at 30 September 2015 to £7,158m at 30 September 2016. The SME lending portfolio has been revitalised and the core book has returned to growth. The core book grew at 6.1% versus system growth of 2.2%[1], increasing from £5,992m at 30 September 2015 to £6,358m at 30 September 2016.

The Group continues to run off the non-core portfolio which has fallen from £1,752m at September 2014 to £800m at September 2016.

Origination activity improved in the year with a 15% increase in volumes of loans and facilities granted and the book is well diversified across the product portfolio.

Unsecured personal lending

The Group's unsecured personal lending portfolio comprises credit cards, personal loans and overdrafts originated through branches or by way of digital or other direct channels. Unsecured personal lending balances decreased by 5.4% from £1,218m at 30 September 2015 to £1,153m at 30 September 2016. This was primarily due to reduced appetite for in personal loan volumes via our digital platform, after competitive pressures reduced margins to unattractive levels. This impact was offset by an increase in origination via the branch network and direct (telephone) channel in the year. Credit card balances grew slightly in the year primarily as a result of competitive offers available to customers for the majority of the year.

Customer deposits [(2)]

	2016 £m	2015 £m
Current accounts	**13,248**	12,982
Variable rate savings accounts	**8,240**	7,790
Fixed rate term deposits	**5,500**	5,483
Other wholesale deposits	**12**	94
Total customer deposits	**27,000**	26,349
Due to customers	**26,954**	26,282
Other financial liabilities at fair value	**46**	67
Total customer deposits	**27,000**	26,349

(2) Spot balances excluding accrued interest payable.

Customer deposits increased by £651m (2.5%), from £26,349m at 30 September 2015 to £27,000m at 30 September 2016, primarily due to an increase in current accounts and variable rate savings accounts.

Current accounts

Funding provided by current accounts increased by £266m (2.0%) from £12,982m at September 2015 to £13,248m at September 2016. There have been positive impacts from the £150 switching offer which was in place in the first half, the 25 month fee free offer on BCAs, as well as the launch of 'B' (spot balance as at September 2016: £42m). These were offset by the managed run-off of £740m non-core corporate deposits. Excluding this, underlying current account growth was 8.2%.

Savings accounts

Variable rate savings account balances increased by £450m (5.8%) from £7,790m at 30 September 2015 to £8,240m at 30 September 2016 primarily driven by a substantial increase in ISAs due to attractive pricing, with additional benefit from strong early performance on 'B' savings (spot balance as at September 2016: £151m). This was in part offset by outflows as a result of ratings-sensitive customers exiting in response to credit rating changes following separation from NAB.

[1] System growth is sourced from the BoE 'Industrial analysis of monetary financial institutions' lending to UK residents' report (c1.2), and excludes individuals and individual trusts, activities auxiliary to financial intermediation, insurance companies & pension funds and financial intermediation (excluding insurance and pension funds) results.

Strategic Report (continued)

Balance sheet analysis (continued)

Fixed rate term deposits

Fixed rate term deposits increased by £17m (0.3%) from £5,483m at 30 September 2015 to £5,500m at 30 September 2016, driven by subdued market demand and in line with the Group's ongoing strategy to proactively run off the higher rate part of the book that originated in 2012.

Debt securities in issue [1]	2016 £m	2015 £m
Retail mortgage backed securities ('RMBS')	**3,208**	3,031
Covered bonds	**797**	721
Related party [2]	**479**	857
Total debt securities in issue	**4,484**	4,609

(1) Spot balances excluding accrued interest payable.

(2) Includes subordinated debt issued to CYBG. Lannraig note issuance to NAB of £352m (2015: £382m) is now included within RMBS as the note has moved from related to third party following the demerger and IPO.

Debt securities in issue decreased by £125m from £4,609m at 30 September 2015 to £4,484m at 30 September 2016. In the period a new Lanark note of £750m was issued in August 2016, and the remaining outstanding principals on the USD800m Lanark 2012-2 1A, USD300m Lanark 2013-1A and £350m Lanark 2013-1B notes were redeemed in line with the scheduled programme terms. Subordinated notes of £475m previously issued to NAB were repurchased in 2016 with a new £475m issuance made to CYBG, the parent company of the Group.

Strategic Report (continued)

Balance sheet analysis (continued)

Key Credit Metrics (audited)

	2016	2015
Impairment charge on credit exposures (£m)		
SME lending (including lease finance)	31	45
Retail lending	8	33
	39	78
Of which:		
Specific charge for impairment losses	25	73
Collective charge for impairment losses	14	5
	39	78
Impairment provisions on credit exposures (£m)		
SME lending (including lease finance)	157	168
Retail lending	58	62
	215	230
Of which		
Specific provision	64	92
Collective provision	151	138
	215	230
Credit risk adjustments held on loans at fair value (£m)		
SME lending	24	38
Of which		
Individually assessed credit risk adjustments	8	11
Collectively assessed credit risk adjustments	16	27
	24	38
Impairment (credits)/losses on loans held at fair value	(11)	(18)
Past Due and impaired assets (£m)		
90+ DPD assets	150	143
Impaired assets (1)	233	263
Asset Quality measures (%)		
90+ DPD plus impaired assets to customer loans	1.27%	1.41%
Specific provisions to impaired assets (2)	30.8%	39.2%
Net write-offs to customer loans (3)	0.18%	0.35%
Total provision to customer loans (4)	0.79%	0.93%
Total impairment charge to average customer loans (5)	0.09%	0.21%

(1) Impaired assets for September 2016 and September 2015 includes £19m and £25m of impaired fair value loans respectively.
(2) Total specific provision includes the individually assessed credit risk adjustments on loans at fair value.
(3) Net write-offs includes loans at fair value.
(4) Total provision to customer loans includes the credit risk adjustments on loans at fair value through profit and loss.
(5) Total impairment charge to average customer loans includes loans held at fair value through profit and loss.

The Group's strategy to target selective areas for balance sheet growth particularly through mortgage origination has influenced the low impairment charge. High underwriting standards and a controlled risk appetite have resulted in a portfolio with strong asset quality which has, in turn, led to a low impairment charge to average customer loans ratio across all portfolios. Most asset quality measures improved in the period as the influence of a strong customer focused culture, prudent risk management and a stable UK economy took effect. Some economic pressure on the oil & gas and agriculture sectors has had a softening effect on the portfolios, evidenced by an increased level of collective provision. While the portfolio remains sensitive to economic shocks, broader based negative effects from Brexit have yet to be observed and prolonged economic stability underpinned by low interest rates and higher employment has supported customer confidence.

Strategic Report (continued)

Balance sheet analysis (continued)

Retail asset quality remains strong with lower default rates and impairment losses observed across the period. The 'lower for longer' interest rate environment has sustained customer confidence, supporting strong growth in the mortgage portfolio and stable asset quality.

The level of impairment losses on credit exposures has reduced significantly in the period to September 2016 due to the lower levels of specific provision required, reflective of the reduction in the levels of defaulted and impaired lending. Stabilisation of asset values has also supported recoveries and write backs from provisions previously recognised.

The ratio of total provisions to customer loans reduced by 14 basis points to 0.79% in the year to 30 September 2016 driven by the reduced levels of specific provision held and continued growth in the portfolio, particularly mortgages which have a lower provisioning requirement.

Capital and Funding

Whilst RWA increased by £810m from £18,207m at 30 September 2015 to £19,017m at 30 September 2016, and the Group was required to absorb short term volatility in the IAS 19 pension position, underlying capital generation ensured the CET1 ratio remained robust at 12.6%.

The Group continues to have a strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and management of liquidity risk, at an appropriate cost. The blended cost of funding has reduced from 108bps to 100bps, through the repricing of term deposits and a reduction in expensive wholesale funding, principally from NAB, which was repaid in advance of separation. The LDR increased from 109% to 112% due to growth in customer lending combined with a managed reduction in short term corporate deposits.

Key performance indicators

The Directors do not rely on key performance indicators at the individual subsidiary level. The performance of the Group is included in the Annual Report & Accounts of CYBG PLC. The business is managed within the CYBG Group and the results are consistent with the Group's status as a fully integrated and wholly owned subsidiary of the CYBG Group. For this reason, the Company's Directors believe that providing futher indicators for the Group itself would not enhance an understanding of the development, performance or position of the Group.

Principal risks and mitigating actions

The Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve its strategic objectives.

The Directors have performed a robust assessment of the principal risks facing the Group, including those that would threaten its business model and future performance, solvency or liquidity.

Principal risks	Key mitigating actions
Credit Risk is the risk of loss of principal or interest stemming from a borrower's failure to meet contracted obligations to the Group in accordance with the terms agreed. Credit risk is evident at both a portfolio and transactional level.	• Significant credit risk strategies, credit risk appetite and tolerances for credit risk are approved and reviewed by the Board and Board's Risk Committee, and inherent in the Group's business model. • The credit portfolio is closely monitored including risk sensitivity analysis with reviews of asset quality metrics with actions initiated where required.

Strategic Report (continued)

Principal risks and mitigating actions (continued)

Balance Sheet & Prudential Regulation Risks cover a number of categories of risk which affect the manner in which the Group can support its customers in a safe and sound manner. The risks include the need to withstand times of stress for the loss of funding (liquidity), the impact of restricted access to future sources of deposits (funding), the impact of providing a defined benefit pension scheme to employees (pension) and the need to withstand severe unexpected losses (capital). The Group may face changes in values of assets and liabilities as a result of movements in market factors such as interest rates, foreign exchange rates, volatility and credit spreads which may give rise to losses (Market Risks). Balance Sheet risks are subject to rules and guidance (Prudential Regulation) and these are subject to a high level of change. There is a risk of failing to understand and comply with relevant rules or inadequate change management.	• Liquidity is managed in accordance with standards that are approved by the Board and supported by annual Funding and Contingency Funding Plans. • Liquidity is managed on a daily basis ensuring normal daily cash requirements are met and adequate sources of liquidity are available to support unforeseen cash outflows. • The Group completes a formal annual assessment of Liquidity Adequacy which is shared with the PRA; this includes analysis of key risks with consideration of stress scenarios. • Capital is forecast and monitored on a monthly basis by Treasury overseen by the Asset and Liability Committee (ALCO). • The Group completes a formal annual assessment of its capital requirements which is shared with the PRA, the outcome of the process influences the allocation and quantum of capital and feeds directly into risk appetite. • The Group has a designated Prudential Risk team who independently monitor, oversee and challenge Balance Sheet risks. • The Group undertakes a detailed assessment of the capital requirements inherent in its strategy including consideration of the impact of significant loss scenarios in order to inform the Board of potential areas of weakness in the Group's business model and also to ensure an appropriate level of capital is held in both business as usual and stressed environments.
Regulatory and Compliance Risk consists of regulatory strategy and change risk, regulatory relationship risk and the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, industry codes of conduct and voluntary initiatives.	• The Group proactively assesses the impacts of legal and regulatory developments, liaises with the various regulatory bodies and participates in industry fora. • Continued and significant senior management focus and levels of business resource are directed towards maintaining full regulatory compliance and this is considered when setting Risk Appetite. • The Executive Risk Committee approves all material changes to regulatory policy and protocols. The Group's governing principles include the management and maintenance of regulatory policies and regulatory engagement.
Conduct Risk is defined as the risk of treating customers unfairly and / or delivering inappropriate outcomes resulting in regulatory fines, compensation, redress costs and / or reputational damage.	• The Group has a Conduct Framework, with supporting target outcomes and operating principles. • Products are designed to meet customer needs and expectations, with governance processes embedded to ensure those objectives are met.

Strategic Report (continued)

Principal risks and mitigating actions (continued)

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Impacts from Operational Risks arise from the day to day activities of the Group, which may result in direct or indirect losses and could adversely impact the Group's financial performance and position.	• The Group has an established Operational Risk Framework to enable identification, management and mitigation of Operational Risks. • Risk categories are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events. • Supplier relationships are categorised based on criticality of the support provided. Contingency planning focuses on alternative options and management approaches in the event of an outage with regular scenario tests performed. • Regular reviews and oversight of the Group's systems and infrastructure including the risk of cyber attack.
Financial Crime Risk is the risk that the Group's Products and Services will be used to facilitate Financial Crime against the Group, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes. It also includes risks associated with external or internal acts intended to defraud, misappropriate, or circumvent existing controls.	• The Group has an established Financial Crime Framework supporting ongoing management, monitoring and mitigation of Financial Crime Risk. • The Group completes ongoing risk assessments, monitoring and reporting, with appropriate Know Your Customer (KYC) procedures. • The Group operates zero tolerance for internal fraud and has a control framework in place to mitigate against this risk.
Strategic, Business and Financial Performance Risk is the risk of significant loss, loss of earnings and / or damage arising from business decisions that impact the long term interests of stakeholders or from an inability to adapt to external developments.	• The Board approves and oversees the execution of the Strategic Plan and associated strategic risk following the recommendations of the Chief Executive Officer and Executive Leadership Team. • A consolidated report outlining the triggers and exposure to strategic risk is independently prepared and presented to the Board's Risk Committee by the Chief Risk Officer.
People Risk is the risk of not having sufficiently skilled and motivated employees who are clear on their responsibilities and accountabilities and who behave in an ethical way. This could lead to inappropriate decision making that is detrimental to customers, other employees or shareholders and could ultimately lead to Regulatory sanction.	• Roles, responsibilities and performance expectations are defined in role profiles and expanded through objective setting and ongoing performance management. • The quality and continuity of our leadership is reviewed and assessed through succession planning and talent management activity. • Decisioning authorities and delegations are clearly articulated and approved at least annually by the Board. • A robust and proportionate employment screening policy is applied at the point of recruitment. • A mandatory suite of compliance learning is assigned to all employees.

Strategic Report (continued)

Emerging risks

The Group monitors the environment in which it operates to identify emerging risks that may have an impact on its operations and strategy; the Group currently considers its top emerging risks to be:

Emerging risks	Key mitigating actions
The UK vote to leave the EU ('Brexit')	The outcome of the EU Referendum has created a period of economic uncertainty for the UK and wider environment. Without certainty or clarity as to exit plans, a number of market commentators have predicted a slowdown in the economy. The Group has implemented appropriate monitoring and oversight activities with external implications continuing to be assessed and has, where possible, established mitigating actions.
Macroeconomic environment	While the Group's customer base is, and is expected to remain, predominantly UK based, its business will be subject to inherent risks arising from macroeconomic conditions in the UK and geopolitical uncertainty. The impact of the sustained low interest rate environment following the recent reduction in the BoE Base Rate places increased pressure on NIM and has an adverse effect on valuations of the Defined Benefit Pension Scheme with a resultant adverse impact on Capital. In addition, depressed oil prices may also impact economic growth and have implications relative to the Group's strategic objectives. The Group's credit portfolio continues to be monitored closely with appetite adjusted where appropriate and risk sensitivity analysis conducted on an ongoing basis. Regular assessments of strategic plans are undertaken to minimise and negate potential impacts.
Separation from NAB	There is a risk that the functions and processes developed and restructured as part of the separation from NAB may not operate as intended or may not have been properly created or completed, which could result in operational difficulties. TSAs and associated exit plans are in place with NAB to provide ongoing support for a small number of functions and processes over agreed timeframes. Other functions and processes already transitioned were tested for readiness and are now subject to oversight through the Group's Risk Management Framework.
BTL Lending	Regulatory and taxation changes such as limits to the income tax relief on mortgage interest expense and additional stamp duty may result in lower yields on BTL property investments and may negatively affect mortgage supply and demand. The Group has a balanced portfolio with growth through a number of channels and products. The lending portfolio is subject to regular monitoring and stress testing. Customer affordability checks and full BTL credit assessments are conducted at the point of application. Risk Appetite includes a number of BTL measures which are regularly reviewed and adjusted as appropriate.
Cybercrime and IT	An inability to appropriately respond to the increased threat of cybercrime associated with digital expansion, or maintain pace with industry trends and customer expectations may materially affect the Group's financial and operational performance. The Group continues to invest and enhance information security defences in response to emerging and known threats. Procedures are in place to ensure compliance with data protection regulations by both employees and third party service providers, and to implement security measures to help prevent cyber theft.

Strategic Report (continued)

Emerging risks (continued)

Regulatory capital requirements	The Group may be impacted by certain revisions in the methodology for calculating regulatory capital which may include, amongst other things, changes to the approach for calculating the standardised approaches for credit risk and operational risk, on which the BCBS is consulting. The Group continually assesses the impact of changes to prudential requirements and, when appropriate, will seek to mitigate the impact by applying changes to business processes including the implementation of IRB.
Banking reform, ring fencing and resolution	The relevant regulatory authorities in the UK and Europe have proposed reforms to a number of aspects of the banking sector. While the impact of these remains uncertain, the evolution of these and future initiatives may impact on the business, financial conditions and results of operations. The majority of the Group's activities are expected to be permitted activities for ring fenced banks under the proposed rules and therefore, the Group does not expect to make material changes to its current legal structure or operations.
MREL	The BoE has published its policy to implement the Bank Recovery and Resolution Directive (BRRD) requirement for firms to meet the MREL, designed to ensure sufficient loss absorbing capacity and continuity of critical functions without recourse to public funds. MREL is set annually on a case by case basis and the requirement for firms to meet MREL will be phased in between 2016 and 2022. The BoE will communicate the Group's MREL requirements. There are risks that in order to comply with MREL the Group will need to begin issuing debt instruments that satisfy MREL and this may be at a significantly higher cost to other forms of debt leading to a deterioration in the Group's financial results. Amongst other factors, the cost will be influenced by the market's response to MREL and the Group's credit rating and it is uncertain what impact MREL will have on credit ratings. MREL requirements will be applied across the industry and the relative impact on the Group compared to competitors is not known; however, there is a risk that the relative impact may adversely impact the Group's competitiveness.
Potential changes to UK corporation tax	The UK tax environment for banking groups is unsettled. Recent material changes have included a new 8% surcharge on taxable profits (without relief for losses) from 1 January 2016, compounding the adverse impact of 2015 changes that made charges for compensation payments largely non-deductible for tax. Further, from 1 April 2016, only 25% of a bank's taxable profit can be relieved by brought forward losses, greatly increasing the horizon over which losses may be used whilst accelerating cash tax outflow. This change, enacted alongside a further reduction, to 17% from 1 April 2020, in the mainstream rate of tax, has triggered a reassessment of the carrying value of deferred tax assets. Other changes announced but not yet enacted include a proposed restriction on the tax deductibility of interest and interest like amounts. Any restriction in interest expense could increase the tax charge. The application of this proposed change to Financial Services businesses remains subject to consultation between the industry and HM Treasury, with further announcements expected in draft legislation due in December 2016.

Strategic Report (continued)

Emerging risks (continued)

Use of data	The EU Commission's General Data Protection Regulation is to be introduced from 25 May 2018 meaning that the Group will be subject to increased regulatory burden when processing personal customer, employee and other data in the course of its business and may be subject to increased sanctions for breach. Changes to legislation may also inhibit the Group's ability to use data to carry out its business objectives. The Payment Services Directive 2 (PSD2) requiring to be implemented from 13 January 2018, introduces changes to the use and control of customers' data. Assuming that customers provide consent, their banks will have to provide merchants, Third Party Payment Providers and Account Information Service Providers, such as aggregator sites, access to details of their bank accounts. Another feature of PSD2 is the requirement to introduce strong customer authentication systems to increase the security around payments.

Outlook

Over the next twelve months the Group will continue to support CYBG, the Group's ultimate parent, in delivering its targets and executing its strategy.

The Strategic Report was approved by the Board of Directors on 21 November 2016 and was signed on its behalf by:

David Duffy

Chief Executive Officer

Clydesdale Bank PLC

Risk Report

RISK MANAGEMENT FRAMEWORK

Effective management of risk is a core capability for a successful financial services provider and is fundamental to the Group's strategy. The Group has implemented significant changes to strengthen its risk capabilities since becoming standalone and continues to develop in line with industry developments and best practice.

Risk Principles

Risk exists in every aspect of the Group's business, throughout the operating environment and is a core consideration within the Strategic Plan. The Group's approach to risk management is based on a principle that risk management capability must be embedded within the business' front line teams to be effective. This overriding principle embodies the following concepts::

- Commercial decisions are made on the basis of proactive consideration of risk and the potential impact on customers;
- Business managers use the Risk Management Framework to support decision making involving risk and reward trade offs; and
- Employees are responsible for risk management in their day to day activities.

Risk Management and Internal Controls

The Board actively monitors the Group's risk management and internal control systems. A review of the effectiveness of those systems has been performed incorporating all material controls, including financial, operational and compliance controls.

Risk Strategy

The Group has a clearly defined strategy in order to manage and mitigate risk in the daily course of its business. The strategy consists of:

- Ensuring all principal and emerging risks are identified and assessed;
- Risk appetite which is clearly articulated and influences the Group's strategic plan;
- A clearly defined risk culture which emphasises risk management throughout all areas of the business whilst maintaining independent oversight;
- Ongoing analysis of the environment in which the Group operates to proactively address potential risk issues as they arise; and
- Supporting commercial decisions and people with appropriate risk processes, systems and controls.

Risk Appetite Statement

'Risk Appetite' is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity, to achieve its strategic objectives. The RAS articulates and helps communicate to stakeholders, the Group's risk appetite. This is important as it provides the definitive view on the broad direction of risk taking activity the Board is comfortable that the Group undertakes and allows decision makers (including those with delegated authority and also those providing oversight) to exercise judgement with greater confidence and speed.

The RAS aligns to the risks identified and defined in the Risk Management Framework (RMF). The design and structure of the RAS has taken into consideration best practice recently articulated by the European Central Bank which is aimed at ensuring boards should be strongly involved in the validation process and monitoring of the RAS.

The Group's RAS is prepared by the Chief Risk Officer with consideration of the strategic objectives and business model of the Group as well as the environment in which it operates. Monthly reporting to Executive Committees and Board includes details of performance against relevant RAS settings, breaches and trends.

Risk Report (continued)

RISK MANAGEMENT FRAMEWORK (continued)

Risk Management Framework

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy. The Group identifies and manages risk using the Risk Management Framework, which is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, control, mitigate, monitor and report all internal and external sources of material risk.

Risk Culture

Central to the Group's risk culture is the fair treatment of customers and meeting obligations to stakeholders, including shareholders and employees. The Board and senior management are responsible for providing a clear view of risk culture through their actions and words, and proactively addressing any identified areas of weakness or concern.

Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships.

Initiatives that support appropriate risk culture include: the performance management framework; escalation procedures encouraging employees to raise concerns; messaging from the Chief Executive Officer and members of the Executive Leadership Team emphasising the importance of risk identification, management and mitigation.

Underpinning the RMF and at the heart of the Group's risk culture, is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model and a formal delegation framework through which employees are able to make risk based decisions.

Risk Management

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy. Board oversight of risk management is facilitated by the Boards' Risk and Audit Committees; the Board approves the Group's overall governance, risk and control frameworks and risk appetite.

Risk Policies and Procedures

The Policy Framework is a key component of the Group's RMF providing structure and governance for the consistent, effective management of Policies. In developing the Policy Framework, the Group aims to set a tone that demonstrates the risk culture expected across the organisation. This aligns with the behavioural expectations for all employees which form a core part of our performance management approach. Policies and supporting standards define the minimum control requirements which must be observed across the Group to manage material sources of risk within risk appetite.

Risk Governance and Oversight

The Group's risk governance structure strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

Risk Report (continued)

RISK MANAGEMENT FRAMEWORK (continued)

Three Lines of Defence

Effective operation of a Three Lines of Defence model is integral to the Group's approach to risk management and is based on an overriding principle that risk capability must be embedded within the First Line of Defence teams to be effective. This principle, which is more fully explained in the Risk Report section of the CYBG PLC Annual Report & Accounts, embodies the following concepts:

- Commercial decisions are made on the basis of proactive consideration of risk and the impact on customers;
- Risk management activities are focused on enhancing sustainable business performance;
- Management must use the RMF, to support decision making involving risk and reward trade offs;
- Regular assessments are undertaken to confirm the effectiveness of the Risk and Control Frameworks in relation to both the current and emerging risk profile; and
- Risk management responsibilities are clearly understood by all employees when carrying out their day to day activities.

Control is exercised through a clearly defined delegation of authority, with communication and escalation channels throughout the Group.

Stress testing

Stress testing is an important and recognised risk management tool, used to assess the vulnerability of financial institutions through the modelling of adverse scenarios. The Group undertakes stress testing, following the Basel Committee principles, aimed at understanding potential impacts arising from adverse conditions relevant to its business and to aid the development and understanding of potential management actions and contingency plans.

Stress testing forms an integral part of the overall governance and risk management culture. Involvement from the Board and senior management in the stress testing programme is essential for its effective operation.

Methodology

Stress testing at the Group complies with regulatory requirements and is subject to a rigorous review and challenge process. The Group's approach ensures that a clear link exists between the economic scenarios and stress testing outputs, supported by a structured review and sign off process.

While the stress testing process is underpinned by models, it is also reliant on judgements made by senior management and key personnel across the Group including, but not limited to:

- Finance, who manage the macroeconomic scenario process and prepare and review stressed business plans;
- Credit Risk, who prepare and review credit stress outputs, including impairment charges, RWA and write-offs;
- Treasury, who provide funding and liquidity impacts and construct capital plans based on the outcomes of stress testing; and
- Products and Customer Banking, who guide on potential management actions in response to stress scenario mitigation.

Reverse Stress Testing

Reverse stress testing requires a different approach. It starts from an outcome of business failure and identifies instances where this might occur. Severe but plausible scenarios with an unacceptably high risk are used to inform business planning to prevent or mitigate specific business risks. Reverse stress tests are also utilised as the start point for recovery and resolution planning scenarios and are recognised as a required risk management tool in the form of an early warning indicator framework.

Risk Report (continued)

RISK MANAGEMENT FRAMEWORK (continued)

Stress testing (continued)

Stress testing within the Group's risk governance and capital framework

Stress testing outputs are used to inform the strategic planning process and the RAS. The plan is subjected to sensitivity analysis, forming a key element of the planning process from an overall risk assessment perspective, and provides the Board with further detail when looking to approve the plan.

Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP. The Group runs a number of adverse macroeconomic stresses in order to determine the impacts on the Group's financial and capital position, taking account of changes to impairments, margins, volumes and costs relative to the base case plan, and considers the actions which the Group may choose to deploy in response to such events materialising.

Stress testing is also a key feature of the ILAAP where stress testing scenarios are modelled regularly to provide insight into potential vulnerabilities in the Group's funding and liquidity strategies. Stress testing results of liquidity are also reported to ALCO on a monthly basis.

The Executive Leadership Team and Board engages at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to the selection and development of scenarios and thereafter, considers how the results are integrated into future strategic decision making, contingency planning, capital and business planning and risk appetite.

Prior to Board submission, ALCO reviews the scenarios, assumptions and results of liquidity and capital stress testing and provides initial review and challenge of outputs.

CREDIT RISK

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument.

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 and off balance sheet.

Risk Appetite

The Group controls the levels of credit risk it takes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical, product and industry segments. The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions, regular asset quality analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group.

Credit Strategies and Policies

Credit risks associated with lending are managed through the application of detailed lending policies and standards which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Group maintains a dynamic approach to credit management and aims to take necessary steps if individual issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to borrower, economic or sector specific weaknesses.

Roles and responsibilities for the management, monitoring and mitigation of credit risk within the Group are clearly defined in line with the Group's RMF.

Risk Report (continued)

CREDIT RISK (continued)

Credit Strategies and Policies (continued)

Significant credit risk strategies and policies are approved, and reviewed annually, by the Credit Risk Committee. For complex credit products and services, the Chief Credit Officer (CCO) and Credit Risk Committee provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management, with appropriate oversight through governance committees.

Exposures

Credit risk exposures are categorised as Retail (secured and unsecured) and SME. In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to customers. To ensure appropriate credit limits exist, especially for SME lending, a single large exposure policy is in place within the Group and forms part of the risk appetite measures which are monitored and reported on a monthly basis. The overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities. Exposures are also managed in accordance with the Large Exposure reporting requirements of the CRR.

Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

Measurement

The Group uses statistical models to measure credit risk exposures. Models are supported by both internal and external data. The 'probability of default' (PD) (that borrowers will not meet their contractual obligations), current exposures, and the likely loss ratio on defaulted obligations are calculated to measure and mitigate credit risk. Portfolios are assessed using segmentation for measurement, reporting and monitoring purposes.

Subject to regulatory approval, the Group is progressing toward attaining permission to use IRB models to measure the credit risk of loans and advances to customers. In the meantime, all exposures are measured under the standardised approach for regulatory capital.

Key credit metrics

Detail on key credit metrics is provided within the Strategic Report at page 8.

Risk Report (continued)

CREDIT RISK (continued)

Maximum exposure to credit risk (audited)

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

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Cash and balances with central banks (note 10)	**5,955**	6,431	**5,955**	6,431
Due from related entities (note 11)	**7**	786	**2,510**	3,013
Due from other banks	**945**	128	**425**	36
Financial assets available for sale (note 12)	**1,731**	1,462	**1,724**	1,455
Financial assets held to maturity (note 12)	**-**	-	**1,447**	1,440
Other financial assets at fair value (note 13)	**750**	1,097	**750**	1,097
Derivative financial assets (note 14)	**585**	285	**388**	228
Loans and advances to customers (note 15)	**29,202**	27,482	**27,683**	26,208
Due from customers on acceptances	**4**	4	**4**	4
	39,179	37,675	**40,886**	39,912
Contingent liabilities (note 32)	**123**	109	**123**	109
Other credit commitments (note 32)	**7,690**	7,886	**7,660**	7,855
Maximum credit risk exposure	**46,992**	45,670	**48,669**	47,876

Mitigation

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

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

Other mitigating measures are described below:

Specialist expertise

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

Credit policy and adherence to Policy Standards

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

Risk Report (continued)

CREDIT RISK (continued)

Mitigation (continued)

Portfolio oversight

Portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposures are regularly reviewed. This entails the production and analysis of regular portfolio monitoring reports for review by senior management.

Controls over rating systems

The Group has established an Independent Model Validation Unit that sets common minimum standards. The standards are designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements.

Stress Testing

Stress test scenarios are regularly prepared with the outcomes reviewed and relevant actions taken. Outputs will typically include impairment charges, RWA and write-offs. Management will consider how each stress scenario may impact on different components of the credit portfolio. The primary method applied uses migration matrices, modelling the impact of PD rating migrations and changes in portfolio default rates to changes in macroeconomic factors to obtain a stressed position for the credit portfolios. Loss Given Default is stressed based on property price movements.

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

Derivatives:

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

Master netting agreements:

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if any counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis.

Derivative financial instrument contracts are typically subject to the International Swaps and Derivatives Association ('ISDA') master netting agreements, as well as Credit Support Annexes ('CSA'), where relevant, around collateral arrangements attached to those ISDA agreements. Derivative exchange or clearing counterparty agreements exist if contracts are settled via an exchange or clearing house.

Risk Report (continued)

CREDIT RISK (continued)

Stress Testing (continued)

Credit Assessment and Mitigation for Retail & SME Customers

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

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

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

For SME customers, credit risk is managed in accordance with lending policies, the Group's risk appetite and the RMF. Lending policies and performance against risk appetite are reviewed regularly. Credit risk is further mitigated by focusing on business sectors where the Group has specific expertise and through limiting exposures on higher value loans and to certain sectors. When making credit decisions for SME customers, the Group will routinely assess the primary source of repayment, most typically the cash generated by the customer through its normal trading cycle. Secondary sources of repayment are also considered and, whilst not the focus of the lending decision, collateral will be taken when available. The Group seeks to obtain security cover and, where appropriate, personal guarantees from borrowers.

Risk Report (continued)

CREDIT RISK (continued)

Lending Balances

Distribution of loans and advances to customers by credit quality (audited)

Group
As at 30 September 2016

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	**57**	**388**	**612**	**21,485**	**502**	**5,665**	**28,709**
Past due but not impaired	**6**	**12**	**15**	**285**	**11**	**144**	**473**
Impaired	**-**	**-**	**-**	**66**	**2**	**146**	**214**
	63	**400**	**627**	**21,836**	**515**	**5,955**	**29,396**

As at 30 September 2015

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	70	363	668	20,170	418	5,277	26,966
Past due but not impaired	9	13	15	268	6	172	483
Impaired	-	-	-	66	2	170	238
	79	376	683	20,504	426	5,619	27,687

Bank
As at 30 September 2016

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	**57**	**388**	**612**	**20,015**	**491**	**5,665**	**27,228**
Past due but not impaired	**6**	**12**	**15**	**258**	**11**	**144**	**446**
Impaired	**-**	**-**	**-**	**58**	**2**	**146**	**206**
	63	**400**	**627**	**20,331**	**504**	**5,955**	**27,880**

As at 30 September 2015

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	70	363	668	18,949	410	5,277	25,737
Past due but not impaired	9	13	15	239	3	172	451
Impaired	-	-	-	55	-	170	225
	79	376	683	19,243	413	5,619	26,413

[1]SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and where there is no objective evidence of impairment
Past due but not impaired	Loans that are in arrears but have not been individually assessed as impaired
Impaired	Loans which have been individually assessed for impairment as there is objective evidence of impairment including changes in customer circumstances

Monitoring

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

- **Credit Risk Committee (CRC):** The CRC ensures that the Credit RMF and associated policies remain effective. The Committee has oversight of the quality, composition and concentrations of the credit risk portfolio and considers strategies to adjust the portfolio to react to changes in market conditions.
- **RAS Measures:** Measures are monitored monthly and reviewed bi-annually, at a minimum, to ensure that the measures accurately reflect the Group's risk appetite, strategy and concerns relative to the wider macro environment. All measures are subject to extensive engagement with the Executive Leadership Team, the Board and are subject to endorsement from Executive Governance Committees prior to Board approval. Regulatory engagement is also scheduled as appropriate.
- **Risk Concentration:** Concentration of risk is managed by client/ counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to control exposures to a single entity / counterparty. Concentrations are also considered through the RAS process focussing particularly on comparing the portfolio against market benchmarks.
- **Single Large Exposure excesses:** All excesses are reported to the Transactional Credit Committee (TCC) and the CCO. Any exposure which continues or is expected to continue beyond 30 days will also be submitted to the TCC with proposals to correct the exposure within an agreed period, not to exceed 12 months.

Concentrations

Loans and advances to customers (audited)

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Overdrafts	**1,536**	1,563	**1,536**	1,563
Credit cards	**400**	376	**400**	376
Lease finance	**515**	426	**504**	413
Mortgages	**21,836**	20,504	**20,331**	19,243
Other term lending – SME	**4,393**	4,025	**4,393**	4,025
Other term lending – retail	**690**	763	**690**	763
Other lending	**26**	30	**26**	30
Gross loans and advances to customers	**29,396**	27,687	**27,880**	26,413
Accrued interest receivable	**76**	75	**70**	71
Unearned income	**(26)**	(26)	**(25)**	(24)
Deferred and unamortised fee income	**(29)**	(24)	**(30)**	(26)
Impairment provisions on credit exposures (note 16)	**(215)**	(230)	**(212)**	(226)
	29,202	27,482	**27,683**	26,208

The Group also has a portfolio of fair valued business loans and advances of £750m (2015: £1,097m) (note 13). Combined with the above this is equivalent to total loans and advances of £29,952m (2015: £28,579m).

Risk Report (continued)

CREDIT RISK (continued)

Concentrations (continued)

The following tables show the levels of industry concentration of credit risk as at 30 September:

	Group		Bank	
Gross loans and advances to customers including loans designated at fair value through profit or loss (audited) [(1)]	**2016** **£m**	2015 £m	**2016** **£m**	2015 £m
Government and public authorities	**36**	27	**36**	27
Agriculture, forestry, fishing and mining	**1,458**	1,515	**1,458**	1,515
Financial, investment and insurance	**698**	659	**698**	659
Property – construction	**262**	260	**262**	260
Manufacturing	**577**	576	**577**	576
Instalment loans to individuals and other personal lending (including credit cards)	**1,344**	1,477	**1,344**	1,477
Property – mortgage	**21,836**	20,504	**20,331**	19,243
Asset and lease financing	**515**	426	**504**	413
Other commercial and industrial	**3,421**	3,340	**3,421**	3,340
	30,147	28,784	**28,631**	27,510

[(1)] Includes balances due from customers on acceptances and excludes accrued interest.

	Group		Bank	
Contingent liabilities and credit-related commitments (audited)	**2016** **£m**	2015[(1)] £m	**2016** **£m**	2015[(2)] £m
Government and public authorities	**422**	469	**422**	469
Agriculture, forestry, fishing and mining	**382**	380	**382**	380
Financial, investment and insurance	**125**	202	**125**	202
Property – construction	**156**	172	**156**	172
Manufacturing	**658**	656	**658**	656
Instalment loans to individuals and other personal lending (including credit cards)	**1,931**	1,955	**1,931**	1,955
Property – mortgage	**1,780**	1,818	**1,750**	1,787
Asset and lease financing	**98**	102	**98**	102
Other commercial and industrial	**2,261**	2,241	**2,261**	2,241
	7,813	7,995	**7,783**	7,964

[(2)] The 2015 comparatives have been restated to conform with current year industry categorisations.

Risk Report (continued)

CREDIT RISK (continued)

Mitigation and management of credit risk

Credit quality of loans and advances

For SME lending, the Group has an internally developed credit rating system, as defined under the Group's credit risk management policy, that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the PD for each customer and can be broadly mapped to external agencies' rating scales. Impaired assets consist of SME lending and secured Retail lending where current circumstances indicate that losses of loan principal and / or interest may be incurred.

Description	eCRS	PD
Senior investment grade	1 to 5	0 < 0.11
Investment grade	6 to 11	0.11 < 0.55
Sub-investment grade	12 to 23	0.55 < 99.99

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's standard credit rating system. The credit rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's ratings policy.

The table below represents the credit quality of SME loans and advances that are neither past due nor impaired (audited):

	Group		**Bank**	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Senior investment grade	**1,077**	1,174	**1,075**	1,172
Investment grade	**1,557**	1,615	**1,555**	1,613
Sub-investment grade	**3,533**	2,906	**3,526**	2,902
	6,167	5,695	**6,156**	5,687

Credit quality of loans held at fair value through profit or loss that are neither past due nor impaired (audited):

	Group		**Bank**	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Senior investment grade	**6**	47	**6**	47
Investment grade	**259**	445	**259**	445
Sub-investment grade	**466**	580	**466**	580
	731	1,072	**731**	1,072

For Retail lending, the Group has developed specific credit rating systems for both origination of new lending and for ongoing customer and account management purposes. These systems assign risk estimates to all Retail lending and enable active management of customer exposures and portfolios.

Risk Report (continued)

CREDIT RISK (continued)

Collateral

Collateral held as security and other credit enhancements

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

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

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

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

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

LTV ratio (audited)	2016 %	2015 %
Less than 50%	**38**	34
50% to 75%	**48**	51
76% to 80%	**5**	5
81% to 85%	**3**	4
86% to 90%	**2**	2
91% to 95%	**1**	1
96% to 100%	**-**	-
Greater than 100%	**-**	-
Unknown	**3**	3
	100	100

(1)LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the Halifax house price index at a given date. Unknown represents loans where data is not currently available due to front book data matching still to be completed and a de minimis amount due to weaknesses in historic data capture processes.

Residential Mortgages

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

Commercial property

Commercial property is the Group's main source of collateral on SME lending and means of mitigating loss in the event of default. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

Risk Report (continued)

CREDIT RISK (continued)

Non property related collateral

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

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

The following table shows the total non property collateral held by sector at 30 September 2016 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high credit quality) and netting. The exposure amount shown below is the total gross exposure (before any credit risk mitigation and credit conversion factors have been applied where applicable) for arrangements which have some form of associated collateral held against them and is not the total exposure for each asset class, as disclosed elsewhere in this section and in the Strategic Report.

Group (audited) **2016**	**Cash** **£m**	**Guarantee** **£m**	**Netting** **£m**	**Total** **£m**	**Exposure** **£m**
Central Government or Central Bank	**721**	**-**	**-**	**721**	**1,027**
Corporates	**49**	**40**	**32**	**121**	**135**
Financial institutions	**504**	**-**	**-**	**504**	**600**
Past due items	**-**	**-**	**-**	**-**	**3**
Public sector entities	**-**	**-**	**-**	**-**	**-**
Regional Government or local authorities	**-**	**-**	**94**	**94**	**94**
Retail	**-**	**-**	**-**	**-**	**-**
Secured by mortgages on commercial real estate	**4**	**-**	**35**	**39**	**107**
Secured by mortgages on residential property	**2**	**-**	**3**	**5**	**12**
	1,280	**40**	**164**	**1,484**	**1,978**

Group (audited) 2015	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	-	-	-	-	-
Corporates	64	53	57	174	205
Financial institutions	-	-	-	-	-
Past due items	-	-	-	-	4
Public sector entities	-	-	-	-	-
Regional Government or local authorities	-	-	114	114	114
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	4	-	31	35	86
Secured by mortgages on residential property	2	-	7	9	18
	70	53	209	332	427

The increase in cash collateral held and corresponding exposure is due to increased repurchase (repo) transactions outstanding at 30 September 2016, reflected within Central Governments or Central Banks and Financial Institutions. There were no repo transactions outstanding at 30 September 2015.

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

Risk Report (continued)

CREDIT RISK (continued)

Forbearance

Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group. The Group implemented revised forbearance policies and definitions in 2014 in order to align the reporting of forbearance with the guidance established by the European Banking Authority (EBA) for FINREP reporting. Forbearance concessions will include the granting of more favourable terms and conditions than those provided at drawdown of the facility or which would not ordinarily be available to others with a similar risk profile. Forbearance parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions. The Group makes every effort to treat customers fairly and aligns its forbearance practices to that principle.

Whilst forbearance alone is not necessarily an indicator of impaired status, it is a trigger for the review of the customer's credit profile and is granted when there is a realistic prospect of the customer repaying all facilities in full. If there is any concern over future cash flows and the Group incurring a loss, then forborne loans will also be classified as impaired in accordance with the Group's impairment policy.

Exposures classified as forborne and performing at the date forbearance measures are granted, continue to be reported as subject to forbearance for a minimum period of two years from that date (the 'probation period'). Exposures classified as forborne and which are non performing when customers were granted forbearance cannot exit non performing status for a minimum of twelve months from the date forbearance was granted, and cannot exit forbearance status for a further two years from the date of returning to performing status (three years in total).

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

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

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

Retail forbearance

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

Debt management for Mortgage customers in financial difficulty

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

Risk Report (continued)

CREDIT RISK (continued)

Retail forbearance (continued)

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

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

Group (audited) As at 30 September 2016	**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 %**
Formal arrangements	**1,843**	**169**	**0.78**	**5.5**	**3.27**
Temporary arrangements	**1,460**	**160**	**0.73**	**2.7**	**1.68**
Interest only conversion	**154**	**22**	**0.10**	**0.1**	**0.26**
Term extension	**123**	**11**	**0.05**	**0.1**	**0.61**
Other	**22**	**2**	**0.01**	**-**	**0.84**
Legal	**195**	**20**	**0.09**	**1.1**	**5.60**
	3,797	**384**	**1.76**	**9.5**	**2.48**

Group (audited) As at 30 September 2015	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 %
Formal arrangements	2,115	179	0.87	4.0	2.22
Temporary arrangements	985	99	0.48	1.5	1.57
Interest only conversion	88	12	0.06	-	0.15
Term extension	131	11	0.06	0.1	0.84
Other	11	1	0.01	-	0.39
Legal	216	23	0.11	1.5	6.56
	3,546	325	1.59	7.1	2.19

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to proactively track and facilitate prematurity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2016, the Group had 102 (2015: 116) customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £12m (2015: £12m).

A further forbearance reserve of £4m (2015: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £13.5m (2015: £11.1m) and to increase overall coverage to 3.52% (2015: 3.42%). When all other avenues of resolution including forbearance have been explored, the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2016 there were 78 repossessions of which 27 were voluntary (2015: 87 including 17 voluntary).

Risk Report (continued)

CREDIT RISK (continued)

Retail forbearance – unsecured consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including current accounts, unsecured loans and credit cards. The Group has assessed the total loan balances subject to forbearance on other types of Retail lending to be £14m at 30 September 2016 (2015: £18m), representing 1.33% of the unsecured Retail portfolio (2015: 1.62%). Impairment provisions on forborne balances totalled £4.2m at 30 September 2016 (2015: £5.5m), providing overall coverage of 29.02% (2015: 29.90%).

SME Forbearance

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

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

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements.

Group (audited) As at 30 September 2016	**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 %**
Term extension	**350**	**320**	**4.43%**	**25.3**	**7.90%**
Deferral of contracted capital repayments	**118**	**143**	**1.99%**	**18.2**	**12.69%**
Reduction in contracted interest rate	**7**	**8**	**0.12%**	**0.6**	**7.01%**
Alternative forms of payment	**7**	**35**	**0.48%**	**11.2**	**32.37%**
Debt forgiveness	**8**	**26**	**0.36%**	**2.4**	**9.16%**
Refinancing	**22**	**51**	**0.70%**	**4.9**	**9.76%**
Covenant breach/reset/waiver	**62**	**208**	**2.88%**	**8.6**	**4.12%**
	574	**791**	**10.96%**	**71.2**	**8.99%**

Risk Report (continued)

CREDIT RISK (continued)

SME Forbearance (continued)

Group (audited) As at 30 September 2015	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 %
Term extension	491	429	6.00%	42.9	10.02%
Deferral of contracted capital repayments	166	152	2.12%	18.6	12.23%
Reduction in contracted interest rate	17	29	0.40%	6.8	23.64%
Alternative forms of payment	3	16	0.22%	4.5	28.76%
Debt forgiveness	24	55	0.78%	14.2	25.61%
Refinancing	33	61	0.86%	4.7	7.56%
Covenant breach/reset/waiver	62	166	2.32%	6.0	3.64%
	796	908	12.70%	97.7	10.77%

Included in other financial assets at fair value is a portfolio of loans which are included in the above table. The principal value of fair value loans subject to forbearance at 30 September 2016 is £101m (2015: £162m), representing 1.40% of the total SME portfolio (2015: 2.27%). Impairment allowances on these amounts totalled £11m (2015: £14m), a coverage of 10.82% (2015: 8.68%).

Credit Quality of Customer Lending

An assessment of the credit quality of loans and advances to customers is shown on page 23.

Loans and advances which were past due but not impaired

Loans and advances that are past due but not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility.

Unsecured retail lending and credit cards are written off when they reach 180 DPD and are not designated as impaired.

Risk Report (continued)

CREDIT RISK (continued)

Loans and advances which were past due but not impaired (continued)

The distribution of gross loans and advances that are past due but not impaired is analysed below:

Group
2016 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending (1) £m	Total £m
1 to 29 DPD	**5**	**6**	**6**	**81**	**11**	**82**	**191**
30 to 59 DPD	**-**	**2**	**3**	**65**	**-**	**27**	**97**
60 to 89 DPD	**-**	**1**	**2**	**28**	**-**	**4**	**35**
Past due 90 days and over	**1**	**3**	**4**	**111**	**-**	**31**	**150**
	6	**12**	**15**	**285**	**11**	**144**	**473**

Group
2015 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending (1) £m	Total £m
1 to 29 DPD	8	6	5	77	6	110	212
30 to 59 DPD	-	2	3	57	-	17	79
60 to 89 DPD	-	2	2	36	-	9	49
Past due 90 days and over	1	3	5	98	-	36	143
	9	13	15	268	6	172	483

(1)SME lending includes business overdrafts.

Bank
2016 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending (1) £m	Total £m
1 to 29 days past due	**5**	**6**	**6**	**70**	**11**	**82**	**180**
30 to 59 days past due	**-**	**2**	**3**	**61**	**-**	**27**	**93**
60 to 89 days past due	**-**	**1**	**2**	**26**	**-**	**4**	**33**
Past due 90 days and over	**1**	**3**	**4**	**101**	**-**	**31**	**140**
	6	**12**	**15**	**258**	**11**	**144**	**446**

Bank
2015 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending (1) £m	Total £m
1 to 29 days past due	8	6	5	62	3	110	194
30 to 59 days past due	-	2	3	53	-	17	75
60 to 89 days past due	-	2	2	34	-	9	47
Past due 90 days and over	1	3	5	90	-	36	135
	9	13	15	239	3	172	451

(1)SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Movement in impairment provisions throughout the year

Group
2016 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Opening balance	**5**	**7**	**11**	**39**	**2**	**166**	**230**
Charge for the year	**(1)**	**3**	**5**	**1**	**1**	**30**	**39**
Amounts written off	**(4)**	**(9)**	**(14)**	**(2)**	**-**	**(39)**	**(68)**
Recoveries of amounts written off in previous years	**4**	**5**	**7**	**1**	**-**	**1**	**18**
Other[2]	**(1)**	**-**	**1**	**-**	**(1)**	**(3)**	**(4)**
Closing balance	**3**	**6**	**10**	**39**	**2**	**155**	**215**
Specific	**-**	**-**	**-**	**19**	**1**	**44**	**64**
Collective	**3**	**6**	**10**	**20**	**1**	**111**	**151**
	3	**6**	**10**	**39**	**2**	**155**	**215**

Group
2015 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Opening balance	8	10	13	27	2	185	245
Charge for the year	(2)	5	12	18	1	44	78
Amounts written off	(4)	(10)	(16)	(6)	(1)	(63)	(100)
Recoveries of amounts written off in previous years	3	2	2	-	-	5	12
Other[2]	-	-	-	-	-	(5)	(5)
Closing balance	5	7	11	39	2	166	230
Specific	-	-	-	22	1	69	92
Collective	5	7	11	17	1	97	138
	5	7	11	39	2	166	230

[1]SME lending includes business overdrafts.
[2]Other includes the unwind of net present value elements of specific provisions and other minor movements.

Risk Report (continued)

CREDIT RISK (continued)

Bank 2016 (audited)	**Retail overdrafts £m**	**Credit cards £m**	**Other retail lending £m**	**Mortgages £m**	**Lease finance £m**	**SME lending [1] £m**	**Total £m**
Opening balance	5	7	11	35	2	166	226
Charge for the year	(1)	3	5	-	1	30	38
Amounts written off	(4)	(9)	(14)	(2)	-	(39)	(68)
Recoveries of amounts written off in previous years	4	5	7	1	-	1	18
Other [2]	(1)	-	1	2	(1)	(3)	(2)
Closing balance	3	6	10	36	2	155	212
Specific	-	-	-	17	1	44	62
Collective	3	6	10	19	1	111	150
	3	6	10	36	2	155	212

Bank 2015 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Opening balance	8	10	13	22	2	185	240
Charge for the year	(2)	5	12	19	1	44	79
Amounts written off	(4)	(10)	(16)	(6)	(1)	(63)	(100)
Recoveries of amounts written off in previous years	3	2	2	-	-	5	12
Other [2]	-	-	-	-	-	(5)	(5)
Closing balance	5	7	11	35	2	166	226
Specific	-	-	-	19	1	69	89
Collective	5	7	11	16	1	97	137
	5	7	11	35	2	166	226

[1] SME lending includes business overdrafts.
[2] Other includes the unwind of net present value elements of specific provisions and other minor movements

Risk Report (continued)

CREDIT RISK (continued)

Other credit risks

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

Eurozone risk

The Group has an exposure to the European Investment Bank of £176m at 30 September 2016 (2015: £100m).

Offsetting of financial assets and liabilities

The Group does not have any financial assets or financial liabilities that are offset with the net amount presented on the balance sheet as IAS 32 'Financial Instruments – Presentation' states that there should be both an enforceable right to set off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions is met by the Group. The table below illustrates the amounts for financial instruments that are covered by enforceable netting arrangements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. loans and advances).

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

Group 2016 (audited)				**Net amounts not offset in the balance sheet**		
	Gross Amounts £m	**Gross amounts offset in the balance sheet (1) £m**	**Net Amounts presented on balance sheet (1) £m**	**Financial instruments £m**	**Cash Collateral Pledged/ Received £m**	**Net Amount £m**
Assets						
Derivative financial instruments (2)	**585**	**-**	**585**	**(306)**	**(55)**	**224**
Liabilities						
Derivative financial instruments (2)	**598**	**-**	**598**	**(306)**	**(245)**	**47**
Securities sold under repurchase agreement	**1,226**	**-**	**1,226**	**(1,226)**	**-**	**-**

Group 2015 (audited)				Net amounts not offset in the balance sheet		
	Gross Amounts £m	Gross amounts offset in the balance sheet (1) £m	Net Amounts presented on balance sheet (1) £m	Financial instruments £m	Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments (2)	285	-	285	(143)	-	142
Liabilities						
Derivative financial instruments (2)	534	-	534	(143)	(246)	145

(1) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation.

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

Risk Report (continued)

CREDIT RISK (continued)

Bank 2016 (audited)	Gross Amounts £m	Gross amounts offset in the balance sheet [1] £m	Net Amounts presented on balance sheet [1] £m	Net amounts not offset in the balance sheet: Financial instruments £m	Net amounts not offset in the balance sheet: Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments [2]	**388**	**-**	**388**	**(172)**	**(55)**	**161**
Liabilities						
Derivative financial instruments [2]	**587**	**-**	**587**	**(172)**	**(309)**	**106**
Securities sold under repurchase agreement	**1,226**	**-**	**1,226**	**(1,226)**	**-**	**-**

Bank 2015 (audited)	Gross Amounts £m	Gross amounts offset in the balance sheet [1] £m	Net Amounts presented on balance sheet [1] £m	Net amounts not offset in the balance sheet: Financial instruments £m	Net amounts not offset in the balance sheet: Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments [2]	228	-	228	(94)	-	134
Liabilities						
Derivative financial instruments [2]	466	-	466	(94)	(246)	126

[1] Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation.
[2] Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

Derivative financial instrument contracts are typically subject to ISDA master netting agreements, as well as CSAs, where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house. The amounts included in Financial Instruments column refers to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement.

£5.9bn of cash is held with the BoE. Due from other banks is all with senior investment grade counterparties. Available for sale financial assets and the credit rating of counterparties are discussed in note 12.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS

Balance Sheet Risks in the financial services industry are highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. The key risks include Capital, Liquidity and Funding Risks, Market Risk which in the case of the Group is non-traded market risk (incorporating Interest Rate and Foreign Exchange Risks), Pension Risk and Non Traded Equity Risk.

12.6%	112%	140%
Common Equity Tier 1	Loan to Deposit Ratio	Liquid Coverage Ratio

Risk appetite

The primary objective for the management and oversight of balance sheet risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility. The Group applies a prudent approach to balance sheet risks in order to safeguard the on-going strength and resilience of the balance sheet.

Risk appetite is approved for balance sheet risks by the Group's Board, with authority delegated to ALCO for subsequent implementation and monitoring. The Board has established a range of measures of risk appetite for capital including Common Equity Tier 1 (CET1), leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet and include, amongst others, measures relating to the proportion of customer funding, the Group's overall funding profile and an Overall Liquid Asset Rule (OLAR). The OLAR covers the Board's appetite in relation to regulatory liquidity requirements and also covers the need to maintain a volume of high quality liquid assets that is sufficient to accommodate outflows of funds in a range of stress scenarios over a 3 month period.

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

In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks. The Group is committed to maintaining a strong capital base.

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

Mitigation measures

The Group's Capital Risk Standard provides the framework for the manner in which capital is managed within the Group. The objectives of the Standard are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators' requirements, managing the ratings agencies' assessment of the Group and ensuring that excessive leverage is not taken. A shortfall in capital resources would occur when the Group exceeds its risk appetite and is at risk of not having sufficient capital to support future growth objectives.

Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, which implemented CRD IV legislation with effect from 1 January 2014. The Group's approach to Pillar 1 is to use the standardised approaches to calculating RWA. The standardised approaches are inherently conservative and the Group is developing the capability to apply for a waiver to utilise IRB methods for the calculation of credit risk capital.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Measurement (continued)

A rigorous approach is taken to assess risks that are not adequately covered by Pillar 1, including Interest Rate Risk in the Banking Book (IRRBB) and pension risk. The Group also undertakes a range of stress scenarios in order to test the impact on capital arising from severe yet plausible scenarios. These approaches to capital are thoroughly documented in the Group's ICAAP and this is subject to review, challenge and approval by the Board.

Capital Buffers

The regulatory capital buffer framework is intended to ensure firms maintain a sufficient amount of capital above their regulatory minimum in order to withstand periods of stress. The UK is implementing the provisions on capital buffers outlined in the CRD to create combined capital buffers including a: Capital Conservation Buffer (CCB); Countercyclical Capital Buffer (CCyB); Global Systemically Important Institution Buffer (G-SIIB); and Systemic Risk Buffer (SRB). In the UK, the CCB has been introduced with transitional provisions from 2016 (0.625%) to 2019 (2.5%).

The CCyB has been effective from 1 May 2014 and is dependent upon the BoE view of credit conditions in the economy. In March 2016 the Financial Policy Committee (FPC) raised the rate to 0.5% for UK exposures (with effect from 29 March 2017). As a result of increased concerns around the prospects for the UK economy following the UK's vote to leave the EU the decision to raise the CCyB to 0.5% has been reversed. The BoE noted that "absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK CCyB rate until at least June 2017" (the FPC reaffirmed the Group's position on 22 September 2016). The BoE commented that this action reinforces their expectation that all elements of the substantial capital and liquidity buffers that have been built up by banks are able to be drawn on, as necessary.

Beyond June 2017, the future path of the CCyB is less certain. It is anticipated that the CCyB will move gradually to 1% in a neutral risk environment. The Group's capital planning considers the impact of all relevant capital buffers.

The PRA's final rules on the approach to identifying other systemically important institutions (O-SII) were published in February 2016. In line with expectations the Group was not designated an O-SII. Similarly the FPC issued its final framework for setting the SRB in May 2016. This confirmed that banks with total assets of less than £175bn (which includes the Group) will be subject to a 0% SRB.

Monitoring

The Capital Plan is approved by the Board on an annual basis. The Group's ALCO monitors the capital plan and forecast positions on a monthly basis. This ensures that performance trends are appropriately reviewed and that there is transparency on the impact on capital ratios, risk appetite and the future outlook.

Capital Restructuring

In February 2016, concurrently with the demerger and IPO of the CYBG Group, a capital restructure was completed to simplify the CYBG Group's capital base and ensure that the CYBG Group is the 'single point of entry' for the purposes of Recovery and Resolution planning and MREL requirements. The Group repurchased £450m of Additional Tier 1 (AT1) capital and £475m of Tier 2 capital, and replaced this with new CRD IV compliant issuance of nominal value of £450m AT1 (including an equity conversion mechanism) and nominal value of £475m Tier 2 issued by the Group to CYBG PLC. The repurchase took place at market value and this resulted in a net gain of £1m which was realised within the Group.

Recent Developments

Information on MREL and Banking Reform, ring fencing and resolution all of which may impact the Group's capital and funding structures, are provided in the Emerging Risks section.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital position

The Group's capital position as at 30 September 2016 is summarised below.

Regulatory capital (unaudited) [1]	2016 £m	2015 £m
CET1 capital		
Capital instruments	**324**	2,812
Retained earnings and other reserves	**2,472**	193
Regulatory adjustments and deductions		
Prudent valuation adjustment [2]	**(7)**	(5)
Intangible assets [3]	**(256)**	(265)
Deferred tax asset ('DTA') relying on future profitability [4]	**(71)**	(273)
Cash flow hedge reserve	**(69)**	-
Defined benefit pension fund assets (net of deferred tax liabilities) [5]	**-**	(42)
	2,393	2,420
Tier 1 capital		
Additional Tier 1 (AT1) capital instruments [6]	**425**	450
	2,818	2,870
Tier 2 capital		
Subordinated debt	**479**	475
Credit risk adjustments	**151**	138
	630	613
Total capital	**3,448**	3,483

[1] This table shows the capital position on a CRD IV 'transitional' basis. As at 30 September 2015 this included grandfathered legacy Tier 2 instruments under the transitional rules implemented by the PRA. These instruments were replaced and are fully compliant with CRD IV at 30 September 2016, accordingly the 30 September 2016 capital also reflects the CRD IV 'fully loaded' basis.
[2] A prudent valuation adjustment is applied in respect of fair valued instruments as required under regulatory capital rules.
[3] Intangible assets shall be deducted from capital for regulatory purposes.
[4] Under CRD IV, deferred tax assets that rely on future profitability are deducted from CET1 capital.
[5] Under CRD IV, defined benefit pension fund assets shall be deducted from CET1 capital (net of deferred tax liability).
[6] The AT1 instrument, with a nominal value of £450m, was issued at a discount in February 2016.

Reconciliation of statutory total equity to regulatory capital (unaudited)	2016 £m	2015 £m
Statutory total equity	**3,221**	3,458
Pension regulatory adjustments	**-**	(42)
Deductions from capital	**(263)**	(270)
Equity based compensation reserve	**-**	(3)
DTA relying on future profitability	**(71)**	(273)
Cash flow hedge reserve	**(69)**	-
Regulatory Tier 1 capital	**2,818**	2,870

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Regulatory capital flow of funds (unaudited)	CRD IV 2016 £m	CRD IV 2015 £m
CET1 capital		
CET1 capital at 1 October	**2,420**	2,227
Share capital: ordinary share new issuance	**426**	770
Share premium	**-**	(243)
Retained earnings and other reserves (including structured entities)	**2,279**	(13)
Prudent valuation adjustment	**(2)**	(3)
Intangible assets	**9**	(265)
DTA relying on future profitability	**202**	(50)
Defined benefit pension fund assets	**42**	(3)
Share capital redenomination	**(2,914)**	-
Cash flow hedge reserve	**(69)**	-
	2,393	2,420
Tier 1 capital		
Tier 1 capital at 1 October	**450**	-
Capital instruments repurchased: Perpetual Capital Notes	**(450)**	-
Capital instruments issued: Perpetual Subordinated Contingent Convertible Notes	**425**	-
Capital instruments issued: AT1 Perpetual Capital Notes	**-**	450
	425	450
Total Tier 1 capital	**2,818**	2,870
Tier 2 capital		
Tier 2 capital at 1 October	**613**	1,211
Credit risk adjustments	**13**	3
Subordinated debt redemption	**-**	(601)
Capital instruments repurchased: Subordinated Debt	**(475)**	-
Capital instruments issued: Perpetual Subordinated Debt	**479**	-
	630	613
Total capital	**3,448**	3,483

Minimum Pillar 1 capital requirements (unaudited)	2016 £m	2015 £m
Credit risk	**1,353**	1,304
Operational risk	**128**	125
Counterparty risk	**17**	11
Credit valuation adjustment	**23**	16
Tier 1 regulatory capital requirements	**1,521**	1,456

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

RWA movements

RWA flow statement (unaudited)	**2016**	2015
	£m	£m
RWA at 1 October	**18,207**	18,472
Book size growth / (reduction)	**628**	50
Book quality (improvement) / deterioration	**182**	(180)
Methodology and policy	**-**	(130)
Other	**-**	(5)
RWA at 30 September	**19,017**	18,207

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

Capital requirements for calculating RWA	**At 30 September 2016**			At 30 September 2015		
	Capital required £m	**RWA £m**	**Exposure £m**	Capital required £m	RWA £m	Exposure (restated) £m
Central Governments or Central Banks	**-**	**-**	**6,986**	-	-	6,477
Regional Governments or Local Authorities	**2**	**20**	**192**	2	22	108
Public Sector Entities	**-**	**5**	**13**	-	3	3
Multilateral development banks	**-**	**-**	**195**	-	-	100
Financial Institutions	**19**	**234**	**1,337**	17	215	837
Corporates	**283**	**3,540**	**3,853**	263	3,282	3,465
Retail	**72**	**897**	**1,196**	74	930	1,240
Secured by mortgages on immovable property	**899**	**11,242**	**26,482**	869	10,862	25,197
Exposures in default	**33**	**408**	**340**	34	427	356
Collective investments undertakings	**-**	**3**	**3**	-	3	3
Equity exposures	**1**	**11**	**9**	1	16	10
Items associated with particularly high risk	**1**	**15**	**10**	-	-	-
Covered bonds	**2**	**19**	**191**	-	-	-
Other items	**41**	**518**	**1,649**	44	541	1,901
Total credit risk	**1,353**	**16,912**	**42,456**	1,304	16,301	39,697
Operational risk	**128**	**1,606**		125	1,562	
Counterparty risk	**17**	**214**		11	138	
Credit valuation adjustment	**23**	**285**		16	206	
	1,521	**19,017**		1,456	18,207	

The 'Exposure' amounts disclosed above are post credit conversion factors and pre credit mitigation. Comparative disclosures have been restated to conform with the current period's presentation.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital position & CET1 movements (unaudited)	2016 £m	2015 £m
RWA [(1)]		
Retail mortgages	**7,998**	7,526
Business lending	**7,087**	7,061
Other Retail lending	**916**	951
Other lending	**152**	113
Other [(2)]	**759**	650
Credit risk	**16,912**	16,301
Operational risk	**1,606**	1,562
Counterparty risk	**214**	138
Credit valuation adjustment	**285**	206
Total RWA	**19,017**	18,207
Capital ratios		
CET1 ratio	**12.6%**	13.3%
Tier 1 ratio	**14.8%**	15.8%
Total capital ratio	**18.1%**	19.1%

(1) RWA are calculated under the standardised approach.

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

Leverage ratio (unaudited)	2016 £m	2015 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**2,393**	2,420
AT1 capital	**425**	450
Total Tier 1	**2,818**	2,870
Exposures for the leverage ratio		
Total statutory assets	**39,963**	38,701
Adjustment for off-balance sheet items	**1,982**	2,015
Adjustment for derivative financial instruments	**(399)**	19
Adjustment for securities financing transactions (SFTs)	**601**	-
Other adjustments	**(403)**	(585)
Leverage ratio exposure	**41,744**	40,150
Leverage ratio	**6.8%**	7.2%

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

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

- capital: Tier 1 capital defined according to CRD IV on an end point basis (assuming the full impact of CRD IV requirements on Tier 1 capital were in force with no transitional provisions).
- 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.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

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 6.8% which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018. The Group will continue to monitor closely the leverage ratio against emerging rules and minimum calibration.

Funding and liquidity risk

Funding risk relates to the impact on the Group's strategy of being unable to raise funds from customers and the wholesale markets of sufficient quantity and of appropriate mix and tenor. An inability to raise sufficient funds may lead to a reduction in lending growth or a requirement to raise the price paid for deposits, both outcomes having an adverse effect on shareholder value. Where funding risk manifests itself in an adverse effect on mix and tenor, for example a high proportion of short term wholesale deposits, there is an increased liquidity risk to the Group.

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Risk assessment

The framework for the Group's approach to funding risk leads to the development of a Group funding plan that is subject to approval by the Board and is consistent with risk appetite and the Group's strategic objectives. The development of the Group's funding plan is informed by the requirements of the Group's Balance Sheet Risk Policy Standards.

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. Exposures relate to the outflow of funds under a series of stress scenarios less the impact of inflows from assets, liquidation of high quality liquid assets or through other actions instigated by the Group.

Liquidity within the Group is managed in accordance with the ILAAP that is approved by the Board. The ILAAP documents the manner in which the Group meets its OLAR which covers all regulatory and internal liquidity requirements. In addition the Group has a liquidity standard which details, amongst other items, the control standards and risk measurement requirements for liquidity and authorities and responsibilities.

Oversight of liquidity risk is undertaken by ALCO. To meet the requirements of regulatory authorities the liquidity of the Group is managed on a daily basis using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances. All balance sheet risks are subject to independent oversight from the second line balance sheet and liquidity risk oversight function.

Stress testing of the Group's liquidity risk is undertaken on a frequent basis and results are provided to ALCO and the Board. The ILAAP is used to establish key risk drivers and assumptions for liquidity risk and these provide the framework for ongoing stress testing. Stress testing considers the impact of severe yet plausible scenarios to consider the potential impact on the Group's funding and liquidity profile. The Group holds a portfolio of high quality assets that act as a buffer against the impact of liquidity risk. Funding plans take a long term view and these consider the impact of prolonged periods of market disruption in order to identify potential vulnerabilities in the profile of the Group's funding.

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

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Risk assessment (continued)

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, counterparty, term structure and market.

The Group can source funding through a range of channels including the following:

- Retail, SME and corporate deposits.
- Commercial paper programme.
- Access to money markets through cash deposits and certificates of deposit.
- 'Lanark' residential mortgage securitisation programme (owner occupied).
- 'Lannraig' buy-to-let mortgage securitisation programme.
- Regulated Covered Bond (RCB) programme.
- Access to the facilities within the Bank of England Sterling Monetary Framework which include the recently announced Term Funding Scheme.

The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage backed debt.These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet. The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage backed debt.

Monitoring

The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from the risk management function. In relation to funding and liquidity risk, the primary management committee is ALCO. ALCO meets monthly and reports to the Executive Risk Committee.

Key risks

An assessment of a number of key risk drivers for funding and liquidity risks has been completed as part of the ILAAP process and a summary of the most material key risks is shown in the table below.

Risk	Rationale for assessment
Wholesale Funding	While wholesale borrowing is largely medium term and the Group has proven access to term debt markets there is residual refinancing risk around the medium term funding transactions.
Funding Tenors	Funding Tenors are an additional component of wholesale funding risk. The Group must maintain an appropriate mix by tenor in order to manage maturity concentrations.
Retail Funding Risk	While the overall assessment of the retail funding key risk driver is low, the potential impact if this risk was to crystallise is high. This is reflective of the shape of the Group's balance sheet and an appropriate reliance on customer deposits as a retail driven bank. The Group holds a portfolio of high quality liquid assets in order to act as a buffer against the effects of liquidity risk.

At 30 September 2016, the Group continues to have a strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and liquidity risk. Funding is predominantly provided by Retail and SME customers and this is supported by medium term secured funding issuance from the Group's Lanark and Lannraig securitisation programmes and its RCB platform. These funding programmes are a source of strength for the Group and leverage the Group's high quality mortgage book as a source of collateral for secured funding.

The LDR increased from 109% to 112% due to growth in customer lending combined with a managed reduction in short term corporate deposits which provided little liquidity benefit to the Group.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

External credit ratings

The outlook for the Fitch and Moody's ratings is stable, and on 3 October 2016, Fitch affirmed the current ratings of Clydesdale Bank PLC. On 7 July 2016, as part of an industry wide exercise following the UK's EU referendum, S&P affirmed Clydesdale Bank PLC's ratings but revised the outlook from Stable to Negative. S&P stated "we could revise down the anchor for UK banks to 'bbb' from 'bbb+' over the next two years if prolonged uncertainty following the referendum weakens the macroeconomic outlook and economic resilience of the UK economy".

Clydesdale Bank PLC's long term credit ratings are summarised below:

	Outlook as at 21 November 2016[1]	**30 September 2016**	30 September 2015
Fitch	**Stable**	**BBB+**	A
Standard & Poor's	**Negative**	**BBB+**	BBB+
Moody's [2]	**Stable**	**Baa2**	Baa1

[1] For detailed background on the latest credit opinions, including commentary on the impact of the demerger and IPO, by S&P and Fitch, please refer to the respective rating agency websites.
[2] Long Term Deposit Rating.

Additional collateral to be provided in the event of a notch downgrade

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

Assets and liabilities by maturity

The following tables represent a breakdown of the Clyesdale Bank PLC balance sheet, according to the assets and liabilities contractual maturity. Many of the longer term monetary assets are variable rate products, with behavioural maturities shorter than the contractual terms. Accordingly, this information is not relied upon by Clydesdale Bank PLC in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Group 2016 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,642	-	-	-	-	1,313	5,955
Due from related entities	-	7	-	-	-	-	7
Due from other banks	862	83	-	-	-	-	945
Financial assets available for sale	-	7	20	1,019	649	36	1,731
Other financial assets at fair value	-	34	88	275	353	-	750
Derivative financial instruments	2	46	72	242	223	-	585
Loans and advances to customers	2,021	285	648	4,271	21,577	400	29,202
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	111	34	40	-	-	599	784
Total assets	7,638	500	868	5,807	22,802	2,348	39,963
Liabilities							
Due to other banks	81	417	311	500	-	-	1,309
Other financial liabilities at fair value	-	2	11	35	-	-	48
Derivative financial instruments	2	47	73	123	353	-	598
Due to customers	21,169	1,802	1,933	2,186	-	-	27,090
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	15	4	-	-	479	-	498
Debt securities in issue	-	18	214	2,992	797	-	4,021
All other liabilities	1,959	85	132	-	-	998	3,174
Total liabilities	23,226	2,379	2,674	5,836	1,629	998	36,742
Off balance sheet items							
Contingent liabilities	-	19	44	12	48	-	123
Other credit commitments	7,690	-	-	-	-	-	7,690
Total off balance sheet items	7,690	19	44	12	48	-	7,813

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Group 2015 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,978	-	-	-	-	1,453	6,431
Due from related entities	772	-	-	-	14	-	786
Due from other banks	36	92	-	-	-	-	128
Financial assets available for sale	-	-	100	782	565	15	1,462
Other financial assets at fair value	1	11	78	731	276	-	1,097
Derivative financial instruments	3	27	48	70	137	-	285
Loans and advances to customers	2,221	203	701	3,844	20,137	376	27,482
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	86	54	47	-	-	839	1,026
Total assets	8,097	391	974	5,427	21,129	2,683	38,701
Liabilities							
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	1	1	65	-	-	67
Derivative financial instruments	3	28	41	248	214	-	534
Due to customers	20,370	1,505	2,045	2,487	-	-	26,407
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	115	8	-	381	475	-	979
Debt securities in issue	-	14	852	1,973	927	-	3,766
All other liabilities	1,822	117	114	-	-	1,040	3,093
Total liabilities	22,310	2,067	3,056	5,154	1,616	1,040	35,243
Off balance sheet items							
Contingent liabilities	-	25	13	11	52	8	109
Other credit commitments	7,886	-	-	-	-	-	7,886
Total off balance sheet items	7,886	25	13	11	52	8	7,995

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Bank 2016 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,642	-	-	-	-	1,313	5,955
Due from related entities	1,710	98	-	-	702	-	2,510
Due from other banks	425	-	-	-	-	-	425
Financial assets available for sale	-	7	20	1,019	649	29	1,724
Held to maturity	-	-	2	1,049	396	-	1,447
Other financial assets at fair value	-	34	88	275	353	-	750
Derivative financial instruments	2	48	65	159	114	-	388
Loans and advances to customers	2,017	275	640	4,200	20,151	400	27,683
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	111	34	40	-	-	616	801
Total assets	8,907	500	855	6,702	22,365	2,358	41,687
Liabilities							
Due to other banks	81	417	311	500	-	-	1,309
Other financial liabilities at fair value	-	2	11	35	-	-	48
Derivative financial instruments	2	36	73	123	353	-	587
Due to customers	21,169	1,802	1,933	2,186	-	-	27,090
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	56	23	5	-	5,521	-	5,605
Debt securities in issue	-	-	8	-	700	-	708
All other liabilities	1,959	70	131	-	-	998	3,158
Total liabilities	23,267	2,354	2,472	2,844	6,574	998	38,509
Off balance sheet items							
Contingent liabilities	-	19	44	12	48	-	123
Other credit commitments	7,660	-	-	-	-	-	7,660
Total off balance sheet items	7,660	19	44	12	48	-	7,783

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Bank 2015 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,978	-	-	-	-	1,453	6,431
Due from related entities	3,000	-	-	-	13	-	3,013
Due from other banks	36	-	-	-	-	-	36
Financial assets available for sale	-	-	100	782	565	8	1,455
Financial Assets held to maturity	-	-	-	-	1,440	-	1,440
Other financial assets at fair value	1	11	78	731	276	-	1,097
Derivative financial instruments	3	27	33	70	95	-	228
Loans and advances to customers	2,204	201	694	3,792	18,941	376	26,208
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	86	77	47	-	-	469	679
Total assets	10,308	320	952	5,375	21,330	2,306	40,591
Liabilities							
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	1	1	65	-	-	67
Derivative financial instruments	3	13	42	194	214	-	466
Due to customers	20,370	1,505	2,045	2,487	-	-	26,407
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	157	8	-	5,447	475	-	6,087
Debt securities in issue	-	-	-	-	707	-	707
All other liabilities	1,822	116	114	-	-	978	3,030
Total liabilities	22,352	2,037	2,205	8,193	1,396	978	37,161
Off balance sheet items							
Contingent liabilities	-	25	13	11	52	8	109
Other credit commitments	7,855	-	-	-	-	-	7,855
Total off balance sheet items	7,855	25	13	11	52	8	7,964

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Cash flows payable under financial liabilities by contractual maturity

Group 2016 (audited)	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	81	420	318	505	-	-	1,324
Other financial liabilities at fair value	-	2	12	40	-	-	54
Trading derivative financial instruments	2	52	114	192	308	-	668
Due to customers	21,169	1,811	1,954	2,217	-	-	27,151
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	23	285	3,712	991	-	5,011
Due to related entities	15	10	18	80	479	-	602
All other financial liabilities	1,912	-	-	-	-	-	1,912
Hedging derivative liabilities							
Contractual amounts payable	-	8	71	141	100	-	320
Total financial liabilities	23,179	2,330	2,772	6,887	1,878	-	37,046

Group 2015 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	2	3	75	-	-	80
Trading derivative financial instruments	3	16	35	52	226	-	332
Due to customers	20,370	1,517	2,074	2,516	-	-	26,477
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	27	918	2,152	1,123	-	4,220
All other financial liabilities	1,791	-	-	-	-	-	1,791
Hedging derivative liabilities							
Contractual amounts payable	-	49	106	669	41	-	865
Contractual amounts receivable	-	(28)	(50)	(518)	-	-	(596)
Total financial liabilities	22,164	1,977	3,089	4,946	1,390	-	33,566

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Cash flows payable under financial liabilities by contractual maturity (continued)

Bank 2016 (audited)	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	**81**	**420**	**318**	**505**	**-**	**-**	**1,324**
Other financial liabilities at fair value	**-**	**2**	**12**	**40**	**-**	**-**	**54**
Trading derivative financial instruments	**2**	**40**	**114**	**192**	**308**	**-**	**656**
Due to customers	**21,169**	**1,811**	**1,954**	**2,217**	**-**	**-**	**27,151**
Liabilities on acceptances	**-**	**4**	**-**	**-**	**-**	**-**	**4**
Debt securities in issue	**-**	**-**	**40**	**130**	**797**	**-**	**967**
Due to related entities	**56**	**29**	**23**	**80**	**5,521**	**-**	**5,709**
All other financial liabilities	**1,912**	**-**	**-**	**-**	**-**	**-**	**1,912**
Hedging derivative liabilities							
Contractual amounts payable	**-**	**8**	**7**	**141**	**100**	**-**	**256**
Total financial liabilities	**23,220**	**2,314**	**2,468**	**3,305**	**6,726**	**-**	**38,033**

Bank 2015 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	2	3	75	-	-	80
Trading derivative financial instruments	3	16	35	52	226	-	332
Due to customers	20,370	1,517	2,074	2,516	-	-	26,477
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	-	43	130	894	-	1,067
All other financial liabilities	1,791	-	-	-	-	-	1,791
Hedging derivative liabilities							
Contractual amounts payable	-	17	47	93	32	-	189
Total financial liabilities	22,164	1,946	2,205	2,866	1,152	-	30,333

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

Market risk

Market risk is the risk associated with adverse changes in the fair value, or accrual income and expense, of assets and liabilities held by the Group as a result of movements in market factors such as interest rates, foreign exchange rates, volatility and credit spreads. The Group's balance sheet is predominantly UK based and is denominated in GBP therefore foreign exchange risk is not a major part of the Group's risk profile.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income and economic value to movements in market interest rates. The major contributors to interest rate risk are:

- the investment of non-interest bearing deposits and equity into interest bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities;
- basis risk, for example, the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets or the risk arising from changing relationships between different interest rate yield curves; and
- customer optionality, e.g. the right to repay borrowing in advance of contract maturity dates.

Exposures

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange products and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. Controls include the hedging of these products as and when they arise.

Measurement

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings based approaches. In accordance with the Group IRRBB standard, risk measurement techniques include: basis point sensitivity, Value at Risk ('VaR'), Earnings at Risk ('EaR'), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

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

- the use of basis point sensitivity analysis;
- historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- VaR and EaR are measured on a statistical basis: 99% confidence level with appropriate holding periods depending on varying risk types;
- EaR utilises a twelve month forecast period;
- eight years of business day historical data is used in modelling;
- VaR methodology is based on proportional rather than absolute changes in historical interest rates;
- investment term for capital is modelled with a benchmark term agreed by ALCO;
- investment term for core non interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by ALCO; and
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO.

Foreign Exchange Risk is assessed based on the absolute exposure in each currency.

Mitigation measures

Market risks are overseen by ALCO with delegation for day to day management given to the Group's Treasury division. The Group's Treasury division use a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange. Basis risk is managed through a combination of wholesale market basis risk management products, pricing strategies and product innovation. As part of an objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income. The use of derivatives gives rise to the need to apportion transactions into hedge relationships.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Fair value hedges

The Group hedges part of its existing interest rate risk, resulting from potential movements in the fair value of fixed rate assets and liabilities, using interest rate swaps. The fair value of these swaps is disclosed in note 14. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate and foreign currency risk. The interest and foreign currency risk arise from variable interest rate assets and liabilities which are hedged using cross currency and interest rate swaps, and material non-GBP denominated transactions which are hedged using FX forward contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the period as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed in note 14.

Monitoring

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

Interest rate risk (audited)

	Group			
	Value at risk		Earnings at risk	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
As at 30 September	**15**	27	**2**	9
Average value during the year	**25**	25	**5**	5
Minimum value during the year	**13**	19	**2**	2
Maximum value during the year	**36**	29	**11**	9

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Principal financial assets and liabilities (audited)

The following table shows the Group's principal financial assets and liabilities and the main non-traded market risk types they are exposed to:

	2016 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	**5,955**				✔
Financial assets available for sale	**1,731**	✔	✔		✔
Loans and advances to customers	**29,202**	✔	✔	✔	✔
Derivative financial instruments	**585**	✔	✔	✔	✔
Other financial assets at fair value	**750**	✔	✔		✔
Liabilities					
Due to customers	**27,090**	✔	✔	✔	
Due to other banks	**1,309**	✔	✔	✔	
Derivative financial instruments	**598**	✔	✔	✔	
Other financial liabilities at fair value	**48**	✔	✔		
Debt securities in issue	**4,021**	✔	✔	✔	

	2015 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	6,431				✔
Financial assets available for sale	1,462	✔	✔		✔
Loans and advances to customers	27,482	✔	✔	✔	✔
Derivative financial instruments	285	✔	✔	✔	✔
Other financial assets at fair value	1,097	✔	✔		✔
Liabilities					
Due to customers	26,407	✔	✔	✔	
Due to other banks	393	✔	✔	✔	
Derivative financial instruments	534	✔	✔	✔	
Other financial liabilities at fair value	67	✔	✔		
Debt securities in issue	3,766	✔	✔	✔	

Foreign currency assets and liabilities split by type

The Group does not incur material foreign currency exposure.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Pension risk

The Group operates a Defined Benefit (DB) pension scheme, the Yorkshire and CB Pension Scheme (the 'Scheme'). Clydesdale B PLC is the Scheme's principal employer and there are no other participating employers.

DB pension schemes provide a promise to pay members a pre-determined level of income at retirement which is independent of the contributions and investment returns (assets) used to fund these benefit promises (collectively the 'liabilities'). The Scheme provides members with pensions based primarily on years of service and salary. As such, there are significant risks associated with managing a DB scheme, both in terms of benefits already built up and future benefit accrual. These risks will continue until the Scheme is formally wound up, either in the event that all the liabilities are transferred to a third party (for example an insurer) or once all individual member benefits are paid.

The Scheme's assets are held under a separate trust and the Scheme is managed by a corporate Trustee Board independently of the Group, according to the Scheme Trust Deed and Rules. Therefore, the Group's ability to directly manage the Scheme is limited to certain powers within the governing documentation. Aside from the Group's role to sponsor the Scheme to ensure there are sufficient assets to meet benefit payments as they fall due, the Group's main focus is directed on mitigating the impact on capital and earnings through working with the trustee to implement risk reduction initiatives. A number of activities have been implemented since 2003 with the specific aim of reducing risk in the Scheme, including a de-risking journey plan and a number of benefit reforms.

The principal cause of risk within the Scheme is the difference between the assets and the liabilities. The assets are exposed to market valuation movements, within and between asset classes, whilst the liabilities are more sensitive to interest rate and inflation rate changes, and changes in other actuarial assumptions which may not be borne out in experience, for example life expectancy.

There are various bases, with differing assumptions, for measuring the Scheme liabilities. Conversely, the Scheme assets are consistently valued at current market values. Therefore, the variation in the net funding position between the bases depends on the liability valuation. The two key bases used to value DB scheme liabilities are IAS 19, a standardised accounting measure which is the basis for income statement, balance sheet and capital reporting, and the Trustee's Technical Provisions basis which determines the cash funding contributions to the Scheme in respect of both future benefit accrual and to repair any deficit agreed as part of a triennial valuation.

The IAS 19 valuation is disclosed in note 28. The rate used to discount the liabilities on the IAS 19 basis is a key driver of volatility and, as prescribed by IAS 19, is based on yields on high quality corporate bonds. As a consequence, the IAS 19 valuation can move adversely as a result of low rates and narrowing credit spreads. Inflation is another key source of volatility. This is because member benefits have an element of index linking and therefore the liabilities increase with rises in long term inflation assumptions, although in practice, over the long term, the relationship between interest and inflation rates tends to be negatively correlated resulting in a degree of risk offset.

The triennial valuation (the 'valuation') uses the trustee's actuarial assumptions and a liability discount rate based on gilt yields. The last formal valuation indicated a deficit of £450m as at 30 September 2013. The Group agreed a deficit repayment schedule with the trustee resulting in payments of £65m and £150m to the Scheme in October 2013 and June 2014 respectively. Further annual payments of £50m are due from 1 October 2017 until October 2022 when a final payment of £55m will be made.

Risk Report (continued)

REGULATORY, COMPLIANCE & CONDUCT RISK

Regulatory and Compliance risk consists of regulatory strategy and change risk and regulatory relationship risk. Regulatory strategy and change risk is the risk of failing to identify and monitor changes in the regulatory environment and of failing to take opportunities to help shape the development of emerging legislative frameworks and / or to effectively implement the required changes. Regulatory relationship risk is the risk of damaging the Group's relationship with regulators through non-compliance with regulatory requirements, not keeping regulators informed of relevant issues impacting (or which may potentially impact) the Group, and not meeting the information requests and review findings of regulators, by providing incorrect or inadequate information, not meeting regulatory deadlines or obstructing the regulator from fulfilling its role.

Risk appetite

The Group has no appetite for regulatory breaches.

Mitigation measures

- The Group has a regulatory engagement policy designed to ensure an open and cooperative relationship is maintained with regulators at all times, ensuring that all key interactions with regulators are managed, recorded and escalated as appropriate.
- All employees are required to achieve mandated standards to meet their 'compliance gateway' obligations.
- Material changes to regulatory policies and protocols are approved by either the Executive Leadership Team or the Board.
- The Chief Risk Officer and Risk Leadership Team consider compliance risk topics when setting risk appetite and through ongoing risk assessment, profiling and reporting.

Monitoring

A risk management oversight and compliance monitoring plan is approved by Board's Risk Committee on an annual basis which independently assesses the control framework underpinning compliance with laws and regulations.

Conduct Risk

Conduct Risk is the risk of treating customers unfairly and / or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.

Risk appetite

The Group has a conservative appetite for conduct risk.

Exposures

As part of the demerger, the group's parent entity, CYBG and NAB have entered into a Conduct Indemnity Deed where NAB has agreed to provide CYBG with a capped indemnity in respect of certain historic liabilities relating to conduct in the period prior to the demerger date. Details of this Conduct Indemnity and its impact on CYBG PLC and the Group are included in note 26 – Provisions.

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 26 reflecting the Group's current position in relation to redress provisions for PPI, IRHPs and other smaller historic conduct matters. The final amount required to settle the Group's potential liabilities for these matters is materially uncertain. 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.

Consideration of customer outcomes is embedded within the Group's operating processes, and metrics are regularly monitored to help ensure outcomes are appropriate.

Risk Report (continued)

REGULATORY, COMPLIANCE & CONDUCT RISK (continued)

Conduct Risk (continued)

Mitigation measures

The Group has a conduct framework which recognises the key conduct risks inherent in the Group's strategy, through which which it seeks to apply the highest standards in the design and sale of products, and the treatment of its customers. The framework incorporates target outcomes and operating principles to ensure the Group's business model and supporting business practices achieve fair treatment of customers and the avoidance of customer detriment.

Products are subject to a product governance framework methodology and are designed and sold to meet customer needs and expectations with governance processes embedded to ensure those objectives are met.

Monitoring

This is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly and products are designed and sold to meet their needs, customer expectations are met and complaints are dealt with effectively and fairly. All three lines of defence consider conduct risk as part of their oversight and assurance activities.

Risk Report (continued)

OPERATIONAL RISK (including Strategic, Business & Financial Performance Risks)

Operational risk (including Strategic, Business & Financial Performance Risks) is the risk of loss resulting from inadequate or failed internal processes, people, strategies and systems or from external events including, for example, the prospect of a cyber attack. It is a core component of the RMF and is embedded in day to day business activities. Responsibilities are set out in a structured operational risk framework that seeks to identify, assess, mitigate, monitor, and report the operational risks and events that could impact the achievement of business objectives or impact core business processes.

Business units are responsible for the day to day management of operational risk, with oversight from the risk management function and independent assurance activities undertaken by Internal Audit.

The requirements of the operational risk management framework are defined in an overarching operational risk policy and related minimum standards, and reflect the Group's operational risk appetite.

Risk Appetite

The Group is prepared to tolerate a level of operational risk exposure within agreed thresholds and limits. Operational risks arise from the day to day business activities, which may result in direct or indirect losses and could adversely impact the Group's financial performance, levels of customer care and reputation.

Approach to Monitoring and Mitigating Exposures

Losses may result from both internal and external events, and are categorised using risk categories aligned to Basel II. The Basel II categories are used to ensure that the identification, assessment, mitigation, monitoring and reporting of risks and events, is applied consistently.

The Group has identified, assessed and is currently monitoring all key operational risks across the above noted categories, including undertaking an assessment of control effectiveness, monitoring trends in key risk indicators and escalating events, in accordance with policy requirements.

Stress testing

The Group undertakes scenario analysis to gain insights into the stresses the business could be subject to in the event of this type of operational risk materialising. The Group maintains a suite of operational risk scenarios covering the Basel II event types relevant to its business. As part of the scenario analysis approach, the suite of operational risk scenarios are reviewed and updated on a regular basis for existing potential impacts and identification of potential new risk events. Management then document a proposed response to identify how the scenarios would be managed and monitored if they occurred.

Risk Category	
Customer, products and sales practices	The risks associated with the fair treatment of customers and the potential customer impact on all the Group's core activities.
Regulatory environment and market practices	The risks associated with ensuring the Group complies with a large volume of laws and regulations, including managing regulatory change.
Payments and process management	The risks associated with the management of large volumes of transactions, including ensuring core processing activities are conducted safely and efficiently.
Workplace practices and environment	The risks associated with failing to provide a safe environment for customers and colleagues, including ensuring there is adequate capacity of resource, with clearly defined objectives and an effective and efficient management structure in place.
Systems and infrastructure	The risks associated with failing to maintain the Group's systems and infrastructure, including as a result of a potential cyber-attack.
Third party providers	The risks associated with failing to manage third party providers effectively, which may also impact on the level of service available to customers.
Strategic Execution Risk	The risks associated with failing to manage change effectively, including the ability to define and deliver a plan that enables the Group to meet its strategic objectives.

Risk Report (continued)

FINANCIAL CRIME RISK

Financial Crime Risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes. It also includes risks associated with external or internal acts intended to defraud, misappropriate, and circumvent policy, funds, information, regulations and property. The Group maintains an overarching financial crime policy and four policy standards aligned to each material financial crime risk. These are:

Sanctions – The Group has no appetite for non-compliance with the legal and regulatory obligations relative to Sanctions and Embargoes. To reflect the Group's risk appetite and to protect the Group from financial and reputational damage, including regulatory censure, fines and enforcement action, the Sanctions & Embargoes Policy articulates a set of minimum standards and requirements which must be complied with.

Anti-Money Laundering – The Group applies a prescribed high risk customer model which sets out the types of customer it has no risk appetite to onboard as well as customers with whom the Group is prohibited from entering into or maintaining a customer relationship. All other customers who are not prescribed shall be subject to controls commensurate with their risk.

Anti-Bribery and Corruption – The Group does not tolerate the direct or indirect offer, payment, solicitation or acceptance of bribes in any form. The Group has in place risk assessments, policies and guidelines on interacting with customers, suppliers and agents, including specific policies for gifts and hospitality. Senior managers across the business are required to complete an evaluation of risk areas as part of the risk assessment process.

Fraud – The Group accepts that in order to conduct business in a commercially viable manner, it is willing to sustain fraud losses within an agreed set of parameters. The application of fraud risk management considers customer impacts, industry trends and financial impacts of fraud which on occasion provide conflicting priorities. Emerging risks are identified and assessed with action taken to mitigate them. An agreed loss plan is set and performance against this is overseen by the Policy owner and reported through the appropriate Governance Committees. With regard to internal fraud, the Group recognises the risk of internal fraud but has no appetite for it. Consequently there is a control framework in place to mitigate that risk.

Exposures

There are currently no significant exposures to report. The Group continues to review the external environment for any change in regulatory or legislative direction, taking action as appropriate.

Mitigation measures

Risk Assessments against the four financial crime policy standards take place on an annual basis. Over and above these assessments, regular oversight of higher risk activities are performed as part of the formal oversight plan and embedded activities take place throughout the year. Key performance metrics relative to the critical financial crime systems (sanctions / politically exposed persons screening for customers and payments, transaction monitoring, account opening performance) are discussed at a regular, formal calibration meeting. Performance of systems is also measured using a third party tool to ensure effectiveness is not being eroded or diminishing. Training completion and compliance is subject to annual oversight.

All standards are reflected in the Group policies and standards and financial crime prevention manual, the content of which is provided by financial crime risk and updated as appropriate.

Monitoring

The financial crime team is responsible for strategy, governance, standard setting, oversight, training and reporting to the competent authorities and governance committees / Board.

The control framework is owned by financial crime risk but management and execution of customer identity and verification, customer due diligence, enhanced due diligence, identifying high risk customers, including correspondent banking relationships and record keeping is the responsibility of first line business units.

Account opening pass rates are oversighted as part of a regular process undertaken by financial crime risk and reported monthly.

Risk Report (continued)

FINANCIAL CRIME RISK (continued)

Higher risk customers are referred to financial crime risk and senior management within Customer Banking for agreement and sign off that business is within appetite and then continue to be monitored on an ongoing basis.

Screening customers for sanctions / politically exposed persons and transaction monitoring is carried out by financial crime risk. Sanctions screening for payments is carried out by the Payments team in the first line. Critical financial crime systems oversight is independently tested by Internal Audit.

Report of the Directors

The Directors of the Bank with its subsidiary undertakings (which together comprise the 'Group') submit their report and consolidated financial statements for the year ended 30 September 2016.

Corporate Governance

Details of the corporate governance framework applying to the Bank is set out in the Corporate Governance Report within the CYBG PLC Annual Report & Accounts.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2016 was £352m (2015: loss of £308m). The loss attributable to the shareholders for the year ended 30 September 2015 amounted to £558m (2015: loss of £249m). A dividend of £51m was paid in respect of the ordinary shares for this financial year (2015: £Nil). The Group's strategic highlights and business developments are set out in the Strategic Report.

Future developments and financial risk management objectives and policies

The Bank provides a wide range of banking and financial services through branches and offices in the UK. Information regarding future developments and financial risk management objectives and policies of the Group in relation to the use of financial instruments that would otherwise be required to be disclosed in the Report of the Directors, and which is incorporated into this report by reference, can be found in the Strategic Report and the Risk Report.

Directors and Directors' interests

The current Directors are shown on page 1. Directors who are not full-time employees of the Group or a related body corporate are appointed in accordance with the Articles of Association and may be eligible for reappointment thereafter. No Directors retired by rotation during the year.

Directors' interests

No Director had any interest in the shares of the Bank or its subsidiaries at any time during the year

Appointments

David Bennett was appointed as a Non-Executive Director of the Company on 22 October 2015.
Paul Coby was appointed as a Non-Executive Director of the Company on 1 June 2016.
Clive Adamson was appointed as a Non-Executive Director of the Company on 1 July 2016.
Fiona MacLeod was appointed as a Non-Executive Director of the Company on 12 September 2016.
Tim Wade was appointed as a Non-Executive Director of the Company on 12 September 2016.

Resignations

Richard James Sawers resigned as a Non-executive Director of the Company on 2 February 2016.
David Philip Allvey resigned as a Non-executive Director of the Company on 31 March 2016.
Alexander John Shapland resigned as a Non-executive Director of the Company on 20 May 2016.
Barbara Ann Ridpath resigned as a Non-executive Director of the Company on 20 May 2016.

Directors' liabilities

During the year, CYBG PLC paid a premium for a contract insuring the Directors and officers of CYBG PLC, its subsidiaries and controlled entities against personal liabilities which may arise in the course of the performance of their duties, as well as protecting the Group itself to the extent that it is obligated to indemnify Directors and officers for such liability.

Report of the Directors (continued)

Directors' Indemnities

The Directors have each entered into individual deeds of access, insurance and indemnity with the CYBG Group which, amongst other things and subject to certain exceptions, indemnify the Directors to the maximum extent permitted by law and regulation against liabilities to a person other than the Company or an associated company that they may incur as an officer of the Company and any other subsidiary of CYBG Group. Each such provision constitutes a 'third party indemnity provision' and a 'qualifying indemnity provision' for the purposes of section 234 to 236 of the Companies Act 2006. These provisions are in force for the benefit of the Directors at the date of this Report, and were in force when this Report was approved and during the financial year to which this Report relates. Such deeds are available for inspection at the Company's registered office.

The CYBG Group has an insurance policy in place for the benefit of all trustees, employees, Directors, officers, members and partners of the Company whilst acting in the capacity of a trustee or administrator of employee benefit or pension plans. This policy therefore indemnifies the Directors of Yorkshire and Clydesdale Bank Pension Trustee Limited and YCB DC Trustee Limited (each a 'Trustee Company'), the trustees of two occupational pension schemes operated by the CYBG Group, against liability incurred by them in connection with the management and administration of the pension schemes. This insurance policy constitutes a 'pension scheme indemnity provision' and a 'qualifying indemnity provision' for the purposes of section 235 to 236 of the Companies Act 2006. These provisions are in force for the benefit of the Directors of Trustee Companies at the date of this Report, and were in force when this Report was approved and during the financial year to which this Report relates. Such policy is available for inspection at the Company's registered office.

In addition, the CYBG Group had appropriate Directors' and Officers' Liability Insurance cover in place throughout the financial year.

Colleagues

Policies and practices in respect of employee issues are managed on a consistent basis across the CYBG Group, and the following sections reflect this approach.

Our people are integral to the ongoing success of the Group. As the public face of our business, they connect us with our customers and other external stakeholders, and act as a valuable source of ideas for ways in which we can continually improve our processes, products and services. Only through the engagement and support of our people can we help our customers achieve their financial goals. Our annual feedback survey, myVoice, showed a 6 percentage point increase in engagement relative to the previous year, taking us to 2 percentage points above the UK financial services industry norm. It also showed a 10 percentage point increase in colleague advocacy. As we continue to build a high performing PLC, our aim is to foster a culture that attracts, retains, motivates and rewards people who consistently deliver the right customer-focused outcomes regardless of where they work or what they do across the Group.

Supporting and empowering our people

Continuing our digital transformation we have maximised the use of technology, introducing tools that enable our people to develop the right skills, knowledge and experience to deliver great customer outcomes. Offering our people access to the highest quality personal development material is a key part of our approach and why we invested in a new interactive learning tool known as myLearning at the start of the year. myLearning delivers an end-to-end learning experience that encompasses technical skills, compliance and personal development to help people perform their role and progress their career with the Bank.

Our aim is to create a culture that supports a high performing business, encouraging greater accountability, customer centricity and commercial viability. Ensuring we nurture and reward those who actively foster that culture is a priority for the Group.

Report of the Directors (continued)

Colleagues (continued)

The launch of our new intranet, Our World, was another important step in our digital journey, bringing together the information people need to perform their role. Containing information on our strategy, brand, the communities where we live and work, as well as the latest products and services available, it is a valuable resource for colleagues across all parts of the Group.

Recognising the unique requirements of those working across our network, this year we developed our first ever tablet based application for colleagues. The myComms app helps us communicate better with customer facing colleagues who don't always have instant access to email or the intranet. It has been extremely popular, has enabled colleagues to spend more time on supporting customers and paved the way for more innovation in this area.

Priorities for next year

Our aim is to create a culture that supports a high performing business, encouraging greater accountability, customer centricity and commercial viability. Ensuring we nurture and reward those who actively foster that culture is a priority. From a new reward structure to the development of talent and leadership across our business, we have a number of initiatives in plan to help achieve that. Introducing operational excellence in our core support areas is helping design and deliver best-in-class operational capabilities, while investing in our people to develop enhanced leadership, coaching and capability skills. Recognising the benefits flexible working brings to our people, our customers and our business overall, we are investing in new and innovative digital solutions that will provide more flexibility and create a greater sense of community for colleagues, regardless of where they work. Following the recent introduction of our Simply Thank You employee recognition scheme and our new approach to bonus, we will continue to evolve and grow our reward and recognition package, enabling us to recognise positive customer-focused behaviours and performance consistently and fairly across the Bank.

Equality of employment opportunities

It is the policy of the Group to promote equality of employment opportunities by giving full and fair consideration to applications from people with disabilities. If existing employees become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled employees.

Additional information can be found in the Strategic Report section of the CYBG PLC Annual Report & Accounts

Political donations

No political donations were made during the year (2015: £Nil).

Management of risk

Risk and capital related disclosures for the Group are included within the Strategic Report and Risk Report. The information contained within these disclosures has not been audited by the Group's external auditor, except where labelled accordingly.

Risk and capital related disclosures for the CYBG Group can be found in the CYBG PLC Pillar 3 Report, www.cybg.com/investor-centre/financial-results, and also within the Risk Report section of the CYBG PLC Annual Report & Accounts.

Significant contracts

Details of related party transactions are set out in note 11 of the financial statements.

Share capital

Information about share capital is shown in note 30.

Report of the Directors (continued)

Research and Development Activities

The Group does not undertake formal research and development activities although it does invest in new platforms and products in each of its business lines in the ordinary course of business. In addition to new products and services the Group also invests in internally generated intangible assets including software and computers systems. Further details can be found in Note 21 of the Group's consolidated financial statements.

Going concern

The Group's Directors have made an assessment of the Group's ability to continue as a going concern and are satisfied that the Group has the resources to continue in business for the foreseeable future.

The Group's use of the going concern basis for preparation of the accounts is discussed in note 1 of the Group's consolidated financial statements.

Events after the balance sheet date

There have been no material post balance sheet events.

Auditors

In accordance with section 485 of the Companies Act 2006, a resolution to reappoint Ernst & Young LLP, and to authorise the Directors to fix their remuneration, will be proposed at the next Annual General Meeting.

The Directors who were members of the Board at the time of approving the Report of the Directors are listed on page 1. Having made enquiries of fellow Directors and of the Group's auditor, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Group's auditor is unaware; and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditor is aware of that information.

By order of the Board

Lorna McMillan
Company Secretary
21 November 2016

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRSs') and applicable law. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss of the Group and Bank for that year. In preparing these financial statements the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Group and Bank have complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Lorna McMillan
Company Secretary
21 November 2016

Independent auditor's report to the members of Clydesdale Bank PLC

We have audited the financial statements of Clydesdale Bank PLC for the year ended 30 September 2016 which comprise the Group Consolidated Income Statement, the Group and Bank Statements of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Statements of Cash Flows and the related notes 1 to 38. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 66 the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 30 September 2016 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Bank's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion:

- the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.
- the Strategic Report and the Report of the Directors have been prepared in accordance with applicable legal requirements.

Independent auditor's report to the members of Clydesdale Bank PLC (continued)

Opinion on other matter prescribed by the Companies Act 2006 (continued)

In light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Report of the Directors.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Steven Robb (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP, Statutory Auditor
Leeds
21 November 2016

Notes:

1. The maintenance and integrity of the Clydesdale Bank PLC website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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

Clydesdale Bank PLC
Consolidated income statement
for the year ended 30 September 2016

	Note	2016 £m	2015 £m
Interest income and similar income		1,101	1,110
Interest expense and similar charges		(294)	(321)
Net interest income	5	807	789
Gains less losses on financial instruments at fair value		9	2
Other operating income		182	213
Non-interest income	6	191	215
Total operating income		998	1,004
Personnel expenses		(280)	(198)
Restructuring expenses		(45)	(17)
Depreciation and amortisation expense		(88)	(20)
Other operating and administrative expenses		(898)	(999)
Total operating and administrative expenses before impairment losses	7	(1,311)	(1,234)
Operating loss before impairment losses		(313)	(230)
Impairment losses on credit exposures	16	(39)	(78)
Loss on ordinary activities before tax		(352)	(308)
Tax (expense)/credit	8	(206)	59
Loss for the year attributable to equity holders		(558)	(249)

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

The notes on pages 75 to 148 form an integral part of these financial statements.

Clydesdale Bank PLC
Statements of comprehensive income
for the year ended 30 September 2016

	Note	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Loss for the year		**(558)**	(249)	**(574)**	(240)
Items that may be reclassified to the income statement					
Change in cash flow hedge reserve					
Gains during the year		**108**	21	**109**	18
Transfers to the income statement		**(1)**	(18)	**(1)**	(18)
Taxation thereon		**(25)**	-	**(25)**	-
		82	3	**83**	-
Change in available for sale reserve					
Gains during the year		**29**	5	**29**	5
Transfers to the income statement		**(8)**	-	**(8)**	-
Taxation thereon		**(6)**	(1)	**(6)**	(1)
		15	4	**15**	4
Total items that may be reclassified to the income statement		**97**	7	**98**	4
Items that will not be reclassified to the income statement					
Remeasurement of defined benefit pension plans	28	**(179)**	(36)	**(179)**	(36)
Taxation thereon		**43**	7	**43**	7
Total items that will not be reclassified to the income statement		**(136)**	(29)	**(136)**	(29)
Other comprehensive losses net of taxation		**(39)**	(22)	**(38)**	(25)
Total comprehensive losses for the year		**(597)**	(271)	**(612)**	(265)
Attributable to equity holders of the parent		**(597)**	(271)	**(612)**	(265)

The notes on pages 75 to 148 form an integral part of these financial statements.

Clydesdale Bank PLC
Balance sheets
as at 30 September 2016

		Group		Bank	
		2016	2015	**2016**	2015
	Note	**£m**	£m	**£m**	£m
Assets					
Cash and balances with central banks	10	**5,955**	6,431	**5,955**	6,431
Due from related entities	11	**7**	786	**2,510**	3,013
Due from other banks		**945**	128	**425**	36
Financial assets available for sale	12	**1,731**	1,462	**1,724**	1,455
Financial assets held to maturity	12	**-**	-	**1,447**	1,440
Other financial assets at fair value	13	**750**	1,097	**750**	1,097
Derivative financial instruments	14	**585**	285	**388**	228
Loans and advances to customers	15	**29,202**	27,482	**27,683**	26,208
Due from customers on acceptances		**4**	4	**4**	4
Current tax assets		**-**	-	**6**	23
Property, plant and equipment	18	**99**	109	**99**	96
Investment properties	19	**22**	32	**22**	32
Investments in controlled entities and associates	20	**-**	2	**16**	16
Intangible assets	21	**256**	265	**256**	-
Deferred tax assets	22	**219**	389	**214**	308
Defined benefit pension assets	28	**-**	52	**-**	52
Other assets	23	**188**	177	**188**	152
Total assets		**39,963**	38,701	**41,687**	40,591
Liabilities					
Due to other banks	24	**1,309**	393	**1,309**	393
Other financial liabilities at fair value	13	**48**	67	**48**	67
Derivative financial instruments	14	**598**	534	**587**	466
Due to customers	25	**27,090**	26,407	**27,090**	26,407
Liabilities on acceptances		**4**	4	**4**	4
Current taxes		**8**	-	**-**	-
Provisions for liabilities and charges	26	**852**	1,006	**852**	1,006
Due to related entities	11	**498**	979	**5,605**	6,087
Debt securities in issue	27	**4,021**	3,766	**708**	707
Retirement benefit obligations	28	**79**	4	**79**	4
Deferred tax liabilities	22	**27**	10	**27**	10
Other liabilities	29	**2,208**	2,073	**2,200**	2,010
Total liabilities		**36,742**	35,243	**38,509**	37,161
Equity (parent entity interest)					
Share capital	30	**324**	2,812	**324**	2,812
Other equity instruments	31	**425**	450	**425**	450
Other reserves	31	**104**	4	**102**	1
Retained earnings	31	**2,368**	192	**2,327**	167
Total equity		**3,221**	3,458	**3,178**	3,430
Total liabilities and equity		**39,963**	38,701	**41,687**	40,591

The notes on pages 75 to 148 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 21 November 2016 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Ian Smith
Chief Financial Officer

Company name: Clydesdale Bank PLC
Company number: SC001111

Clydesdale Bank PLC
Statements of changes in equity
for the year ended 30 September 2016

Group	Notes	Share capital £m	Other equity instruments £m	Share premium account £m	Merger reserve £m	Equity based compensation reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Capital contribution reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2014		2,042	-	243	338	2	2	8	(16)	-	(114)	2,505
Loss for the year		-	-	-	-	-	-	-	-	-	(249)	(249)
Other comprehensive income/(losses)		-	-	-	-	-	-	4	3	-	(29)	(22)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	4	3	-	(278)	(271)
Shares issued - ordinary shares		770	-	-	-	-	-	-	-	-	-	770
Shares issued - ordinary B shares		338	-	-	-	-	-	-	-	-	-	338
Cancellation of B ordinary shares		(338)	-	-	-	-	-	-	-	-	338	-
Capitalisation of merger reserve		-	-	-	(338)	-	-	-	-	-	-	(338)
Capital contribution		-	-	-	-	-	-	-	-	-	4	4
Other equity instruments issued		-	450	-	-	-	-	-	-	-	-	450
Transfer of share premium		-	-	(243)	-	-	-	-	-	-	243	-
Transfer to share option reserve		-	-	-	-	1	-	-	-	-	(1)	-
Equity based compensation expensed		-	-	-	-	7	-	-	-	-	-	7
Equity based compensation settled		-	-	-	-	(7)	-	-	-	-	-	(7)
As at 30 September 2015	30, 31	**2,812**	**450**	**-**	**-**	**3**	**2**	**12**	**(13)**	**-**	**192**	**3,458**
Loss for the year		-	-	-	-	-	-	-	-	-	(558)	(558)
Other comprehensive income/(losses)		-	-	-	-	-	-	15	82	-	(136)	(39)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	15	82	-	(694)	(597)
AT1 distribution paid (net of tax)	9	-	-	-	-	-	-	-	-	-	(15)	(15)
Dividend paid		-	-	-	-	-	-	-	-	-	(51)	(51)
Shares issued - ordinary shares		426	-	-	-	-	-	-	-	-	-	426
Share capital reduction		(2,914)	-	-	-	-	-	-	-	-	2,914	-
Capital contribution	26	-	-	-	-	-	-	-	-	7	-	7
Other equity instruments issued		-	425	-	-	-	-	-	-	-	-	425
Capital note repurchase		-	(450)	-	-	-	-	-	-	-	21	(429)
Transfer from asset revaluation reserve		-	-	-	-	-	(1)	-	-	-	1	-
Equity based compensation expensed		-	-	-	-	5	-	-	-	-	-	5
Equity based compensation settled		-	-	-	-	(8)	-	-	-	-	-	(8)
As at 30 September 2016	30, 31	**324**	**425**	**-**	**-**	**-**	**1**	**27**	**69**	**7**	**2,368**	**3,221**

The notes on pages 75 to 148 form an integral part of these financial statements.

Clydesdale Bank PLC
Statements of changes in equity (continued)
for the year ended 30 September 2016

Bank

	Notes	Share capital £m	Other equity instruments £m	Share premium account £m	Merger reserve £m	Equity based compensation reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Capital contribution reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2014		2,042	-	243	338	2	2	8	(16)	-	(144)	2,475
Loss for the year		-	-	-	-	-	-	-	-	-	(240)	(240)
Other comprehensive income/(losses)		-	-	-	-	-	-	4	-	-	(29)	(25)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	4	-	-	(269)	(265)
Shares issued - ordinary shares		770	-	-	-	-	-	-	-	-	-	770
Shares issued - ordinary B shares		338	-	-	-	-	-	-	-	-	-	338
Cancellation of B ordinary shares		(338)	-	-	-	-	-	-	-	-	338	-
Capitalisation of merger reserve		-	-	-	(338)	-	-	-	-	-	-	(338)
Other equity instruments issued		-	450	-	-	-	-	-	-	-	-	450
Transfer of share premium		-	-	(243)	-	-	-	-	-	-	243	-
Transfer to share option reserve		-	-	-	-	1	-	-	-	-	(1)	-
Equity based compensation expensed		-	-	-	-	7	-	-	-	-	-	7
Equity based compensation settled		-	-	-	-	(7)	-	-	-	-	-	(7)
As at 30 September 2015	30, 31	**2,812**	**450**	**-**	**-**	**3**	**2**	**12**	**(16)**	**-**	**167**	**3,430**
Loss for the year		-	-	-	-	-	-	-	-	-	(574)	(574)
Other comprehensive losses		-	-	-	-	-	-	15	83	-	(136)	(38)
Total comprehensive losses for the year		-	-	-	-	-	-	15	83	-	(710)	(612)
AT1 distributions paid (net of tax)	9	-	-	-	-	-	-	-	-	-	(15)	(15)
Dividends paid		-	-	-	-	-	-	-	-	-	(51)	(51)
Shares issued - ordinary shares		426	-	-	-	-	-	-	-	-	-	426
Nominal share value reduction		(2,914)	-	-	-	-	-	-	-	-	2,914	-
Capital note redemption		-	(450)	-	-	-	-	-	-	-	21	(429)
Other equity instruments issued		-	425	-	-	-	-	-	-	-	-	425
Capital contribution	26	-	-	-	-	-	-	-	-	7	-	7
Transfer from asset revaluation reserve		-	-	-	-	-	(1)	-	-	-	1	-
Equity based compensation expensed		-	-	-	-	5	-	-	-	-	-	5
Equity based compensation settled		-	-	-	-	(8)	-	-	-	-	-	(8)
As at 30 September 2016	30, 31	**324**	**425**	**-**	**-**	**-**	**1**	**27**	**67**	**7**	**2,327**	**3,178**

The notes on pages 75 to 148 form an integral part of these financial statements.

Clydesdale Bank PLC
Statement of cash flows
for the year ended 30 September 2016

	Note	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Operating activities					
Loss on ordinary activities before tax		**(352)**	(308)	**(376)**	(305)
Adjustments for:					
Non-cash or non-operating items included in loss before tax	33	**(644)**	(721)	**(628)**	(717)
Changes in operating assets	33	**(2,279)**	(1,837)	**(1,626)**	(1,522)
Changes in operating liabilities	33	**1,585**	2,021	**1,653**	2,033
Interest received		**1,101**	1,257	**1,053**	1,196
Interest paid		**(198)**	(432)	**(198)**	(385)
Tax repayment received		**-**	5	**-**	5
Tax received/(paid) - group relief		**5**	(9)	**4**	(20)
Net cash (used in)/provided by operating activities		**(782)**	(24)	**(118)**	285
Cash flows used in investing activities					
Dividends received		**-**	-	**-**	32
Interest received		**11**	8	**4**	8
Proceeds from sale or maturity of investments		**101**	-	**101**	526
Proceeds from sale of AFS investments		**56**	-	**56**	-
Proceeds from sale of tangible fixed assets (1)		**17**	17	**17**	17
Purchase of tangible fixed assets (1)		**(22)**	(15)	**(22)**	(15)
Purchase of intangible fixed assets		**(99)**	-	**(51)**	-
Purchase of financial assets available for sale		**(357)**	(269)	**(357)**	(269)
Purchase of financial assets held to maturity		**-**	-	**-**	(481)
Investment in controlled entities		**-**	-	**-**	(4)
Net cash used in investing activities		**(293)**	(259)	**(252)**	(186)
Cash flows from financing activities					
Interest received		**1**	3	**65**	40
Interest paid		**(97)**	(120)	**(161)**	(189)
Proceeds from ordinary shares issued	30	**426**	770	**426**	770
Proceeds from other equity instruments issued	31	**425**	450	**425**	450
Redemption of other equity instruments		**(429)**	-	**(429)**	-
Redemption of medium term notes	11	**-**	(427)	**-**	(427)
Redemption of subordinated debt	11	**(474)**	(562)	**(474)**	(562)
Redemption and principal repayment on residential mortgage backed securities and covered bonds	17	**(1,029)**	(921)	**-**	(400)
Issuance of residential mortgage backed securities and covered bonds	17	**750**	1,207	**-**	-
Net decrease in amounts due from related entities		**786**	694	**541**	(26)
Net increase/(decrease) in amounts due to related entities		**407**	(354)	**(332)**	702
Equity based compensation settled		**(8)**	-	**(8)**	-
AT1 distributions paid	9	**(19)**	-	**(19)**	-
Dividends paid	9	**(51)**	-	**(51)**	-
Net cash provided by/(used in) financing activities		**688**	740	**(17)**	358
Net (decrease)/increase in cash and cash equivalents		**(387)**	457	**(387)**	457
Cash and cash equivalents at the beginning of the year		**6,337**	5,880	**6,337**	5,880
Cash and cash equivalents at the end of the year (2)	33	**5,950**	6,337	**5,950**	6,337

(1) Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

(2) Cash and cash equivalents is cash and balances with central banks less mandatory deposits plus cash equivalents within other assets, less due to other banks, due to related entities and other liabilities.

The notes on pages 75 to 148 form an integral part of these financial statements.

Notes to the consolidated financial statements

1. Basis of preparation

Reporting entity

The Bank is incorporated in the UK and registered in Scotland. On 8 February 2016, CYBG PLC became the new ultimate holding company for the Group by way of a share for share exchange with the immediate parent at the time, CYBI Limited, and was unconditionally listed on the London Stock Exchange. On 30 September 2016, CYBG became the immediate holding company of the Group by acquiring the Bank's entire share capital from CYBI Limited for consideration of £1. CYBG PLC also heads the largest and smallest group in which the results of the Group are consolidated. The consolidated financial statements comprise the Bank and its controlled entities (together the 'Group'). The Group's controlled entities are listed in note 20.

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with IFRS as adopted by the EU and applied in accordance with the provisions of the Companies Act 2006. No individual income statement is presented for the Bank, as permitted by Section 408 of the Companies Act 2006.

Basis of measurement

The financial information has been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment properties, financial assets available-for-sale and certain other financial assets and liabilities at fair value through profit or loss including all derivative contracts.

Presentation of risk offsetting and maturity disclosures

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

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. In addition, the Risk Report includes the Group's risk management objectives and the Group's objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2016, the Directors have considered a number of factors incorporating a wide range of information, including the current balance sheet position, the principal and emerging risks which could impact the performance of the Group and the Group's strategic and financial plan which includes future projections of profitability, capital adequacy, liquidity and funding. 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 Bank and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully in line with its business model and stated strategic aims. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

Notes to the consolidated financial statements (continued)

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Bank 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. For details of controlled entities refer to note 20.

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. 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 consolidated financial statements have been prepared using uniform accounting policies and are based on the same accounting period as that of Clydesdale Bank PLC.

New accounting standards and interpretations adopted during the year

The Group has not adopted any new or amended accounting standard or interpretation in the current year.

New accounting standards and interpretations not yet adopted

The following standards and amendments are relevant to the Group and were available for adoption in the European Union (EU), but are not mandatory and have not been applied by the Group in preparing these financial statements. The Group is currently assessing the impact of IFRS 15: 'Revenue from Contracts with Customers'; with this exception, none of the amendments listed are expected to have a significant impact for the Group:

- IFRS 15 'Revenue from Contracts with Customers', issued May 2014 and effective for financial years beginning on or after 1 January 2018. This standard establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard provides a single, principles based five step model to be applied to all contracts with customers. In April 2016, the International Accounting Standards Board (IASB) issued Clarifications to IFRS 15 to address certain implementation issues identified and provide additional transitional relief options.
- Amendments to IAS 16 and IAS 38: 'Clarification of Acceptable Methods of Depreciation and Amortisation', issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation are not appropriate.
- 'Annual Improvements to IFRS 2012-2014 Cycle', issued September 2014 and effective for financial years beginning on or after 1 January 2016. The IASB have made amendments to the following standards that are relevant to the Group and Company: IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'.
- Amendments to IAS 1: 'Disclosure Initiative', issued December 2014 and effective for financial years beginning on or after 1 January 2016. Narrow scope amendments providing clarification to existing IAS 1 'Presentation of Financial Statements' requirements.

There are a number of other standards and amendments relevant to the Group that are not available for adoption in the EU, nor effective at 30 September 2016 and have not been applied by the Group in preparing these financial statements. The most significant of these pronouncements is IFRS 9 'Financial Instruments', issued July 2014 and effective for financial years beginning on or after 1 January 2018. An update on the Group's implementation of IFRS 9 is provided below.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

New accounting standards and interpretations not yet adopted (continued)

Update on the implementation of IFRS 9

Implementation strategy and approach

The Group continues to work on its implementation strategy for IFRS 9, which is expected to receive EU endorsement by the end of the 2016 calendar year, and has mobilised an IFRS 9 project team to ensure implementation in line with the Standard and other evolving regulatory guidance and industry practice. The project has representation from both the Finance and Risk functions, with a Steering Committee and formal Project Control Board in place to provide the necessary oversight. As noted in the Corporate Governance Report of the CYBG PLC Annual Report & Accounts, the Board has also established a sub committee to oversee the implementation of IFRS 9 and the application of regulatory IRB to capital.

The primary objectives of the project include: defining accounting policies and approaches; co-ordinating with the Group's IRB Programme to ensure risk models meet the required specifications; delivery of data and system changes; and updating the credit provisioning operating model and overall governance framework. Key decisions on the impairment requirements of IFRS 9 involve appropriate internal stakeholder consultation; rigorous internal review performed by senior representation from both Finance and Risk; external review and challenge exercises; and presentation of the adopted impairment accounting policy decisions to the project oversight committees. Both Finance and Risk are jointly responsible for the sign off of the impairment accounting policy judgement papers, and consistent with IAS 39, modelling is owned by Risk, with Finance as the overall project sponsor.

The Group's intention is to perform an end-to-end parallel run during the year commencing 1 October 2017, capturing the IFRS 9 requirements for classification and measurement and impairment. The most significant of these will be the impairment requirements of the Standard, which will be closely monitored during the parallel run phase, to compare the results with expectations and to ensure that the Group's initial proposed staging criteria produces an impairment allowance which accurately reflects the increased credit risk provision in those financial assets that will be subject to a lifetime expected loss calculation.

The Group's current view on the three phases of IFRS 9 (classification and measurement, impairment and hedging) is as follows:

Classification and measurement

An initial assessment of the classification and measurement requirements of IFRS 9 has been undertaken with the main issue arising being the classification of financial assets in the IAS 39 category of available for sale (AFS) that does not exist under IFRS 9.

IFRS 9 simplifies the classification of financial assets by reducing the number of categories to just three (amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL)). The final classification is based on a combination of the Group's business model and the contractual cash flow characteristics of the instruments. The option to designate a financial asset at FVTPL in IAS 39 is largely retained in IFRS 9, with IFRS 9 also affording a further option to designate certain equity instruments at FVOCI instead of accounting for these as FVTPL.

The majority of the Group's financial assets under IAS 39 relate to loans and advances to customers and are currently classified under loans and receivables and held at amortised cost; the Group expects these will remain in the amortised cost category on implementation of IFRS 9.

The Group is still considering the classification options that are available for other financial assets including Treasury assets and other debt instruments currently held as AFS.

Impairment (including modelling development)

The impairment of financial assets under IFRS 9 is based on an expected credit loss (ECL) model which replaces the current incurred loss methodology under IAS 39 and is the area where IFRS 9 will have the most significant impact.

IFRS 9 requires a 12-month (Stage 1) ECL calculation where financial assets have not experienced a significant increase in credit risk since origination; and a lifetime ECL calculation when there has been a significant increase in credit risk (Stage 2 and 3). The lifetime ECL calculation is further refined into separate stages depending on whether the financial asset is credit impaired or not. When a financial asset is credit impaired (Stage 3), the resultant methodology to calculate the loss allowance under IFRS 9 uses the same criteria as the Group's IAS 39 methodology for specific provisions however it is anticipated that not all financial assets which are classified as Stage 3 will already have been subject to a specific provision under IAS 39.

The area of IFRS 9's impairment criteria where the greatest judgement is required relates to when financial assets display a significant deterioration in credit quality since initial recognition and subsequently move from a 12-month ECL calculation (Stage 1) to a non-credit impaired lifetime ECL calculation (Stage 2).

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

New accounting standards and interpretations not yet adopted (continued)

Update on the implementation of IFRS 9 (continued)

The Group has reflected on what a significant increase in credit risk since initial recognition means in terms of both Retail and Non-Retail portfolios and determined that there is no single factor that influences this decision; rather a combination of different criteria require to be assessed before concluding that a significant increase in credit risk since initial recognition has taken place. For example, in Non-Retail portfolios, a combination of the Group's internal rating system and other qualitative factors such as 'watch' status and 'approaching financial difficulty' status could be used in making this determination. For Retail portfolios, the proposed approach will move accounts to a lifetime ECL when the residual lifetime PD has deteriorated since origination by a pre-determined threshold, supplemented with other credit quality indicators. The 30 DPD presumption for a significant increase in credit risk since origination that exists within IFRS 9, will not be rebutted, and will form part of the overall assessment. The Group will not take advantage of the low credit risk exemption offered in IFRS 9. The low credit risk exemption allows entities not to assess whether there has been a significant increase in credit risk in a financial asset since initial recognition where the financial asset is deemed as being of low credit risk at the reporting date. The Group will assess all financial assets under the same criteria. For both Retail and Non-Retail portfolios, the Group's forbearance programmes will also play a part in determining a significant increase in credit risk since initial recognition.

The Group will look to align the accounting and regulatory definition of default for IFRS 9 in both Retail and Non-Retail portfolios. As part of this alignment, a review of the Group's forbearance strategies will be necessary and where a total or partial change outside the normal terms and conditions of a contract is identified, this may come under the Group's revised definition of default. Other forbearance measures undertaken by the Group that do not fall under the definition of default would form part of the assessment of a significant increase in credit risk since origination and attract a lifetime ECL calculation under Stage 2.

The Group will look to leverage off the model development work that is necessary under the IRB Programme as far as practically possible for IFRS 9 purposes with new Retail models and the transformation and alignment of existing Non-Retail models developed for all products and portfolios. The model development programme for IFRS9 will run concurrently with the IRB Programme. The Group will look to apply appropriate and proportional segmentation to the modelling approach for the Retail portfolio of mortgages, personal loans, credit cards and current accounts. For the Non-Retail portfolio, the segmentation that exists within the Group's internal rating system already meets the requirements of IFRS 9.

The Group's loan commitments and financial guarantee contracts will be assessed under IFRS 9's impairment criteria as part of the overall Retail and Non-Retail impairment methodologies. In addition, the Group will also apply the single impairment principles introduced by IFRS 9 to all other financial assets identified by the Group under the amortised cost and FVOCI classification categories.

The Group will continue to refine the ECL approach under IFRS 9 and provide an update on the progress made at each reporting period until implementation. This is in line with the approach recommended by the Enhanced Disclosure Task Force in its ECL report in November 2015.

Hedging

Until the guidance on hedge accounting is finalised by the IASB, the Group will look to exercise the accounting policy choice afforded by IFRS 9 and continue to apply the hedge accounting requirements of IAS 39. The Group is assessing the revised hedge accounting disclosures required by the amendment to IFRS 7 'Financial Instruments: Disclosures' and will look to implement these where appropriate.

Other standards and amendments

Listed below are the other standards and amendments relevant to the Group that are not available for adoption in the EU, nor effective at 30 September 2016 and that have not been applied by the Group in preparing these financial statements. The Group is currently assessing the impact of these standards and amendments.

- IFRS 16 'Leases' issued on 13 January 2016 and effective for financial years beginning on or after 1 January 2019. This standard replaces IAS 17: Leases and will result in most leases being brought onto a lessee's balance sheet under a single lease model, removing the distinction between finance and operating leases. The standard requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessor accounting requirements remain aligned to the current approach under IAS 17.
- Amendments to IAS 12: 'Recognition of Deferred Tax Assets for Unrealised Losses' issued on 19 January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments clarify the requirements on the recognition of deferred tax assets for unrealised losses.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Other standards and amendments (continued)

- Amendments to IAS 7: 'Disclosure initiative' issued on 29 January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments to IAS 7: Statement of Cash Flows require disclosures that enable users of the financial statements to evaluate changes in liabilities arising from an entity's financing activities.
- Amendments to IFRS 2: 'Classification and Measurement of Share-based Payment Transactions' issued on 20 June 2016 and effective for financial years beginning on or after 1 January 2017. 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.

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

Initially, at the date of a foreign currency transaction, the Group records an asset, liability, expense or revenue arising from the transaction using the end of day spot exchange rate between the functional and foreign currency on the transaction date.

Subsequently, at each reporting date, the Group translates foreign currency monetary items at the closing spot 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. Foreign currency non-monetary items measured at fair value will be 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.

Revenue recognition

Net interest income

Interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating amortisation using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the 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 of the effective interest rate includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Where it is not possible to estimate reliably 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 as revenue within the effective interest rate calculation. When the non-utilisation of a commitment fee occurs, this is taken as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Direct loan origination costs are netted against loan origination fees and the net amount recognised as revenue over the life of the loan as an adjustment of yield. All other loan related costs are expensed as incurred.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Revenue recognition (continued)

Fees and commissions

Fees and commissions not integral to the effective interest rate, arising from services provided to customers and third parties are recognised on an accruals basis when the service has been provided or on completion of the underlying transaction to which the fee relates.

Gains less losses on financial instruments at fair value through profit or loss

Gains less losses on financial instruments at fair value through profit or loss comprise fair value gains and losses from three distinct activities:

- derivatives classified as held for trading;
- hedged assets, liabilities and derivatives designated in hedge relationships; and
- financial assets and liabilities designated at fair value through profit or loss.

For trading derivatives, the full change in fair value is recognised inclusive of interest income and expense arising on those derivatives. However, in cases where a trading derivative is economically hedging an interest bearing financial asset or liability designated at fair value through profit or loss, the interest income and expense attributable to the derivative is recognised within net interest income and not as part of the fair value movement of the trading derivative.

Hedged assets, liabilities and derivatives designated in hedge relationships result in the recognition in income of (i) fair value movements on both the hedged item and hedging derivative in a fair value hedge relationships (the net of which represents hedge ineffectiveness), and (ii) hedge ineffectiveness on cash flow hedge relationships.

Other assets and liabilities at fair value comprise fair value movements on those items designated as fair value through profit or loss.

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

Dividend income

Dividend income is recorded in the income statement on an accruals basis when the Group's right to receive the dividend has been established.

Taxation

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 in equity, in which case the tax is also recognised in equity.

Income tax expense or revenue is the tax payable or receivable on the current year's taxable income based on the applicable tax rate adjusted by changes in deferred tax assets and liabilities.

Current tax

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

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. 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.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Taxation (continued)

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise against which those temporary differences and losses may be utilised.

Dividends on ordinary shares

Final dividends on ordinary shares classified as equity instruments are recognised as a liability and deducted from equity when they are approved by the Bank's Directors. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

Cash and cash equivalents

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

Repurchase and reverse repurchase agreements

Securities sold subject to repurchase agreements ('repos') are retained in their respective balance sheet categories. The counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate based upon the counterparty to the transaction.

Securities purchased under agreements to resell ('reverse repos') are accounted for as collateralised loans. Securities borrowed are not recognised in the financial statements unless they are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability. Receivables due to the Group under reverse repo agreements are normally classified as deposits with other banks or cash and cash equivalents as appropriate.

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

Financial instruments

Recognition and derecognition of financial instruments

A financial asset or a financial liability is recognised on the balance sheet when the Bank becomes party to the contractual provisions of the instrument. Loans and receivables are recognised when cash is advanced (or settled) to the borrowers.

Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date, being the date that the Group is committed to purchase or sell a financial asset.

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, financial assets held to maturity and financial assets available for sale. Management determines the classification of its financial assets at initial recognition.

The Bank classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss, and other financial liabilities which, subsequent to initial recognition, are measured at amortised cost.

The Bank 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.

A financial liability is derecognised from the balance sheet when the Bank has discharged its obligation to the contract, or the contract is cancelled or expires.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Financial Instruments (continued)

Offsetting financial instruments

A financial asset and a financial liability shall be offset and the net amount presented on the balance sheet if, and only if, the Bank currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Financial instruments designated at fair value through profit or loss

Upon initial recognition, financial assets and liabilities may be designated as held at fair value through profit or loss and are initially recognised at fair value, with transaction costs being recognised in the income statement immediately. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise. Items held at fair value through profit or loss comprise both items held for trading and items specifically designated as fair value through profit or loss at initial recognition.

Restrictions are placed on the use of the designated fair value option and the classification can only be used in the following circumstances:

- if a host contract contains one or more embedded derivatives, the Group may designate the entire contract as being held at fair value;
- designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (i.e. eliminate an accounting mismatch) that would otherwise arise from measuring related assets or liabilities on a different basis; or
- assets and liabilities are both managed and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

Financial assets held for trading

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling in the near term, or 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 assets - Available for sale

Financial assets available for sale can be listed or unlisted, and are non-derivative financial assets that are designated as available for sale and are not classified into any of the categories of (i) fair value through profit or loss; or (ii) loans and receivables and are recognised on trade date.

Financial assets available for sale are initially recognised at fair value including direct and incremental transaction costs. They are subsequently measured at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale or impairment when the cumulative gain or loss is transferred to the income statement.

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise.

Financial liabilities

A financial liability is classified as held for trading if it is incurred principally for the purpose of selling in the near term, or 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.

All other financial liabilities are measured at amortised cost using the effective interest method.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Financial instruments (continued)

Fair value measurement

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.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument.

Where no 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 given 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.

The carrying value of financial assets at fair value through profit or loss reflects the credit risk attributable to the counterparty. Changes in the credit profile of the counterparty are reflected in the fair value of the asset and recognised in the income statement.

Derivative financial instruments and hedge accounting

All derivatives are recognised on the balance sheet at fair value on trade date and are classified as trading except where they are designated as part of an effective hedge relationship. The carrying value of a derivative is 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 method of recognising the resulting fair value gain or loss on a derivative depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge); or hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge). Hedge accounting is used for derivatives designated in this way providing certain criteria are met. The Group makes use of derivative instruments to manage exposures to interest rates and foreign currency.

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 Group documents 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%.

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequent to initial designation, 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. The movement in the fair value of the hedged item attributable to the hedged risk 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 on an effective interest basis over the remaining life of the asset or liability.

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. Specifically, the separate component of equity 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(s) 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 existing in equity at that time 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.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. This could occur for two reasons:

- the derivative is held for purposes of short term profit taking; or
- the derivative is held to economically hedge an exposure but does not meet the accounting criteria for hedge accounting.

In both these cases, the derivative is classified as a trading derivative and changes in the value of the derivative are immediately recognised in the income statement.

Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale or designated at fair value through profit or loss. They arise when the Group provides money or services directly to a customer with no intention of trading the loan. Loans and advances include overdrafts, credit card lending, market rate advances, bill financing, mortgages, lease finance and term lending.

Loans and advances are initially recognised at fair value including direct and incremental transaction costs. They are subsequently recorded at amortised cost, using the effective interest method, adjusted for impairment losses and unearned income. 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.

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to 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 accounting mismatch. When this option is applied the asset is included within other financial assets at fair value, and not within loans and advances. 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.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Impairment of financial assets other than fair value loans

The Group assesses at each balance sheet date whether there is evidence that a financial asset or a portfolio of financial assets that is not carried at fair value through profit or loss is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ('a loss event'), and that loss event (or events) has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and advances and held to maturity financial assets, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and is included in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure and any costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss.

When a loan is uncollectible, 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 reduce the amount of the expense in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

If the originally contracted terms of loans and advances are amended, the amounts are classified as restructured and may also be disclosed as forbearance if the customer is experiencing, or is about to experience, difficulties in meeting their financial commitments to the Group. Such accounts accrue interest as long as the loan performs in accordance with the restructured terms.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Impairment of financial assets other than fair value loans (continued)

Equity and debt instruments - classed as available for sale

In the case of equity instruments classified as available for sale, the Group seeks evidence of a significant or prolonged decline in the fair value of the security below its cost to determine whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement.

Reversals of impairment of equity shares classified as available for sale are not recognised in the income statement. Increases in the fair value of equity shares classified as available for sale after impairment are recognised directly in equity.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Where evidence of impairment exists, the net loss that has been previously recognised directly in equity is recognised in the income statement. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- fulfilment of the arrangement is dependent on the use of a specific asset or assets; and
- the arrangement conveys a right to use the asset.

As lessee

The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals are charged to the income statement on a straight line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Sale and leaseback leases entered into by the Group as lessee are primarily operating leases. Where an operating lease is established at fair value, any excess of sales proceeds over the carrying amount is recognised immediately in the income statement.

As lessor

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 net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within depreciation expense in the income statement consistent with the nature of the asset.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Property, plant and equipment

All freehold and long term leasehold land and buildings are revalued annually on an open market basis by the Directors to reflect current market values, based on advice received from independent valuers. In addition, full independent valuations are carried out on a three year cycle on an open market basis, including directly attributable acquisition costs but without deducting expected selling costs. For properties that are vacant, valuations are carried out on an open market basis. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

All other items of property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to acquisition.

Property, plant and equipment carrying amounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of (i) the asset's fair value less costs to sell and (ii) the asset's value in use.

Where a group of assets working together supports the generation of cash inflows largely independent of cash inflows from other assets or groups of assets, the recoverable amount is assessed in relation to that group of assets (a cash-generating unit).

With the exception of freehold 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. For major classes of property, plant and equipment, the annual rates of depreciation or amortisation are:

- buildings 2%
- leases (leasehold improvements) the lower of the expected lease term and the asset's useful life; and
- motor vehicles, fixtures and equipment 10% to 33.33%

The residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale, are included in the income statement. Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Investment properties

These are properties (land or buildings, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business.

Investment property assets are carried at fair value, with fair value movements taken to the income statement in the year in which they arise. Investment property assets are revalued annually by the Directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis being the amounts for which the assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction at the valuation date. Newly acquired investment property assets are held at cost (equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding 12 months.

Investments in controlled entities and associates

The Group's investments in controlled entities and associates are valued at cost or valuation less any provision for impairment. Such investments are reviewed annually for impairment, or more frequently when there are indications that impairment may have occurred. Losses relating to impairment in the value of shares in controlled entities and associates are recognised in the income statement.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Intangible assets

The 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 computer software costs are amortised on a straight line basis over their expected useful lives, usually between three and eight years. Impairment losses are recognised in the income statement as incurred.

Computer software is stated at cost, less amortisation and provision for impairment, if any.

Impairment of non-financial assets

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. 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.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to identify cash generating units and they represent a group of assets that generate cash inflows that are largely independent from other assets or groups of assets.

Provisions for liabilities and charges

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.

Conduct Indemnity

As part of the demerger, NAB and CYBG PLC have entered into a Conduct Indemnity Deed. The accounting for this matter is discussed in note 26.

Pension and post retirement costs

Employees of the Group are entitled to benefits on retirement, disability or death from the Group's pension plans. The Group operates both defined contribution and defined benefit pension schemes.

Defined contribution pension scheme

The defined contribution scheme receives fixed contributions from Group companies and the Group's obligation for contributions to these plans is recognised 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 the future payment is available.

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings for benefits accruing after 1 April 2006. A liability or asset in respect of the defined benefit scheme is recognised on the balance sheet and is measured as 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 Group's defined benefit obligation.

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. The Group's policy where actuarial remeasurements arise is to fully recognise such amounts directly in retained earnings 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 Group also provides post-retirement health care for certain retired employees. The calculation of the post-retirement health care liability is calculated in the same manner as the defined benefit pension obligation.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Subordinated debt and related entity balances

Subordinated debt and related entity balances, other than derivatives, are recorded at amortised cost. Subordinated debt comprises dated loan capital which is exclusively provided to the Bank by CYBG PLC. Subordinated debt instruments are included within amounts due to related entities on the balance sheet.

Debt issues

Debt issues are short and long term debt issued by the Group including commercial paper, notes, term loans and residential mortgage backed securities (RMBS). Debt issues are typically recorded at amortised cost using the effective interest method. Premiums, discounts and associated issue expenses are recognised using the effective interest method through the income statement from the date of issue to accrete the carrying value of securities to redemption values by maturity date. Interest is charged to the income statement using the effective interest method.

Securitisation

The Group has securitised certain loans (principally housing mortgage loans) by transfer of these to structured entities (SEs) controlled by the Group. The securitisation enables a subsequent issue of debt, either by the Bank or the SEs, to investors who gain security of the underlying assets as collateral. Those SEs are fully consolidated into the Group's accounts. All such transferred loans continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction, as the Group retains substantially all the risks and rewards associated with the transferred loans.

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. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

The financial guarantee contract is initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary. Subsequently, the Group records and measures the financial guarantee contract at the higher of:

- where it is likely the Group will incur a loss as a result of issuing the contract, a liability is recognised for the estimated amount of the loss payable; and
- the amount initially recognised less, when appropriate, amortisation of the fee which is recognised over the life of the guarantee.

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.

Equity based compensation

The Group engages in share-based payment transactions in respect of services received from certain of its employees and to provide long term incentives. 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 CYBG PLC shares, performance options or performance rights granted, including, where relevant, any market performance conditions and any non-vesting conditions.

The impact 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 which is reduced as the fair value of awards is recharged to the Group by CYBG PLC. 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 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.

2. Accounting policies (continued)

Equity

Equity based compensation reserve

The equity based compensation reserve represents the outstanding fair value amount in respect of share based payment expense recharged by the Group's ultimate parent, CYBG PLC, for equity based compensation provided to employees and Directors as part of their remuneration, adjusted for deferred tax.

In comparative periods the equity based compensation reserve represented the outstanding fair value amount in respect of share based payment expense recharged by the Group's former ultimate parent, NAB, which had been charged through the income statement and adjusted for deferred tax.

At the date of the demerger, current and former employees of the Group held awards granted in previous periods for which vesting is subject to continuing employment, and in some instances specified performance criteria being met. Following the demerger, existing unvested awards remain in place. NAB will settle the awards granted to Group employees in previous periods in accordance with the original terms of the grant. The Group will compensate NAB for the cost of the awards provided to the Group's employee. Subsequent to the demerger, the amounts payable to NAB in respect of such awards no longer meet the definition of share based payments under IFRS 2: *Share based payment.* Consequently, amounts within the equity based compensation reserve relating to outstanding NAB awards were reclassified to *Due to other banks* in the consolidated balance sheet immediately following the demerger.

Cash flow hedge reserve

The cash flow hedge reserve records the effective portion of the fair value revaluation of derivatives designated as cash flow hedging instruments.

Other equity instruments

Other equity instruments represent AT1 notes. These are perpetual capital notes with no fixed maturity or redemption date and are classified as equity instruments. Distributions on the AT1 notes are deducted from equity on the payment date net of any tax relief. The Bank has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any distribution that would otherwise be payable on any interest payment date.

Business combinations and disposals

Combination of businesses under common control

Business combinations involving entities under common control, where all combining entities are ultimately controlled by the same entity before and after the business combination, are accounted for using the predecessor values method of accounting. This involves recognising assets and liabilities of the acquired business at the predecessors' book value, without any change to reflect fair value of those assets and liabilities. Any difference between the cost of acquisition and the aggregate book value of the assets and liabilities as of the date of the transfer of the acquired entity is recorded as an adjustment to equity. No additional goodwill is created by the business combination.

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.

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.

Notes to the consolidated financial statements (continued)

3. Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and assumptions 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 most significant use of judgements and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. Sensitivity analysis indicating the impact of reasonable possible changes in this input on the fair value is included within note 36.

The valuation of these financial instruments is described in more detail in note 13.

Impairment losses on loans and advances

The Group reviews its individually significant loans and advances at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Group makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate price indices, country risk and the performance of different individual groups). If the PDs were to improve from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £5m. Alternatively, if PDs deteriorate by 5%, the impairment provision on loans and advances would increase by £5m. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £12m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £22m. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The impairment loss on loans and advances is disclosed in more detail in note 16 and in the Risk Report.

Notes to the consolidated financial statements (continued)

3. Critical accounting estimates and judgements (continued)

PPI redress provision and other conduct related matters

Disclosures in relation to the Group's PPI redress provision can be found in note 26 with the Group holding a provision of £725m at 30 September 2016 (2015: £774m). Significant judgement is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes (both historic and estimated future complaint volumes), uphold rates (how many claims are, or may be, upheld in the customer's favour) and redress costs (the average payment made to customers). Also factored into the estimate is the effect of the past business review and the judgements required around customer mailing response rates. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2016. Consequently, the provision calculated may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. Sensitivity analysis indicating the impact of reasonable possible changes in key assumptions on the PPI provision is included within note 26.

There are similar uncertainties and judgements for other conduct risk related matters, including the Group's IRHP provision, disclosed in note 26, however, the level of liability is materially lower.

Retirement benefit obligations

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. Further details on the assumptions used and sensitivity analysis on the key assumptions are provided in note 28.

Deferred tax assets

Disclosures in relation to the Group's deferred tax assets of £219m (2015: £389m) can be found in note 22. The reduction of £170m principally reflects the impact of changes in legislation restricting the use of certain historic losses to 25% of future profits andthe change in future tax rates, coupled with management's decision to reduce its horizon for recognition of losses reflecting the uncertainty inherent in the taxation of banks. The Group has assessed the recoverability of these deferred tax assets at 30 September 2016 and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The Group has made this assessment with reference to the latest available profit forecasts. The tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses; the Group expects the assets remaining on its balance sheet to be recovered over a horizon consistent with the Group's current corporate planning period which is deemed to be the reasonably foreseeable future in light of the uncertainty surrounding the taxation of banking groups.

Notes to the consolidated financial statements (continued)

4. 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 entity's Chief Operating Decision Maker, the Chief Executive Officer.

The Group's business is organised into two principal operating segments: SME Banking and Retail Banking. The Central Functions of the Group consist of: Finance, Risk Management, Chief Operating Office, Corporate Development and Stakeholder Engagement, CEO Office Support, Products, Propositions & Marketing, Internal Audit and Human Resources.

'Other' reflects elements of income and expenditure that are not recharged to the Group's two principal operating segments such as conduct related provisions, impairment of intangibles and restructuring costs.

SME Banking

The Group's established regional SME franchise offers a full range of business banking products and services to meet customers' banking needs across its small business, commercial and specialist and acquisition finance segments.

The Group's SME franchise is comprised of small businesses (which the Group defines as businesses with lending of up to £0.5m but less than £2.0m in turnover) and commercial businesses (which the Group defines as businesses with lending of more than £0.5m and greater than £2.0m in turnover). Across all business segments, the Group provides working capital solutions through asset finance, invoice finance, international trade, merchant acquiring and treasury services.

The Group offers a full range of lending products and services across a portfolio consisting of term lending, overdrafts and working capital solutions through its SME franchise:

- Term lending: the Group offers a wide variety of term loans, both secured and unsecured, and offers customers a range of repayment and interest rate options. The majority of the Group's business term lending is LIBOR based.
- Overdrafts: business overdrafts are the primary type of revolving variable rate credit facility offered by the Group to business customers.
- Invoice finance: the Group advances funds against the customer's trade receivables.
- Asset finance: these products provide a method of financing capital equipment purchases.
- International trade services: these products facilitate transactions between a buyer and seller located in different countries. The Group offers import loans, export loans, documentary collections and currency guarantees, together with letters of credit for securing trade.
- BCAs: the Group provides business customers' day to day banking, current account facilities (including debit cards, cheque books, regular statements, direct debits and standing orders), online banking and overdraft facilities.

Notes to the consolidated financial statements (continued)

4. Segment information (continued)

Retail Banking

The Group has a comprehensive regional and national retail banking product proposition with a personal deposit portfolio comprising of personal current accounts ('PCAs'), savings accounts and term deposits. The Group's retail loan portfolio comprises of mortgages, personal loans, credit cards and overdrafts:

- PCA: a stable source of funding with a large number of PCA customers having a tenure with the Group of more than ten years.
- Savings accounts: the Group offers a variety of savings accounts that pay a variable rate of interest. It also offers cash ISAs that offer depositors tax free returns.
- Term deposits (sometimes referred to as 'fixed rate savings accounts' or 'time deposits'): offer a fixed interest rate for a fixed term.
- Mortgages: the Group provides mortgage loans on a capital repayment basis, where the loan is required to be repaid during its life, and on an interest-only basis, where the customer pays interest during the term of the mortgage loan with the principal balance required to be repaid in full at maturity. The Group offers both owner-occupied mortgage loans (pursuant to which the borrower is the owner and occupier of the mortgaged property) and BTL loans (pursuant to which the borrower intends to let the mortgaged property).
- Personal loans: the Group provides unsecured personal loans through its branch network and through its digital and telephone distribution channels.
- Credit cards: the Group currently offers three credit card products: Private MasterCard, Business MasterCard and Gold MasterCard.
- Overdrafts: the Group provides overdraft lending across a variety of PCA products, subject to the account holder's status.

Major customers

Revenues from no one single customer amount to greater than 10% of the Group's revenues.

Geographical areas

The Group has no operations outside the UK and therefore no secondary geographical area information is presented.

Operating segments 2016	**SME Banking £m**	**Retail Banking £m**	**Central Functions £m**	**Other £m**	**Total £m**
Net interest income	285	472	50	-	**807**
Non-interest income	77	77	29	8	**191**
Operating income	362	549	79	8	**998**
Operating and administrative expenses	(70)	(119)	(537)	(585)	**(1,311)**
Impairment losses on credit exposures [(1)]	(30)	(9)	-	-	**(39)**
Segment operating profit/(loss) before tax	262	421	(458)	(577)	**(352)**
Average interest-earning assets [(2)]	**10,406**	**19,049**	**6,802**	**-**	**36,257**

(1) The impairment losses on credit exposures of £9m (2015: £33m) for Retail Banking includes losses on certain retail products attributable to SME (private banking) customers.

(2) Average interest earning assets for SME Banking segment includes £3.3bn (2015: £3.3bn) of mortgages originated by private banking.

Notes to the consolidated financial statements (continued)

4. Segment information (continued)

Operating segments 2015	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Net interest income	274	461	54	-	789
Non-interest income	77	94	1	43	215
Operating income	351	555	55	43	1,004
Operating and administrative expenses	(82)	(116)	(539)	(497)	(1,234)
Impairment losses on credit exposures	(45)	(33)	-	-	(78)
Segment operating profit/(loss) before tax	224	406	(484)	(454)	(308)
Average interest earning assets	10,908	17,400	7,471	-	35,779

The components of the 'Other' segment are £1m for gains on capital and debt restructure (2015: £43m) and £7m gain on available for sale asset disposal (2015: £Nil) through non-interest income. Operating and administrative expenses include £450m for PPI redress expense (2015: £390m), £Nil for PPI handling fine (2015: £21m), £Nil for IRHP redress expense (2015: £75m), £34m for other conduct expenses (2015: £Nil), £45m for restructuring expenses (2015: £17m), £11m for separation costs (2015: £10m), £Nil for pension increase exchange result (2015: £18m), £Nil for loss on capital restructure (2015: £2m) and £45m impairment losses on intangible assets (2015: £Nil).

5. Net interest income

	2016 £m	2015 £m
Interest income and similar income		
Loans and advances to other banks	**22**	28
Financial assets available for sale	**11**	8
Loans and advances to customers	**1,037**	1,033
Financial assets at fair value through profit or loss	**27**	37
Due from related entities (note 11)	**1**	3
Other interest income	**3**	1
Total interest income and similar income	**1,101**	1,110
Less: interest expense and similar charges		
Due to other banks	**8**	5
Financial liabilities at fair value through profit or loss	**1**	1
Due to customers	**188**	195
Debt securities in issue	**72**	82
Due to related entities (note 11)	**25**	38
Total interest expense and similar charges	**294**	321
Net interest income	**807**	789

Notes to the consolidated financial statements (continued)

6. Non-interest income

	2016 £m	2015 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	3	29
Other assets and liabilities at fair value	7	(29)
Ineffectiveness arising from fair value hedges (note 14)	-	1
Ineffectiveness arising from cash flow hedges (note 14)	(1)	1
	9	2
Other operating income		
Fees and commission	151	144
Margin on foreign exchange derivative brokerage	19	20
Gains on disposal of available for sale financial assets	8	-
Net fair value movement on investment properties	(1)	(1)
Other income	5	50
	182	213
Total non-interest income	191	215

Gains less losses on financial instruments at fair value incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans and movements in fair value are recognised in the income statement as part of non-interest income. 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. In general, as interest rates fall, the fair value of the loan portfolio increases. Conversely, as interest rates rise, the fair value of the loan portfolio decreases. Similarly, if credit spreads widen, the fair value of these loans will decrease, and vice versa. A credit risk gain on fair value loans and associated liabilities of £11m, offset by a fair value loss of £4m, has been recognised in the current period (2015: £18m and £47m, respectively). The valuation technique used is reflective of current market practice.

In the year ended 30 September 2016 fees and commission income includes an additional £13m of income as a result of the acquisition of CYB Intermediaries Limited on 30 September 2015.

On 2 November 2015 Visa Inc. announced the proposed acquisition of Visa Europe Limited ('Visa Europe') which was completed on 21 June 2016. The Bank was a principal member and shareholder of Visa Europe and in exchange for its share received a combination of cash and preferred stock. Following the acquisition announcement, the fair value of the Group's share in Visa Europe was increased by £7m, with a corresponding increase in the Group's available for sale reserve. The fair value gain recognised within the available for sale reserve was recycled to the income statement on completion of the sale and is included within 'gains on disposal of available for sale financial assets' above.

In the year ended 30 September 2016 other income includes a gain of £1m (2015: £2m) on early repurchase of medium term subordinated debt (note 11) and a gain of £Nil (2015: £41m) arising on capital restructures. A loss of £Nil arising on a capital restructure is included in related entity charges (notes 7 and 11) (2015: £2m).

In December 2014, £601m of Tier 2 subordinated debt issued was redeemed. These instruments would have become progressively ineligible for Tier 2 treatment under CRD IV's transitional rules from 1 January 2015 as well as being impacted by the introduction of a 25% capital limit under Pillar 2A. These instruments were replaced by an issue of £770m of ordinary shares and an issue of AT1 capital instruments of £450m to NAB. As a result of the redemptions, the prior year results include gains of £41m in other income arising on capital restructures and a further gain of £2m on early redemption of medium term funding on 30 September 2015, resulting in total gains in the year to 30 September 2015 of £43m.

Notes to the consolidated financial statements (continued)

7. Operating and administrative expenses

	2016 £m	2015 £m
Personnel expenses		
Salaries, wages and non-cash benefits	**184**	148
Related personnel expenses	**27**	14
Defined contribution pension expense	**20**	9
Defined benefit pension expense (note 28)	**28**	9
Equity based compensation	**5**	7
Other personnel expenses	**16**	11
	280	198
Restructuring		
Restructuring expenses	**45**	17
Depreciation expense		
Depreciation of property, plant and equipment (note 18)	**25**	20
Amortisation of intangible assets (note 21)	**63**	-
	88	20
Other operating and administrative expenses		
Operating lease rental	**30**	32
Other occupancy charges	**39**	38
Related entity charges (note 11)	**5**	300
Impairment losses on intangible assets (note 21)	**45**	-
PPI redress expense (note 26)	**450**	390
Other conduct expenses (note 26)	**34**	75
Other operating and administrative expenses	**295**	164
	898	999
Total operating and administrative expenses	**1,311**	1,234

Related entity charges include a loss on capital restructuring of £Nil (2015: £2m) (note 11).

During the year ended 30 September 2015, the Group's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After taking independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change resulted in a one-off credit to the prior year income statement of £18m in 2015, resulting in a reduction in the defined benefit pension expense for that year.

Separation costs of £11m and £Nil (2015: £8m and £2m) are included within other operating and administrative expenses and personnel expenses respectively.

Notes to the consolidated financial statements (continued)

7. Operating and administrative expenses (continued)

Auditor's remuneration

Included within other operating and administrative expenses:	2016 £'000	2015 £'000
Fees payable to the Company's auditor for the audit of the Company's financial statements	1,284	1,048
Fees payable to the Company's auditor for the audit of the Company's subsidiaries	103	91
Total audit fees	1,387	1,139
Audit related assurance services	50	-
Other assurance services	35	1,982
Total non-audit fees	85	1,982
Fees payable to the Company's auditor in respect of associated pension schemes	75	58
Total fees payable to the Company's auditor	1,547	3,179

Included within other assurance is £Nil in respect of assurance work related to the demerger and IPO (2015: £1,926k) which was paid by NAB.

8. Taxation

	2016 £m	2015 £m
Current tax		
UK Corporation tax		
Current year	13	(14)
Adjustment in respect of prior years	(3)	(21)
	10	(35)
Deferred tax (note 22)		
Current year	200	(31)
Adjustment in respect of prior years	(4)	7
	196	(24)
Tax expense/(credit) for the year	206	(59)

Notes to the consolidated financial statements (continued)

8. Taxation (continued)

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

	2016 £m	2015 £m
Loss on ordinary activities before tax	(352)	(308)
Tax credit based on the standard rate of corporation tax in the UK of 20.0% (2015: 20.5%)	(70)	(63)
Effects of:		
Disallowable expenses	57	5
Non-deductible FCA fine	-	4
Regulatory capital and debt restructure	-	(8)
Deferred tax assets derecognised (note 22)	237	16
Impact of rate changes	(11)	1
Adjustments in respect of prior years	(7)	(14)
Tax expense/(credit) for the year	206	(59)

Finance Act (No2) 2015 introduced the Bank Surcharge for the banking entity within the Group from 1 January 2016, being an 8% charge on taxable profits above £25m before the offset of brought forward losses or group relief. There are no such taxable profits in the year and accordingly no surcharge liability arises.

The impact of the corporation tax rate change, restriction on loss utilisation, and the impact of management's concurrent reassessment of the recoverability of deferred tax assets, is discussed in note 22 Deferred tax.

9. Dividends paid

	2016 £m	2015 £m
Ordinary dividend paid	51	-
AT1 distribution	19	-
	70	-

10. Cash and balances with central banks

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
Cash assets	1,313	1,452	1,313	1,452
Balances with central banks (including EU payment systems)	4,642	4,979	4,642	4,979
	5,955	6,431	5,955	6,431
Less mandatory deposits with central banks [1]	(43)	(44)	(43)	(44)
Included in cash and cash equivalents (note 33)	5,912	6,387	5,912	6,387

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

Notes to the consolidated financial statements (continued)

11. Related party transactions

As explained in note 1, on 8 February 2016, CYBG PLC became the new ultimate holding company for Clydesdale Bank PLC by way of a share for share exchange and was listed on the London Stock Exchange. Following the demerger and completion of the IPO, NAB no longer controls, jointly controls or has significant influence over the Bank or its subsidiaries. Consequently, there is no related party relationship between NAB and the Bank or its subsidiaries following the demerger date. As a result, amounts due to and due from NAB and its controlled entities have been reclassified from 8 February 2016, as explained below.

As the related party relationship ceased between the Group and NAB at the date of the demerger, only those transactions with NAB taking place up to the demerger date are disclosed below as related party transactions. The comparative financial information has not been restated.

During the period there have been transactions between the Group, NAB, controlled entities of NAB, controlled entities of the Group, and other related parties.

Amounts due from related entities	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Loans				
NAB Group	**-**	672	**-**	292
Controlled entities of the ultimate parent	**-**	1	**-**	1
Controlled entities of the Bank	**-**	-	**1,507**	1,549
	-	673	**1,507**	1,842
Other receivables				
NAB Group	**-**	110	**-**	110
CYBG	**7**	-	**7**	-
Controlled entities of the ultimate parent	**-**	3	**-**	3
Controlled entities of the Bank	**-**	-	**996**	1,058
	7	113	**1,003**	1,171
Total amounts due from related entities	**7**	786	**2,510**	3,013
Interest income on the above amounts was as follows:				
NAB Group (note 5)	**1**	3	**-**	3
Controlled entities of the Bank	**-**	-	**63**	37
	1	3	**63**	40

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Amounts due to related entities	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Deposits				
NAB Group	**-**	24	**-**	24
CYBG	**15**	-	**15**	-
Immediate parent	**-**	34	**-**	34
Controlled entities of the Bank	**-**	-	**33**	8
	15	58	**48**	66
Debt securities in issue				
NAB Group	**-**	382	**-**	-
Subordinated debt				
NAB Group	**-**	478	**-**	478
CYBG	**483**	-	**483**	-
	483	478	**483**	478
Other payables				
NAB Group	**-**	3	**-**	3
Immediate parent	**-**	48	**-**	-
Controlled entities of the ultimate parent	**-**	10	**-**	10
Controlled entities of the Bank	**-**	-	**5,074**	5,530
	-	61	**5,074**	5,543
Total amounts due to related entities	**498**	979	**5,605**	6,087
Interest expense on the above amounts was as follows (note 5):				
NAB Group	**10**	36	**7**	36
CYBG	**15**	-	**15**	-
Immediate parent	**-**	2	**-**	2
Controlled entities of the Bank	**-**	-	**100**	116
	25	38	**122**	154

On 30 September 2015, the Bank redeemed £429m of medium term notes with NAB early, resulting in a gain of £2m. The gain is included within other income (note 6) along with other capital restructuring gains of £41m.

On 8 February 2016, amounts due from NAB were reclassified as amounts due from other banks. Deposits and other payables previously classified within amounts due to NAB were reclassified as amounts due to other banks. Debt securities in issue were re-classified as balances with third parties (note 27). The comparative financial information has not been restated.

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Derivatives

The following derivative positions were held with NAB:

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Derivative financial assets				
Designated as hedging instruments	**-**	86	**-**	37
Designated as held for trading	**-**	60	**-**	60
	-	146	**-**	97
Derivative financial liabilities				
Designated as hedging instruments	**-**	173	**-**	132
Designated as held for trading	**-**	263	**-**	248
	-	436	**-**	380

On 8 February 2016, derivative positions with NAB were reclassifed as balances with third parties.

Subordinated debt

Subordinated debt comprises dated loan capital. Interest on the debt is payable at a fixed rate, is subordinated to the claims of other creditors and is unsecured. The debt is employed in the general business of the Bank.

On 8 February 2016, the Group repurchased £475m of subordinated debt from NAB at a market value of £474m, resulting in a gain on debt restructure of £1m included within other income (note 6). The replacement notes issued to CYBG PLC on 8 February 2016 are disclosed below for Group and Bank. The rates of interest stated below apply at 30 September.

	2016	2015
	£m	£m
10-year, non-call 5-year with a final maturity of 20 December 2023 - LIBOR +3.41%	**-**	300
10-year, non-call 5-year with a final maturity of 25 January 2021 - LIBOR +4.42%	**-**	175
10 year, 5% fixed rate reset callable subordinated Tier 2 Notes due 2026	**479**	-
	479	475
Accrued interest payable	**4**	3
Total subordinated debt	**483**	478

On 29 December 2014, the Group repaid £526m of subordinated debt to the immediate parent at a market value of £485m, resulting in a gain on capital restructure of £41m included within other income (note 6). On the same day, the Group also repaid £75m of subordinated debt to its ultimate parent at a market value of £77m, resulting in a loss on capital restructure of £2m included within other operating and administrative expenses (note 7).

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Securitisation

The Group has securitised part of its residential and BTL mortgage portfolio. The cash raised from the issue of RMBS through structured entities forms part of the Group's medium term funding. A portfolio of BTL mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £352m (2015: £382m) of the securities issued are held by NAB, which is no longer a related entity. Following the demerger, these notes are included within debt securities in issue (note 27). The comparative financial information has not been restated.

Other transactions with related entities	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Gain on debt and capital restructures				
Controlled entities of the ultimate parent	**1**	43	**1**	43
Non-interest income received				
Controlled entities of the ultimate parent	**-**	5	**35**	5
Administrative expenses (note 7)				
NAB Group	**5**	11	**5**	11
CYBG	**-**	-	**-**	-
Controlled entities of the ultimate parent	**-**	289	**147**	289
	5	300	**152**	300

Included within administrative expenses paid to controlled entities in the year ended 30 September 2015, are recharges from CYB Services Limited, which was owned by the intermediate parent group, CYBI Limited, and which was purchased by the Group on 30 September 2015. On 31 March 2016, assets and liabilities of CYB Services Limited were transferred to Clydesdale Bank PLC for a consideration equal to their net book value of £322m. The consideration was recorded in the respective intercompany accounts and no gains or losses were recognised. No further recharges were made from CYB Services Limited from that date. Results for CYB Services Limited have been consolidated into the Group results from 1 October 2015.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.5m in the year ended 30 September 2016 (2015: £0.6m), were charged to the Group sponsored Scheme. The Group has deposits of £31.7m (2015: £2.1m) at the year end placed by the Scheme at market rates.

Pension contributions of £84m (2015: £51m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank (note 28).

Related party balances with non CYBG related entities

In addition to the balances with CYBG related entities, the Group and Bank also has a £Nil (2015: £3m) term deposit balance due to the Group's associated entity (note 20) on normal commercial terms. The balance is disclosed within due to customers (note 25).

Compensation of key management personnel (KMP)

During the year, the Group has reviewed and updated its definition of key management personnel (KMP) for the purposes of IAS 24 (Related Party Disclosures). KMP comprise Directors of the Bank and members of the Leadership Team. The 2015 comparative figure has been amended to conform with this revised definition.

Group	**2016**	2015
	£m	£m
Salaries and short term benefits	**8**	6
Other long term employee benefits	**1**	-
Post employment benefits	**-**	-
Termination benefits	**2**	2
Share based payments [(1)]	**4**	2
	15	10

[(1)] Expense recognised in the period in accordance with IFRS 2: *Share based payments*, including associated employers' NIC.

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Directors' emoluments

Total emoluments of all Directors for the year ended 30 September 2016 were £6m (2015: £6m).

For the year ended 30 September 2016 the total emoluments disclosed do not include the value of shares or share rights awarded under long term incentive schemes in accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

None of the Directors were members of the Group's defined contribution pension scheme during 2016 (2015: nil). One of the Directors was a member of the Group's defined benefit pension scheme during 2016 (2015: two).

None of the Directors hold share options and none were exercised during the year (2015: nil).

Disclosures in respect of the highest paid Director

	2016	2015
	£m	£m
Aggregate remuneration	**2**	1
Share based awards[1]	**1**	1
	3	2

[1] Reflects deferred bonus and other share based awards for the year, excluding LTIP

The highest paid Director does not hold any share options, nor were they a member of any pension plan during 2016, nor 2015.

Transactions with KMP

KMPs, their close family members and any entities controlled or significantly influenced by the KMPs 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.

Group	**2016**	2015
	£m	£m
Loans and advances	**8**	11
Deposits	**3**	1

No provisions have been recognised in respect of loans provided to KMPs (2015: £Nil). There were no debts written off or forgiven during the year to 30 September 2016 (2015: £Nil). Included in the above are six (2015: ten) loans totalling £7.4m (2015: £9.5m) made to Directors.

In addition to the above, there are guarantees of £0.4m (2015: £0.4m) made to Directors and their related parties.

Notes to the consolidated financial statements (continued)

12. Financial assets available for sale and held to maturity

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Available for sale:				
Listed investments	**1,695**	1,447	**1,695**	1,447
Unlisted investments	**29**	8	**29**	8
Other financial assets	**7**	7	**-**	-
Total financial assets available for sale	**1,731**	1,462	**1,724**	1,455
Held to maturity:				
Listed investments	**-**	-	**836**	1,060
Unlisted investments	**-**	-	**611**	380
Total financial assets held to maturity	**-**	-	**1,447**	1,440

Included in the available for sale ('AFS') listed securities are £1,286m (2015: £1,274m) in UK Government Gilts.

Unlisted securities

These consist of unquoted equity and debt instruments, primarily:

VocaLink Holdings Limited ('VocaLink')

On 21 July 2016, MasterCard announced that it has entered into a definitive agreement to acquire 92.4% of VocaLink for consideration of £700m with an additional earn out of £169m based on attainment of certain performance targets. The allocation of earn out between equity holders varies depending on the exit option chosen. The transaction is subject to regulatory approvals and the completion date is uncertain. VocaLink is an unquoted company which operates the BACS and direct debit schemes in the UK as well as connecting ATMs using the LINK network. The Group currently owns a 3.24% shareholding in VocaLink. Following the announcement of the sale, the fair value of the Group's investment in VocaLink increased by £20m to £25m at 30 September 2016 (2015: £5m), with the corresponding gain recognised in the available for sale reserve within equity.

Visa Inc.

Included within financial assets available for sale - unlisted securities at 30 September 2016 is £2m (2015: £Nil) representing the fair value of Visa Inc. preferred stock received as partial consideration for the sale of the Group's share in Visa Europe (note 6). 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.

Other financial assets

The other AFS financial asset of £7m represents deferred consideration receivable and consists of the rights to future commission.

For further information on valuation methodology for available for sale assets and their classification within the fair value hierarchy, refer to note 36.

Credit quality of investments	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Available for sale				
Senior investment grade	**1,695**	1,447	**1,695**	1,447
Other	**36**	15	**29**	8
	1,731	1,462	**1,724**	1,455
Held to maturity				
Investment grade	**-**	-	**836**	846
Sub investment grade	**-**	-	**611**	594
	-	-	**1,447**	1,440

Notes to the consolidated financial statements (continued)

13. Other financial assets and liabilities at fair value

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Other financial assets at fair value through profit or loss				
Loans and advances	**750**	1,097	**750**	1,097
Other financial liabilities at fair value through profit or loss				
Due to customers - term deposits	**48**	67	**48**	67

Derivatives which do not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 14).

Loans and advances

Included in other financial assets at fair value 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 £750m (2015: £1,097m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £24m (2015: £38m) and the change for the current year is a decrease of £14m (2015: decrease of £36m). The loans are classified as Level 3 in the fair value hierarchy (note 36).

Due to customers - term deposits

Included in other financial liabilities at fair value are fixed rate deposits which have been 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 Bank credit risk is £Nil (2015: £Nil). The Bank is contractually obligated to pay £3m (2015: £4m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as Level 3 in the fair value hierarchy (note 36).

14. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, derivatives that do not meet the hedging criteria within IAS 39, or those for which hedge accounting is not desirable, are accounted for as held for trading (although they are used for risk mitigation). The tables below analyse derivatives between those designated as hedging instruments and those classified as held for trading.

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Fair value of derivative financial assets				
Designated as hedging instruments	**351**	103	**154**	46
Designated as held for trading	**234**	182	**234**	182
	585	285	**388**	228
Fair value of derivative financial liabilities				
Designated as hedging instruments	**257**	244	**257**	191
Designated as held for trading	**341**	290	**330**	275
	598	534	**587**	466

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

Cash collateral on derivatives placed with banks totalled £337m as at 30 September 2016 (2015: £246m). Cash collateral received on derivatives totalled £57m as at 30 September 2016 (2015: £Nil). These amounts are included within due from other banks and due to other banks respectively.

The derivative financial instruments held by the Group and Bank are further analysed below with the notional contract amount being the amount from which the cash flows are derived and is not an indication of the amounts at risk relating to these contracts.

Group **Total derivative contracts as at 30 September 2016** **Derivatives designated as hedging instruments**	**Notional contract amount £m**	**Fair value of assets £m**	**Fair value of liabilities £m**
Cash flow hedges			
Interest rate swaps	15,526	154	79
Cross currency swaps	760	88	-
Forward contracts	5	-	-
	16,291	242	79
Fair value hedges			
Interest rate swaps	1,452	109	178
Cross currency swaps	-	-	-
	1,452	109	178
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward contracts	2,202	84	78
Cross currency swaps	150	11	11
Options	216	5	5
	2,568	100	94
Interest rate related contracts			
Swaps	1,512	123	233
Swaptions	47	-	1
Options	569	2	4
	2,128	125	238
Commodity related contracts	127	9	9
Total derivative contracts	22,566	585	598

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

Group Total derivative contracts as at 30 September 2015 Derivatives designated as hedging instruments	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Cash flow hedges			
Interest rate swaps	16,655	46	76
Cross currency swaps	843	8	53
	17,498	54	129
Fair value hedges			
Interest rate swaps	1,452	35	115
Cross currency swaps	499	14	-
	1,951	49	115
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward contracts	1,990	47	38
Cross currency swaps	150	5	5
Options	273	2	2
	2,413	54	45
Interest rate related contracts			
Swaps	2,084	105	217
Swaptions	67	-	1
Options	706	1	5
	2,857	106	223
Commodity related contracts	160	22	22
Total derivative contracts	24,879	285	534

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

Bank **Total derivative contracts as at 30 September 2016** **Derivatives designated as hedging instruments**	**Notional contract amount £m**	**Fair value of assets £m**	**Fair value of liabilities £m**
Cash flow hedges			
Interest rate swaps	15,526	154	79
Forward contracts	5	-	-
	15,531	154	79
Fair value hedges			
Interest rate swaps	752	-	178
	752	-	178
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward contracts	2,202	84	78
Cross currency swaps	150	11	11
Options	216	5	5
	2,568	100	94
Interest rate related contracts			
Swaps	1,512	123	222
Swaptions	47	-	1
Options	569	2	4
	2,128	125	227
Commodity related contracts	127	9	9
Total derivative contracts	21,106	388	587

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

Bank Total derivative contracts as at 30 September 2015 Derivatives designated as hedging instruments	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Cash flow hedges			
Interest rate swaps	16,655	46	76
	16,655	46	76
Fair value hedges			
Interest rate swaps	753	-	115
	753	-	115
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward contracts	1,990	47	38
Cross currency swaps	150	5	5
Options	273	2	2
	2,413	54	45
Interest rate related contracts			
Swaps	2,084	105	202
Swaptions	67	-	1
Options	706	1	5
	2,857	106	208
Commodity related contracts	160	22	22
Total derivative contracts	22,838	228	466

Derivatives traded to manage the Group's interest rate exposure on a net portfolio basis are accounted for as cash flow hedges. Derivatives traded to manage interest rate risk on certain fixed rate assets, such as UK Government Gilts, are accounted for as fair value hedges. In addition, the Group cash flow hedges its foreign currency exposure on material, highly probable non-GBP denominated transactions.

The Group hedging positions also include those designated as foreign currency and interest rate hedges of debt issued from the Group's securitisation and covered bond programmes respectively. As such, certain derivative financial assets and liabilities have been booked in consolidated structured entities.

Cash flow hedged derivatives include vanilla interest rate swaps within macro hedges and cross currency swaps within a structured entity. The Group has notional commitments in the following periods:

Nominal values per time period	**2016 £m**	2015 £m
Within 0 to 3 months	**1,452**	4,230
Between 3 and 12 months	**6,710**	2,028
Between 1 and 5 years	**8,063**	11,148
Greater than 5 years	**66**	92
	16,291	17,498

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

The Group has hedged the following forecast future cash flows, which vary primarily with interest or foreign exchange rates. These cash flows are expected to impact the income statement in the following periods:

	Forecast receivable cash flows 2016 £m	**Forecast payable cash flows 2016 £m**	Forecast receivable cash flows 2015 £m	Forecast payable cash flows 2015 £m
Within 1 year	**29**	**261**	47	112
Between 1 and 2 years	**16**	**368**	38	235
Between 2 and 3 years	**15**	**59**	26	319
Between 3 and 4 years	**14**	**77**	21	57
Between 4 and 5 years	**8**	**112**	9	68
Greater than 5 years	**-**	**6**	-	96
	82	**883**	141	887

	2016 £m	2015 £m
Gain arising from fair value hedges (note 6)		
Hedging instrument	**15**	109
Hedged item attributable to the hedged risk	**(15)**	(108)
	-	1

	2016 £m	2015 £m
(Loss)/gain from cash flow hedges due to hedge ineffectiveness (note 6)	**(1)**	1

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Overdrafts	**1,536**	1,563	**1,536**	1,563
Credit cards	**400**	376	**400**	376
Lease finance	**515**	426	**504**	413
Mortgages	**21,836**	20,504	**20,331**	19,243
Other term lending - business	**4,393**	4,025	**4,393**	4,025
Other term lending - retail	**690**	763	**690**	763
Other lending	**26**	30	**26**	30
Gross loans and advances to customers	**29,396**	27,687	**27,880**	26,413
Accrued interest receivable	**76**	75	**70**	71
Unearned income	**(26)**	(26)	**(25)**	(24)
Deferred and unamortised fee income	**(29)**	(24)	**(30)**	(26)
Impairment provisions on credit exposures (note 16)	**(215)**	(230)	**(212)**	(226)
	29,202	27,482	**27,683**	26,208

The Group and Bank have transferred £5,435m (2015: £5,923m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 17). The mortgages do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements, the Group and Bank continue to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group and Bank are also exposed to the residual rewards of the mortgages as a result of their ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities is £3,208m (2015: £3,413m) (note 17).

Included within Group and Bank loans and advances to customers are £1,149m (2015: £1,475m) of mortgages assigned to a bankruptcy remote structured entity, Clydesdale Covered Bonds No 2 LLP (note 17). These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2016 there were £797m (2015: £721m) and £698m (2015: £697m) of covered bonds in issue under the covered bond programme, by the Group and Bank respectively (note 17).

The Group and Bank also have a portfolio of fair valued business loans and advances £750m (2015: £1,097m) (note 13). Combined with the above this is equivalent to total loans and advances of £29,952m (2015: £28,579m).

Further information on the Group's and Bank's loans and advances to customers and impairment provisions on credit exposures is included within the Risk Report.

Lease finance

The Group and Bank lease 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 and Bank during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £5m (2015: £2m) and £381m (2015: £297m) respectively. The total receivables from finance leases for the Group and Bank were £8m and £Nil (2015: £6m and £Nil) respectively. The total receivables from hire purchase contracts in the Group and Bank were £482m and £480m (2015: £395m and £390m) respectively.

Finance lease and hire purchase receivables	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Gross investment in finance lease and hire purchase receivables				
Due within 1 year	**224**	183	**221**	178
Due within 1 to 5 years	**288**	241	**281**	234
Due after more than 5 years	**3**	2	**2**	1
	515	426	**504**	413
Unearned income	**(25)**	(25)	**(24)**	(23)
Net investment in finance lease and hire purchase receivables	**490**	401	**480**	390

Notes to the consolidated financial statements (continued)

16. Impairment provisions on credit exposures

Group

	2016 £m	2015 £m
Opening balance	**230**	245
Charge for the year	**39**	78
Amounts written off	**(68)**	(100)
Recoveries of amounts written off in previous years	**18**	12
Other [(1)]	**(4)**	(5)
Closing balance	**215**	230
Specific	**64**	92
Collective	**151**	138
	215	230

(1) Other includes the unwind of net present value elements of specific provisions and other minor movements.

Bank
2016

	2016 £m	2015 £m
Opening balance	**226**	240
Charge for the year	**38**	79
Amounts written off	**(68)**	(100)
Recoveries of amounts written off in previous years	**18**	12
Other [(1)]	**(2)**	(5)
Closing balance	**212**	226
Specific	**62**	89
Collective	**150**	137
	212	226

(1) Other includes the unwind of net present value elements of specific provisions and other minor movements.

	Group		Bank	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Amounts included in				
Loans and advances to customers (note 15)	**215**	230	**212**	226
Non-accrual loans				
Loans and advances to customers	**214**	238	**214**	225
Specific provisions	**(64)**	(92)	**(62)**	(89)
	150	146	**152**	136

Further information on impairment provisions on credit exposures and related credit information is set out within the Risk Report.

Notes to the consolidated financial statements (continued)

17. Securitisations and covered bonds

Securitisations

The Group has securitised a proportion of its retail mortgage loan portfolio under the Group's master trust securitisation programmes. The securitised mortgage loans have been assigned at principal value to bankruptcy remote structured entities. These structured entities have been funded through the issue of residential mortgage backed securities to third party institutional debt investors. The Group is entitled to any residual income from the vehicles after the debt obligations and senior expenses of the programmes have been met. The securitised debt holders have no recourse to the Group other than the principal and interest (including fees) generated from the securitised mortgage portfolio. The Group continues servicing these mortgage loans in return for an administration fee.

The loans do not qualify for derecognition because the Group and Bank remain exposed to the majority of the risks and rewards of the mortgage portfolio, principally the associated credit risk. The securitisation structured entities are consolidated and the securitised mortgage loans retained on the Group's and Bank's balance sheet. The securitised notes in issue are included within debt securities in issue (note 27).

Covered bonds

A subset of the Group and Bank's retail mortgage portfolio has been ringfenced and assigned to a bankruptcy remote Limited Liability Partnership, associated with the covered bond programme, to provide a guarantee for the obligations payable on the covered bonds issued by the Group and Bank. Similar to the securitisation programmes, the Group and Bank is entitled to any residual income after all payment obligations due under the terms of the covered bonds and senior programmes expenses have been met.

The residential mortgages do not qualify for derecognition from the balance sheet because the Group and Bank retain all of the risks and rewards associated with these mortgage loans. The covered bond partnership is fully consolidated with the loans retained on the Group and Bank balance sheets and the covered bonds issued are included within debt securities in issue. The covered bond holders have dual recourse; first to the Bank on an unsecured basis and second to the LLP under the Covered Bond Guarantee secured against the covered pool mortgage assets. The Group continues servicing these mortgage assets in return for an administration fee.

The balances of assets and liabilities in relation to securitisation and covered bonds in issue at 30 September 2016 within the Group and Bank balance sheets are as follows:

2016	Group			Bank		
	Securitisation £m	Covered bonds £m	Total £m	Securitisation £m	Covered Bonds £m	Total £m
At 1 October 2015	3,031	721	3,752	-	697	697
Issuance of debt	750	-	750	-	-	-
Reclassification of notes previously held internally	380	-	380	-	-	-
Repayments	(1,029)	-	(1,029)	-	-	-
Other movements	76	76	152	-	1	1
At 30 September 2016	**3,208**	**797**	**4,005**	**-**	**698**	**698**
Securitised assets	**5,435**	**1,149**	**6,584**	**5,435**	**1,149**	**6,584**

Notes to the consolidated financial statements (continued)

17. Securitisations and covered bonds (continued)

2015	Group			Bank		
	Securitisation £m	Covered bonds £m	Total £m	Securitisation £m	Covered bonds £m	Total £m
At 1 October 2014	2,370	1,063	3,433	-	1,097	1,097
Issuance of debt	1,207	-	1,207	-	-	-
Repayments	(521)	(400)	(921)	-	(400)	(400)
Other movements	(25)	58	33	-	-	-
At 30 September 2015	3,031	721	3,752	-	697	697
Securitised assets	5,923	1,475	7,398	5,923	1,475	7,398

The carrying amounts of covered bonds differ between Group and Bank due to fair value hedging adjustments which form part of the Group but not the Bank. Further information on the liabilities relating to the Group's securitisation and covered bond programmes can be found in note 27.

Other movements consist of exchange rate movements on currency denominated bonds and fair value hedge accounting adjustments.

The Bank securitises mortgages which includes those originated by Yorkshire Bank Home Loans Limited ('YBHL'), a subsidiary of the Group. A legal sale agreement between the Bank and YBHL has been put in place to ensure that the title of such mortgages are transferred to the Bank prior to the completion of any securitisation transactions and these mortgages are included in the securitised asset balances disclosed in the table above and are recognised on the Bank balance sheet.

Included within the securitisation notes disclosed above are £352m (initial transfer value of £380m less repayments during the year of £28m) of Lannraig debt securities (including accrued interest) which are held by NAB and were previously disclosed within amounts due to related entities (note 11). Following the demerger, these notes are included within debt securities in issue (note 27).

The following table sets out the net position of the fair value of financial assets where the counterparty to the associated liabilities has recourse only to the financial assets:

Group	**2016**		2015	
	Securitisation £m	**Covered bonds £m**	Securitisation £m	Covered bonds £m
Fair value of transferred assets	**5,417**	**-**	5,870	-
Fair value of associated liabilities	**3,233**	**-**	3,048	-
	2,184	**-**	2,822	-

There were no events in the year that caused any Group or Bank transferred financial assets to be derecognised.

The Group and Bank have contractual and non-contractual arrangements which may require them to provide financial support to the following types of consolidated structured entities:

Notes to the consolidated financial statements (continued)

17. Securitisations and covered bonds (continued)

Securitisation vehicles

The Bank provides credit support to the structured entities via reserve funds through subordinated debt arrangements and by holding junior notes. The carrying value of exposures totalled £20m in subordinated debt (2015: £Nil) and £610m in junior notes held (2015: £593m). The Bank has a beneficial interest in the securitised mortgage portfolio held by the structured entities as at the reporting date of £977m (2015: £1,308m). Furthermore, the Bank has an obligation to repurchase mortgage exposures if certain representations and warranties are breached.

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 Bank, as sponsor, to provide additional liquidity support.

Covered bonds

At the reporting date the nominal level of over-collateralisation was £599m (2015: £855m) of the outstanding covered bonds. From time to time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme. Furthermore, the Bank has an obligation to repurchase mortgage exposures if certain representations and warranties are breached.

Notes to the consolidated financial statements (continued)

18. Property, plant and equipment

Group	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 2014	11	3	161	83	258
Additions	-	-	10	36	46
Disposals	(1)	-	(7)	(7)	(15)
Transfers	-	-	7	(7)	-
At 30 September 2015	**10**	**3**	**171**	**105**	**289**
Additions	-	-	15	7	22
Disposals	(4)	-	(32)	(12)	(48)
At 30 September 2016	**6**	**3**	**154**	**100**	**263**
Accumulated depreciation					
At 1 October 2014	**1**	**-**	**92**	**59**	**152**
Charge for the year (note 7)	-	-	14	6	20
Accumulated depreciation on purchase	-	-	-	18	18
Disposals	-	-	(4)	(6)	(10)
Transfers	-	-	3	(3)	-
At 30 September 2015	**1**	**-**	**105**	**74**	**180**
Charge for the year (note 7)	-	-	15	10	25
Disposals	-	-	(30)	(11)	(41)
At 30 September 2016	**1**	**-**	**90**	**73**	**164**
Net book value					
At 30 September 2016	**5**	**3**	**64**	**27**	**99**
At 30 September 2015	9	3	66	31	109

In the prior year, additions of £31m and the accumulated depreciation on purchase related to the fixtures and equipment acquired in connection with the purchase of CYB Services Limited on 30 September 2015.

Notes to the consolidated financial statements (continued)

18. Property, plant and equipment (continued)

Bank	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 2014	11	3	161	83	258
Additions	-	-	10	5	15
Disposals	(1)	-	(7)	(7)	(15)
Transfers	-	-	7	(7)	-
At 30 September 2015	**10**	**3**	**171**	**74**	**258**
Additions	-	-	15	38	53
Disposals	(4)	-	(32)	(12)	(48)
At 30 September 2016	**6**	**3**	**154**	**100**	**263**
Accumulated depreciation					
At 1 October 2014	**1**	**-**	**92**	**59**	**152**
Charge for the year	-	-	14	6	20
Disposals	-	-	(4)	(6)	(10)
Transfers	-	-	3	(3)	-
At 30 September 2015	**1**	**-**	**105**	**56**	**162**
Charge for the year	-	-	15	7	22
Accumulated depreciation on purchase	-	-	-	19	19
Disposals	-	-	(30)	(9)	(39)
At 30 September 2016	**1**	**-**	**90**	**73**	**164**
Net book value					
At 30 September 2016	**5**	**3**	**64**	**27**	**99**
At 30 September 2015	9	3	66	18	96

Additions of £31m and accumulated depreciation of £19m were included as part of the transfer of CYB Services Limited to Clydesdale Bank PLC in the period (note 11).

Valuations

The Group's freehold and long term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Group's own Directors' valuations. 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 (Level 3 of the fair value hierarchy as defined in note 36). Valuations are performed annually in July.

There has been no change to the valuation technique during the year. There were no transfers between levels of the fair value hierarchy during the year.

A comparison of the carrying value on the revaluation basis and if the historical cost basis had been used is shown below:

Group	2016 £m	2015 £m
Carrying value as included on the revaluation basis	**8**	12
Carrying value if the historical cost basis had been used	**7**	10

Notes to the consolidated financial statements (continued)

19. Investment properties

Group and Bank	2016 £m	2015 £m
At 1 October	**32**	44
Disposals	**(10)**	(11)
Revaluations	**-**	(1)
At 30 September	**22**	32

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Group's own Directors' valuations.

Investment property is compared to property for which there is observable market data about its realisable value on disposal. Adjustments to this observable data are applied for specific characteristics of the property such as the nature, location or condition of the specific asset. Investment properties are classified in Level 3 of the fair value hierarchy as defined in note 36. There has been no change to the valuation technique during the year. There were no transfers between levels of the fair value hierarchy during the year.

During the year, 97% (2015: 99%) of the investment properties generated total rental income of £1m (2015: £2m) and incurred operating and administrative expenses of £1m (2015: £1m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2015: £Nil).

20. Investments in controlled entities and associates

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
At 30 September	**-**	2	**16**	16

Associates

Associates are undertakings over which the Bank exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2016. The associated undertaking is The Scottish Agricultural Securities Corporation PLC which is registered and operates in Scotland. The investment is accounted for as an associated undertaking on the basis that the Group has significant influence but not control. The associated undertaking's principal activity was the provision of finance and the Group's interest of 33.33% in the issued equity capital of £Nil (2015: £2m) is held by the Bank. The associated undertaking has a 31 March year end. As at 30 September 2016, The Scottish Agricultural Securities Corporation PLC was in the process of being liquidated.

Notes to the consolidated financial statements (continued)

20. Investments in controlled entities and associates (continued)

Wholly owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland
Clydesdale Bank (Head Office) Nominees Limited	In liquidation	Limited by guarantee	100%	Scotland
Craig Yr Haul Management Company Limited	Property management	Ordinary	100%	England
CYB Intermediaries Holdings Limited*	Holding company	Ordinary	100%	England
CYB Intermediaries Limited	Insurance intermediary	Ordinary	100%	England
CYB Services Limited*	IT and Group services	Ordinary	100%	Scotland
Shadwell Holdings (UK) Limited	In liquidation	Ordinary	100%	England
St Vincent (Equities) Limited	Investment company	Ordinary	100%	England
Plaza Ventures Limited	In liquidation	Ordinary	100%	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England
11 Tudor Hill Residential Management Company Limited	Dormant	Ordinary	100%	England
CB Nominees Limited	Dormant	Limited by guarantee	100%	Scotland
CYB SSP Trustee Limited	Dormant	Ordinary	100%	England
Linton Springs Residential Management Company Limited	Dormant	Ordinary	100%	England
St Johns Place Residential Management Company Limited	Dormant	Ordinary	100%	England
YCB DC Trustee Limited	Dormant	Ordinary	100%	Scotland
YCBPS Property Nominee Company Limited	Dormant	Ordinary	100%	England
Yorkshire and Clydesdale Bank Pension Trustee Limited	Dormant	Ordinary	100%	Scotland
Yorkshire Bank PLC	Dormant	Ordinary	100%	England

*Approved to enter Members Voluntary Liquidation on 4 October 2016

The Bank also has an interest in the Yorkshire and Clydesdale Bank Foundation, a charitable foundation registered in Scotland as a company limited by guarantee. Clydesdale Bank PLC acts as a guarantor for £10 and is the main donor.

All subsidiaries have a financial year end of 30 September with the exception of the following entities:

Wholly owned subsidiary undertakings	Accounting reference date
Craig Yr Haul Management Company Limited	31 January
11 Tudor Hill Residential Management Company Limited	31 December
Linton Springs Residential Management Company Limited	31 December
St Johns Place Residential Management Company Limited	31 December

Structured entities

The Group sponsors the formation of structured entities, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well-defined objectives. Although the Bank has no shareholding in these entities, where it is exposed, or has rights, to variable returns from its involvement with the entities and has the ability to affect those returns through its power over the entity, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's financial statements.

In the current and prior year all structured entities which the Group sponsors, or in which the Group holds an interest, are consolidated. Details of the Group's interests in consolidated structured entities are set out in note 17.

The following companies are consolidated structured entities:

Other controlled entities as at 30 September 2016	Nature of business	Country of incorporation
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England
Lanark Holdings Limited	Holding company	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Trustees Limited	Mortgages trustee	England
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Holdings Limited	Holding company	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

On 15 July 2016 the business activities of Lanark Trustees Limited (Jersey) transferred to Lanark Trustees Limited (England).

All of the above controlled entities have a financial year end of 30 September.

20. Investments in controlled entities and associates (continued)

Common control business combinations

As described in note 2, business combinations involving entities under common control, where all combining entities are ultimately controlled by the same entity before and after the business combination, are accounted for using the predecessor values method of accounting. This involves recognising assets and liabilities of the acquired business at book values. Any difference between the cost of acquisition and the aggregate book value of the assets and liabilities as of the date of the transfer of the acquired entity is recorded as an adjustment to equity. No additional goodwill is created by the business combination.

Significant restrictions

As is typical for a Group of its size, there are restrictions on the ability of certain subsidiary entities to make distributions of cash or other assets to the parent company due to statutory, regulatory and contractual requirements.

21. Intangible assets

Group

Capitalised software costs	2016 £m	2015 £m
Cost		
At 1 October	427	-
Additions	99	427
Write-off	(63)	-
At 30 September	**463**	427
Accumulated amortisation		
At 1 October	162	-
Charge for the year (note 7)	63	-
Accumulated amortisation on purchase	-	162
Impairment (note 7)	45	-
Write-off	(63)	-
At 30 September	**207**	162
Net book value at 30 September	**256**	265

Impairment testing of capitalised software assets is performed in accordance with IAS 36. The impairment charge follows a detailed review of the recoverable amount of the various assets. Where 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, the software has been written down to its recoverable amount. An impairment charge of £45m has been recognised in the year to 30 September 2016 (2015: £Nil).

Intangible assets are reviewed annually to consider whether these assets are currently in use. Fully amortised intangible assets of £63m (2015: £Nil) that were no longer in use were written off during the year.

The additions and accumulated amortisation on purchase relate to the capitalised software acquired in connection with the purchase of CYB Services Limited on 30 September 2015.

Notes to the consolidated financial statements (continued)

21. Intangible assets (continued)

Bank

Capitalised software costs	2016 £m	2015 £m
Cost		
At 1 October	-	-
Additions	526	-
Write-off	(63)	-
At 30 September	463	-
Accumulated amortisation		
At 1 October	-	-
Accumulated amortisation on purchase	192	-
Charge for the year	33	-
Impairment (note 7)	45	-
Write-off	(63)	-
At 30 September	207	-
Net book value at 30 September	256	-

Additions of £475m and accumulated amortisation of £192m were included as part of the transfer of CYB Services Limited to Clydesdale Bank PLC in the period (note 11).

Notes to the consolidated financial statements (continued)

22. Deferred tax

Movement in net deferred tax asset

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
At 1 October	**379**	277	**298**	271
Transferred in on purchase of other group entities	**-**	75	**76**	-
Recognised in the income statement (note 8)	**(196)**	24	**(196)**	24
Recognised directly in equity	**9**	3	**9**	3
At 30 September	**192**	379	**187**	298

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

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Deferred tax assets				
Tax losses carried forward	**71**	273	**71**	273
Capital allowances	**127**	108	**122**	27
Cash flow hedge reserve	**-**	4	**-**	4
Impairment provision on credit exposures	**-**	3	**-**	3
Employee equity based compensation	**2**	1	**2**	1
Defined benefit pension scheme deficit	**18**	-	**18**	-
Other	**1**	-	**1**	-
	219	389	**214**	308
Deferred tax liabilities				
Defined benefit pension surplus	**-**	(10)	**-**	(10)
Cash flow hedge reserve	**(21)**	-	**(21)**	-
Gains less losses on financial instruments at fair value	**(6)**	-	**(6)**	-
Net deferred tax asset	**192**	379	**187**	298

At 30 September 2016 the Group had an unrecognised deferred tax asset of £202m (2015: £16m) representing trading losses with a gross value of £1,186m (2015: £80m). 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. Under current UK tax legislation there is no prescribed time period for loss utilisation however as outlined in the 'Emerging/principal risk and uncertainties' section of the Strategic Report, the UK tax environment for banks in particular is unsettled and has been subject to repeated change and increased restrictions, principally on the use of historic losses as discussed below. As a result the period over which brought forward losses will be used to offset taxable profits in the future has lengthened considerably.

The statutory rate of UK corporation tax is 20% from 1 April 2015. A series of reductions in that rate have been enacted by subsequent legislation, in particular to 19% from 1 April 2017 and to 17% from 1 April 2020. In accordance with IAS 12, these rates are taken into account in assessing the value at which assets are expected to be realised and liabilities settled. In addition, from 1 April 2016, only 25% of a bank's profits can be relieved by brought forward losses, significantly extending the timeframe taken to realise value for existing tax losses. This is a further significant restriction on top of the 50% limit imposed at 1 April 2015.

As a result and in accordance with IAS 12, the Directors have assessed the recoverability of the deferred tax assets, and have chosen to derecognise deferred tax assets relating to those losses that the Group does not expect to be able to utilised within the Group's current corporate planning horizon. The combined impact of the legislative changes outlined above, and the Directors' reassessment of the recoverable horizon, is £226m, within a total deferred tax charge of £196m (note 8).

On 31 March 2016 the Group's structure was rationalised by transferring the trade and assets of CYB Services Limited to Clydesdale Bank PLC, reflecting the fact that the service company was redundant. Deferred tax assets at 30 September 2016 have been valued reflecting the new structure. The service company was placed into liquidation on 4 October 2016.

Notes to the consolidated financial statements (continued)

23. Other assets

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Prepayments and accrued income	**29**	35	**29**	23
Other (including items in the course of collection)	**159**	142	**159**	129
	188	177	**188**	152

24. Due to other banks

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Transaction balances with other banks	**23**	-	**23**	-
Securities sold under agreements to repurchase*	**1,226**	-	**1,226**	-
Deposits from other banks	**60**	393	**60**	393
	1,309	393	**1,309**	393

* The underlying securities sold under agreements to repurchase have a carrying value of £1,657m (2015: £Nil).

25. Due to customers

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Non-interest bearing demand deposits	**2,160**	1,986	**2,160**	1,986
Interest bearing demand deposits	**19,328**	18,786	**19,328**	18,786
Term deposits	**5,454**	5,416	**5,454**	5,416
Other wholesale deposits	**12**	94	**12**	94
	26,954	26,282	**26,954**	26,282
Accrued interest payable	**136**	125	**136**	125
	27,090	26,407	**27,090**	26,407

Included within term deposits is £Nil (2015: £3m) relating to the Group's associated entity (notes 11 and 20).

Notes to the consolidated financial statements (continued)

26. Provision for liabilities and charges

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
PPI redress provision				
Opening balance	**774**	515	**774**	515
Charge to the income statement (note 7)	**450**	390	**450**	390
Utilised	**(499)**	(131)	**(499)**	(131)
Closing balance	**725**	774	**725**	774
Customer redress and other provisions				
Opening balance	**214**	413	**214**	413
Charge to the income statement (note 7)	**35**	76	**35**	76
Utilised	**(148)**	(275)	**(148)**	(275)
Closing balance	**101**	214	**101**	214
Restructuring provision (1)				
Opening balance	**18**	24	**18**	24
Charge to the income statement (note 7)	**39**	17	**39**	17
Utilised	**(31)**	(23)	**(31)**	(23)
Closing balance	**26**	18	**26**	18
Total provisions for liabilities and charges	**852**	1,006	**852**	1,006

(1) Restructuring provision includes surplus lease space provision.

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reasonably estimated. The most significant of the provisions held at 30 September 2016 are in relation to conduct risk related liabilities.

The Group has provided its best estimate of conduct risk related liabilities at 30 September 2016 which have arisen as a result of its historical products and past sales practices.

To arrive at best estimates, management have exercised significant judgement around the key assumptions that underpin the estimates and used estimation techniques to quantify them. Ongoing regulatory review and input, as well as rulings from the Financial Ombudsman Service ('FOS') over time, and the Group's internal reviews and assessments of customer complaints, will continue to impact upon the nature and extent of conduct related customer redress and associated costs for which the Group may ultimately become liable in future periods. Accordingly, the total cost associated with such conduct related matters remains inherently uncertain.

PPI redress

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. In the first half of 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 £450m was required incorporating the Group's estimate of the impact of CP 15/39 and a proposed time bar for complaints in summer 2018. It also incorporated a reassessment of the costs of processing cases and the impact of experience adjustments. Following the FCA's updated proposal in respect of the time bar and Plevin in CP 16/20 issued on 26 July 2016, the provision was reassessed in the light of these proposals and recent experience. No further change was made. The total provision raised to date in respect of PPI is £1,646m (2015: £1,196m), with £725m of this remaining (2015: £774m) comprising £299m for customer initiated complaints and proactive customer contact (2015: £301m); £257m for the remediation of complaints closed prior to August 2014 (2015: £270m); and £169m for costs of administering the redress programme (2015: £203m).

To 30 September 2016, the Group has received 282,000 complaints and has allowed for 59,000 further walk in complaints.

Notes to the consolidated financial statements (continued)

26. Provision for liabilities and charges (continued)

PPI redress (continued)

The Group implemented a comprehensive new PPI complaint handling process from August 2014 which involved making a number of significant changes to the PPI operations, which resulted in an increase in operational and administrative costs, in addition to committing to undertake a full review of PPI complaints that were closed prior to August 2014 (approximately 180,000). The Group has begun to reopen these complaints and review the original decisions reached in light of the new PPI complaint handling processes. The provision at 30 September 2016 includes a redress provision of £257m for this review.

In addition to the remediation activity described above, the Group is undertaking a past business review ('PBR') of certain PPI sales to determine if there was actual or potential customer detriment in the sales process leading to a risk of mis-sale and the potential for proactive redress. The provision increase booked in March incorporated a revised estimate of the cost of contacting and redressing, where appropriate, customers who have faced actual detriment or may have experienced potential detriment but who have not actually raised a claim. Proactive customer mailings commenced in March 2016 and will be complete by the end of the calendar year. Key inputs to the calculation of the costs estimate such as the level of customer response to mailings are not currently known but have been based on relevant historical experience and related industry data. Actual experience to date has been below the assumptions used but further customer experiences will be received.

The increase in provision recorded at 31 March 2016 took into account all of the above factors as well as a revision in the Group's expectation of new customer initiated complaints in light of current experience with the overall provision 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 (and the extent to which this is influenced by the activity of claims management companies, the proposed but delayed application of a time bar, Plevin, and FCA advertising); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; (iv) any additional amounts that may need to be paid in respect of previously handled claims; (v) the response rates to the proactive customer contact; and (vi) the costs of administering the remediation programme.

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. Accordingly, the final amount required to settle the Group's potential PPI liabilities remains uncertain.

The table below sets out the key assumptions and the effect on the provision at 30 September 2016 of future, potential, changes in key assumptions:

Assumptions	Change in assumption	Sensitivity [(1)]
Number of expected future customer initiated complaints	+/-10%	£16m
Uphold rates:		
Future complaints	+/-1%	£3m
Pre August 2014 complaints review	+/-1%	£6m
Customer contact response rate		
PBR customer contact response rate [(2)]	+/-1%	£4m
Average redress costs [(3)]	+/-1%	£5m

(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. The sensitivities disclosed do not incorporate the impact, if any, on the administrative cost element of the provision.

(2) The Group's current estimate includes an expected customer response rate of 40%. Approximately 85,000 proactive customer mailings will be sent.

(3) Sensitivity to a change in average redress across customer initiated complaints, pre August 2014 complaints review and PBR customer populations.

Notes to the consolidated financial statements (continued)

26. Provision for liabilities and charges (continued)

PPI redress (continued)

The number of complaints received is monitored against past experience and future expectations and the Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop.

Customer redress and other provisions

In addition to the PPI redress set out above, a provision for customer redress is held in those instances where the Group expects to make payments to customers whether on an ex gratia or compensatory basis. Provisions can arise as a result of legal or regulatory action and can incorporate the costs of skilled persons, independent reviewers, and where appropriate other elements of administration. The most significant of these relates to the Group's IRHPs.

In 2012 the FSA announced that it had reached agreement with a number of UK banks, including the Group, in relation to a review and redress exercise on sales of certain interest rate hedging products to small and medium sized businesses. The Group implemented a programme to identify small and medium sized customers that may have been affected and, where due, pay financial redress. On 31 March 2015 the FCA confirmed the closure of the formal industry wide redress programme to new entrants.

The Group also undertook a secondary review of all past Fixed rate tailored business loans (FRTBL) complaints not in the scope of the formal review. Where the secondary complaint assessment identified a different outcome, the customer has been contacted and, if appropriate, redress offered. The Group is also dealing with a number of new complaints from customers in relation to FRTBL.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for all of these matters and concluded that no changes to the level of provision held are required, reflecting the continued wind down of the formal programmes, which are expected to have completed within the next six months, and the current level of complaints received.

Other provisions also include amounts in respect of a number of individually less significant 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 £34m for other customer redress matters. The ultimate cost to the Group of other 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 lifecycle and in certain circumstances usually early in the life of a potential issue elements of the potential exposure are contingent (note 32). These factors could result in the total cost of review and redress varying materially from the Group's current estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required. During the year £1m (2015: £1m) was also recognised for provisions not related to customer redress / conduct risk.

Conduct Indemnity Deed

The Bank's parent entity, CYBG, and NAB have entered into an agreement under which NAB has provided CYBG with a Capped Indemnity to meet the costs of dealing with conduct matters relating to products sold in the period prior to the demerger date (the 'Conduct Indemnity Deed'). The legacy conduct matters covered by the Capped Indemnity are referred to as 'Relevant Conduct Matters'. The Capped Indemnity provides the CYBG Group with economic protection against certain costs and liabilities (including financial penalties imposed by a regulator) resulting from conduct issues relating to:

a) PPI, standalone interest rate hedging products, voluntary scope tailored business loans and fixed rate tailored business loans; and

b) Other conduct matters, subject to certain limitations and minimum financial thresholds.

Amounts payable under the Capped Indemnity include, subject to certain limitations, payments to customers to satisfy, settle or discharge a Relevant Conduct Matter and the direct costs and expenses of satisfying, settling, discharging or administering such Relevant Conduct Matter. It has been agreed that NAB will meet 90.3% of Qualifying Conduct Costs claimed by the CYBG, up to the amount of the Capped Indemnity.

Claims under the Conduct Indemnity Deed are made by CYBG, whilst the provisions in respect of the qualifying conduct costs are raised and incurred by the Bank. It is intended that the capital impact of providing for Relevant Conduct Matters in the Bank is then mitigated by CYBG using the proceeds of the claim to subscribe for share capital of the Bank. During the year CYBG subscribed for share capital on three occasions (note 30).

Notes to the consolidated financial statements (continued)

26. Provision for liabilities and charges (continued)

Conduct Indemnity (continued)

Where provisions for Relevant Conduct Matters are increased in respect of a reporting period, but proceeds from that claim are not received from NAB prior to the period close, CYBG has put in place an agreement with the Bank in order to mitigate the effect of capital losses at the end of the reporting period. Upon raising a provision for a Relevant Conduct Matter, CYBG indemnifies the Bank for the Qualifying Conduct Costs (excluding the CYBG Group's loss share) until CYBG subscribes for an equivalent amount of capital in the Bank. The Bank recognises and measures amounts receivable from CYBG under this indemnity as a separate asset (see note 11) in accordance with IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* and recognises an associated capital contribution within equity (see note 31). No reimbursement is recognised in the income statement.

The utilisation and undrawn balance of the Capped Indemnity held by the Group's ultimate parent CYBG is set out below:

	Conduct protection £m
Conduct protection provided by NAB	**1,700**
Capital injected into CYBI prior to demerger [1]	(120)
Drawn in period to 30 September 2015[2]	(465)
Undrawn Conduct Indemnity as at 30 September 2015	**1,115**
Drawn in the period to 30 September 2016	(433)
Undrawn balance as at 30 September 2016	**682**

(1) £120m of the £670m of capital injected in CYBI on 24 September 2015 was related to the Conduct Indemnity Deed.

(2) £465m represents the Pre-Covered provision amount.

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. In the year £45m was charged to the income statement of which £6m (2015: £Nil) was charged directly to the income statement and £39m (2015: £17m) was provided for in accordance with the requirements of IAS 37, with £31m (2015: £23m) of the total provision being utilised in the period.

Included within the restructuring provision is an amount for committed rental expense on surplus lease space consistent with the expected years' 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.

Notes to the consolidated financial statements (continued)

27. Debt securities in issue

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Residential mortgage backed securities	**3,208**	3,017	**-**	-
Covered bonds	**698**	697	**698**	697
	3,906	3,714	**698**	697
Fair value hedge adjustments	**99**	38	**-**	-
Total securitised notes and covered bonds (note 17)	**4,005**	3,752	**698**	697
Accrued interest payable	**16**	14	**10**	10
	4,021	3,766	**708**	707

There were no new issuances of covered bonds during the year. The following new issuance of securitised debt occurred:

- 4 August 2016 - GBP 750m Lanark 2016-1 1A.

The following redemptions occurred during the year in line with the scheduled programme terms:

- 22 February 2016 - USD 800m Lanark 2012-2 1A note;
- 22 August 2016 - USD 300m Lanark 2013-1 1A1 note; and
- 22 August 2016 - GBP 350m Lanark 2013-1 1A2 note.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC as at 30 September 2016 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Call date
Class A RMBS				
27 July 2012	USD	**440**	3M GBP LIBOR + 1.63%	22 November 2017
19 March 2014	GBP	**214**	3M EURIBOR + 0.40%	22 August 2017
19 March 2014	USD	**311**	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	GBP	**389**	3M EURIBOR + 0.40%	22 August 2018
11 December 2014	EUR	**274**	3M GBP LIBOR + 0.60%	22 February 2020
06 August 2015	GBP	**239**	3M GBP LIBOR + 0.50%	22 August 2018
06 August 2015	EUR	**241**	3M EURIBOR + 0.45%	22 May 2021
04 August 2016	GBP	**748**	3M GBP LIBOR + 1.00%	22 February 2019
Class A BTL RMBS				
30 September 2011	GBP	**352**	3M GBP LIBOR + 2.20%	19 November 2017
		3,208		
Covered bonds				
31 May 2012	GBP	**797**	4.63%	8 June 2026

Following the demerger on 8 February 2016 securitised debt issued to NAB, previously included within amounts due to related parties (note 11), are included within debt securities in issue.

Notes to the consolidated financial statements (continued)

28. Retirement benefit obligations

The Group operates both defined benefit and defined contribution arrangements. The Bank is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). The Scheme was established under trust on 30 September 2009 as the result of the merger of the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund. The assets of the Scheme are held in a trustee administered fund with the trustee 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 also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members.

The following table provides a summary of the present value of the defined benefit obligation and fair value of plan assets for the Scheme:

	2016 £m	2015 £m
Active members' defined benefit obligation	**(1,264)**	(891)
Deferred members' defined benefit obligation	**(1,776)**	(1,299)
Pensioner and dependent members' defined benefit obligation	**(1,497)**	(1,323)
Total defined benefit obligation	**(4,537)**	(3,513)
Fair value of scheme assets	**4,462**	3,565
Net defined benefit pension (liability)/asset	**(75)**	52
Post-retirement medical benefits obligations	**(4)**	(4)

IAS 19 allows the recognition of an asset, which reflects the Group's ability to recover a surplus either through reduced contributions in the future or through refunds from the Scheme following the settlement of plan assets once all members have left the Scheme.

The Bank has implemented a number of reforms to the Scheme to manage the liability. It closed the Scheme to new members in 2004 and has determined benefits accruing after April 2006 on a career average revalued earnings basis. The principal pension available to new employees since the closure of the Scheme is a defined contribution scheme, 'Total Pension'. The Total Pension income statement charge for the year is shown in note 7.

The last scheme funding valuation was at 30 September 2013 with a calculated deficit of £450m. In the recovery plan dated 7 May 2014 the Group agreed to make the following contributions to eliminate the deficit: £65m on 1 October 2013; £150m by 30 June 2014; £50m on 1 October 2017; thereafter £50m annually until 1 October 2021; and £55m on 1 October 2022. Work in relation to the 30 September 2016 scheme funding valuation is presently under way.

Notes to the consolidated financial statements (continued)

28. Retirement benefit obligations (continued)

Reconciliation of the net defined benefit pension (liability)/asset	2016 £m	2015 £m
Opening net defined benefit pension scheme asset	52	49
Service cost	(31)	(11)
Interest on net defined benefit (liability)/asset	3	3
Remeasurement effects recognised in SOCI	(179)	(36)
Employer contributions	84	51
Administrative expenses	(4)	(4)
Closing fair value of net defined benefit pension scheme (liability)/asset	(75)	52

Reconciliation of the defined benefit pension scheme assets	2016 £m	2015 £m
Opening fair value of defined benefit pension scheme assets	3,565	3,269
Interest income on scheme assets at discount rate	135	133
Return on scheme assets greater than discount rate	791	206
Employer contributions	84	51
Benefits paid	(90)	(84)
Transfer payments	(19)	(6)
Administrative costs paid	(4)	(4)
Closing fair value of defined benefit pension scheme assets	4,462	3,565

Reconciliation of the defined benefit pension scheme obligations	2016 £m	2015 £m
Opening defined benefit pension scheme obligations	(3,513)	(3,220)
Current service cost	(27)	(27)
Past service (cost)/credit	(4)	16
Interest expense on the defined benefit obligation	(132)	(130)
Actuarial gain - experience adjustments	51	40
Actuarial loss - financial assumptions	(1,021)	(282)
Benefits paid from scheme assets	90	84
Transfer payments	19	6
Closing defined benefit pension scheme obligations	(4,537)	(3,513)

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

	2016 £m	2015 £m
Quoted		
Equities	784	645
Government bonds	1,640	1,382
Global sovereign bonds	38	49
Corporate bonds	968	767
Infrastructure	254	217
Secure income alternatives	124	67
Derivatives [1]	440	229
Other	6	45
Cash	93	32
Unquoted		
Property	115	132
Fair value of defined benefit pension scheme assets	4,462	3,565

[1] Derivative financial instruments are used to modify the profile of the assets of the Scheme to better match the Scheme's liabilities. Derivative holdings may lead to increased or decreased exposures to the physical asset categories disclosed above.

28. Retirement benefit obligations (continued)

The Scheme is not invested in any of the Group's own financial instruments.

Through its defined benefit pension plan and post-employment medical plan, the Group is exposed to a number of risks. The main risk to the Bank is that additional contributions are required if the Scheme's assets are not sufficient to pay for the benefits (which will be influenced mainly by inflation and the longevity of members). The level of equity returns will be a key factor in the overall investment return. The investment portfolio is also subject to a range of other risks typical of the assets held, in particular credit risk on bonds and exposure to the property market.

The Trustee has implemented an investment structure (including physical assets and derivatives) that seeks to reduce the Scheme's exposure to inflation and interest rate risks. The current hedge ratio is 50% of liabilities when measured on a self-sufficiency basis. This strategy reflects the Scheme's liability 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.

Amounts recognised in the income statement	**2016**	2015
	£m	£m
Current service cost	**27**	27
Past service cost/(credit)	**4**	(16)
Net interest on net defined benefit (liability)/asset	**(3)**	(3)
Defined benefit expense for the year (note 7)	**28**	8
Administration costs incurred	**4**	4
Cost recognised in the income statement	**32**	12

During the year ended 30 September 2015 the Bank's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After the taking of independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change has resulted in a one-off credit to the income statement of £18m in the prior year (shown within past service costs).

In the current and prior year, past service cost of £4m (2015: £2m) relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements, and in both years these were fully offset in the income statement by a corresponding release from the restructure provision.

Amounts recognised in the statement of comprehensive income	**2016**	2015
	£m	£m
Opening cumulative actuarial losses	**(670)**	(634)
Actuarial gain due to liability experience adjustments	**51**	40
Actuarial loss due to liability assumption changes	**(1,021)**	(282)
Return on scheme assets greater than discount rate	**791**	206
Cumulative actuarial losses recognised in the statement of comprehensive income	**(849)**	(670)

Notes to the consolidated financial statements (continued)

28. Retirement benefit obligations (continued)

Actuarial assumptions	**2016**	2015
	% p. a.	% p.a.
Financial assumptions		
Discount rate	**2.38**	3.80
Inflation ('RPI')	**3.02**	3.25
Inflation ('CPI')	**2.02**	2.25
Career average revalued earnings ('CARE') revaluations:		
Pre 31 March 2012 benefits (RPI)	**3.02**	3.25
Post 31 March 2012 benefits (CPI capped at 5% per annum)	**2.02**	2.25
Pension increases (capped at 2.5% per annum)	**2.05**	2.10
Pension increases (capped at 5% per annum)	**2.94**	3.15
Rate of increase for pensions in deferment	**2.02**	2.25

Demographic assumptions

	2016	2015
Post retirement mortality:	**Years**	Years
Current pensioners at 60 - male	**27.7**	27.6
Current pensioners at 60 - female	**29.6**	29.5
Future pensioners at 60 - male	**29.2**	29.1
Future pensioners at 60 - female	**31.1**	31.0

The table below sets out the sensitivity of the defined benefit obligation and pension cost to realistic changes in the key actuarial assumptions:

Assumption change	**Impact on defined benefit obligation £m**	**Impact on pension cost £m**
Discount rate		
+0.25%	**(234)**	**(8)**
-0.25%	**253**	**7**
Inflation		
+0.25%	**170**	**5**
-0.25%	**(167)**	**(5)**
Life expectancy		
+1 year	**159**	**5**
- 1 year	**(152)**	**(4)**

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.

The discounted mean term of the defined benefit obligation at 30 September 2016 is 22 years. The expected contributions for the year ending 30 September 2017 are £Nil and expected benefit payments for the year ending 30 September 2017 are £85m.

Notes to the consolidated financial statements (continued)

29. Other liabilities

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Accruals and deferred income	**152**	136	**150**	84
Notes in circulation	**1,912**	1,791	**1,912**	1,791
Other	**144**	146	**138**	135
	2,208	2,073	**2,200**	2,010

30. Called up share capital

Group and Bank

Allotted, called up and fully paid	**2016 Number of shares**	2015 Number of shares	**2016 £m**	2015 £m
Ordinary shares of £1 each				
Opening ordinary share capital	**2,811,538,864**	2,041,538,864	**2,812**	2,042
Issued during the year	**425,555,627**	770,000,000	**426**	770
Share capital reduction	**-**	-	**(2,914)**	-
Closing ordinary share capital	**3,237,094,491**	2,811,538,864	**324**	2,812
Ordinary B shares of £1 each				
Opening ordinary share capital	**-**	-	**-**	-
Issued during the year	**-**	337,500,000	**-**	338
Cancelled during the year	**-**	(337,500,000)	**-**	(338)
Closing ordinary B share capital	**-**	-	**-**	-
Closing called up share capital	**3,237,094,491**	2,811,538,864	**324**	2,812

On 8 April 2016, 10,251,984 ordinary shares of £1 were issued, on 22 April 2016, 9,028,340 ordinary shares of £1 were issued and on 9 June 2016, 406,275,303 ordinary shares of £1 were issued. All ordinary shares issued in the period were at par and fully paid up.

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 Bank. The holders of the B shares had no right to receive notice of or to attend, speak or vote at any General Meeting of the Bank. All shares in issue at 30 September 2016 rank equally with regard to the Bank's residual assets. An ordinary dividend of £51m was paid during the year (2015: £Nil) (note 9).

Share capital reduction

Following court approval, on 18 August 2016, the nominal share capital of the Company was reduced to £0.10 per share by the cancellation of £0.90 from the nominal value of each ordinary share. Following the capital reduction £2,914m was transferred to retained earnings.

Notes to the consolidated financial statements (continued)

31. Total equity

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Share capital (note 30)	**324**	2,812	**324**	2,812
Other equity instruments	**425**	450	**425**	450
Equity based compensation reserve	**-**	3	**-**	3
Capital contribution reserve	**7**	-	**7**	-
Asset revaluation reserve	**1**	2	**1**	2
Available for sale reserve	**27**	12	**27**	12
Cash flow hedge reserve	**69**	(13)	**67**	(16)
Total other reserves	**104**	4	**102**	1
Retained earnings	**2,368**	192	**2,327**	167
Total equity	**3,221**	3,458	**3,178**	3,430

Other equity instruments

Other equity instruments represent AT1 notes. On 29 December 2014, Perpetual Capital Notes (6m LIBOR + 690bps) were issued with a principal amount of £350m to the Bank's then immediate parent, CYB Investments Limited. On 30 September 2015, a further £100m of Perpetual Capital Notes (6m LIBOR + 655bps) were issued to CYB Investments Limited. These were perpetual securities with no fixed maturity or redemption date and were structured to qualify as AT1 instruments under CRD IV. These AT1 notes were repurchased on 8 February 2016 for £433m. The resulting gain of £21m was recognised directly within retained earnings.

Subsequently, on 8 February 2016, the Bank issued Perpetual Subordinated Permanent Write Down Notes (fixed 8%) with a nominal value of £450m to CYBG PLC.

Gross AT1 distributions of £19m (2015: £Nil) were paid during the year (£15m (2015: £Nil) net of tax).

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.

In comparative periods the equity based compensation reserve represents the outstanding fair value amount in respect of share based payment expense recharged by the Group's former ultimate parent, NAB, which 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 reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale financial assets.

Notes to the consolidated financial statements (continued)

31. Total equity (continued)

Cash flow hedge reserve

The cash flow hedge reserve records fair value revaluations of derivatives designated as cash flow hedging instruments to the extent that they are effective.

As at 30 September 2016, the cash flow hedge reserve comprised crystallised fair value losses arising from de-designated and matured cash flow hedges of £4.1m (2015: £2.2m loss) offset by deferred gains on derivatives in ongoing cash flow hedges of £94.2m (2015: £15.2m loss). The balance on the cash flow hedge reserve within the consolidated statement of changes in equity is net of tax.

A £2m gain (2015: £17m gain) was recycled into the income statement in relation to de-designated and matured hedges in the period. A £1m loss (2015: £1m gain) was transferred to the income statement due to ineffectiveness arising from cash flow hedges.

32. Contingent liabilities and commitments

The table below sets out the contractual amounts of contingent liabilities and commitments which are not recorded on the balance sheet. Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual 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 client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

	Group		Bank	
Contingent liabilities	**2016**	2015	**2016**	2015
	£m	£m	**£m**	£m
Guarantees and assets pledged as collateral security:				
Due in less than 3 months	**19**	25	**19**	25
Due between 3 months and 1 year	**44**	13	**44**	13
Due between 1 year and 3 years	**9**	9	**9**	9
Due between 3 years and 5 years	**3**	2	**3**	2
Due after 5 years	**48**	52	**48**	52
No specified maturity	**-**	8	**-**	8
	123	109	**123**	109
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**7,690**	7,886	**7,660**	7,855

Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for in the financial statements at 30 September 2016 of £2m (2015: £2m and £Nil).

Notes to the consolidated financial statements (continued)

32. Contingent liabilities and commitments (continued)

Operating lease commitments

Group and Bank

	2016	2015
Leases as lessor	**£m**	£m
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**2**	2
Between 1 year and 5 years	**4**	6
Over 5 years	**1**	2
	7	10
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**29**	31
Between 1 year and 5 years	**94**	95
Over 5 years	**117**	122
	240	248

Other contingent liabilities

Financial Services Compensation Scheme ('FSCS')

The FSCS provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, claims were triggered against the FSCS, initially to pay interest on borrowings which the FSCS has raised from the UK Government to support the protected deposits. During 2015, the FSCS levy was also invoiced to institutions for the third of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings, which remains after the three annual levies have been paid, is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2017 and an accrual of £8m (2015: £9m) is held for the Group's calculated liability to that date. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

There continues to be significant uncertainty and thus judgement required in determining the quantum of conduct risk related liabilities with note 26 reflecting the Group's current position in relation to redress provisions including those for PPI and IRHPs. 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.

33. Notes to the statement of cash flows

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Adjustments included in the loss before tax				
Interest receivable	**(1,101)**	(1,110)	**(1,113)**	(1,124)
Interest payable	**294**	335	**355**	390
Depreciation (note 7)	**88**	20	**57**	20
Net gain on capital and debt restructure (note 6)	**(1)**	(41)	**(1)**	(41)
Loss on sale of tangible fixed assets [1]	**-**	1	**-**	1
Fair value movement on investment properties	**1**	(1)	**1**	(1)
Transfer from cash flow hedge reserve	**1**	(1)	**1**	(1)
Derivative financial instruments fair value movements	**(10)**	(2)	**(11)**	(8)
Impairment losses on credit exposures (note 16)	**39**	78	**38**	79
Impairment losses on software (note 22)	**45**	-	**45**	-
Dividends received from subsidiaries	**-**	-	**-**	(32)
	(644)	(721)	**(628)**	(717)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	**1**	(2)	**1**	(1)
Due from other banks	**(819)**	(113)	**(390)**	(21)
Derivative financial instruments	**(63)**	1	**(76)**	17
Financial assets at fair value through profit or loss	**346**	478	**346**	478
Intangible assets	**-**	(265)	**-**	-
Loans and advances to customers	**(1,758)**	(1,663)	**(1,514)**	(1,816)
Due from customers on acceptances	**-**	1	**-**	1
Defined benefit pension assets	**-**	(39)	**-**	(39)
Other assets	**14**	(235)	**7**	(141)
	(2,279)	(1,837)	**(1,626)**	(1,522)
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	**960**	(567)	**960**	(567)
Derivative financial instruments	**60**	(39)	**118**	(17)
Financial liabilities at fair value through profit or loss	**(19)**	(23)	**(19)**	(23)
Due to customers	**672**	2,380	**672**	2,380
Liabilities on acceptances	**-**	(1)	**-**	(1)
Provisions for liabilities and charges	**(154)**	54	**(154)**	54
Defined benefit pension obligations	**(52)**	-	**(52)**	-
Other liabilities	**118**	217	**128**	207
	1,585	2,021	**1,653**	2,033

[1] Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

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.

	Group 2016 £m	Group 2015 £m	Bank 2016 £m	Bank 2015 £m
Cash and balances with central banks (note 10)	**5,912**	6,387	**5,912**	6,387
Other assets	**111**	86	**111**	86
Due to other banks	**(25)**	(72)	**(25)**	(72)
Due to related entities	**-**	(33)	**-**	(33)
Other liabilities	**(48)**	(31)	**(48)**	(31)
	5,950	6,337	**5,950**	6,337

Notes to the consolidated financial statements (continued)

34. Employees

The average number of full time equivalent employees of the Group during the year was made up as follows:

	2016 Number	2015 Number
Managers	**2,460**	1,419
Clerical staff	**4,258**	3,197
	6,718	4,616

The average monthly number of employees was 7,567 (2015: 5,322). Employees of CYB Services Limited, which was acquired by the Company on 30 September 2015, are not included in the prior year comparative.

All staff are contracted employees of the Company and its subsidiary undertakings. The numbers above disclose the staff remunerated directly by the Group, and do not include contractors.

35. Equity based compensation

Equity based compensation charges comprise:

	2016 £m	2015 £m
Equity settled share based payments	**5**	7

The 2015 and 2016 figures include awards under the CYBG Group's and NAB share plans. The charges under the NAB share plans were classified as equity settled share based payments up to the demerger date and are included in the total above. Following the Demerger these plans no longer meet the definition of share based payments under IFRS 2: *Share based payment*, accordingly, the total above excludes NAB share plan costs after 8 February 2016.

CYBG awards

The CYBG Group implemented a number of share plans, with the following awards made during the year:

Plan	Nature	Awards made during 2016	Award date
Deferred Equity Plan (DEP)	Conditional rights to shares	2015 Demerger LTIP award	11 Feb 2016 31 May 2016
		2015 Deferred bonus awards	11 Feb 2016
		2015 Upfront retained bonus awards	11 Feb 2016
		Commencement awards	4 March 2016
Long Term Incentive Plan (LTIP)	Conditional rights to shares	No awards made	N/A
Share Incentive Plan (SIP)	Non-conditional share award	Demerger Freeshare award	4 March 2016
Save As You Earn Plan (SAYE)	Options to purchase shares at the end of the saving period	No awards made	N/A

35. Equity based compensation (continued)

Further detail on each award is provided below:

Deferred Equity Plan (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 Bank's deferral policy.
- Buyout of equity from previous employment for senior new hires.
- Demerger awards which are also subject to the achievement of performance conditions over a three year period. Further details of the performance conditions are set out in the CYBG PLC Directors' Remuneration Report.

Share Incentive Plan (SIP)

Eligible employees, with shares at the date of the award, were awarded CYBG PLC 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 demerger award made in March 2016, leavers (with the exception of gross misconduct) retain their awards but they must withdraw their shares from the SIP Trust.

Awards /rights made during the year

	Number outstanding on incorporation	Number awarded	Number forfeited	Number released	Number outstanding at 30 September 2016	Average fair value of awards at grant
Deferred Equity Plan						
2015 Demerger	-	2,235,204	-	-	2,235,204	196.96
2015 Bonus	-	1,749,431	(10,037)	(250,004)	1,489,390	195.17
2015 Commencement	-	111,127	-	-	111,127	194.67
Share Incentive Plan						
2016 Demerger Award	-	1,966,592	(2,304) (1)	(141,312)(2)	1,822,976	194.67

(1) Forfeited shares remain in the SIP Trust.

(2) 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. 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.

Legacy NAB awards

Prior to the demerger, employees of the Group received awards under NAB share plans as described below. No deferred bonus, LTIP, or freeshare awards were made under NAB plans in December 2015 due to the planned demerger.

Plan	Nature	Awards
National Australia Bank Staff Share Ownership Plan	Conditional NAB shares which are held in trust	1. Commencement awards 2. Deferred bonus awards (excluding Executive Leadership Team) 3. Upfront bonus awards
National Australia Bank Performance Rights Plan	Conditional NAB Performance rights	4. Deferred bonus awards to the Executive Leadership Team 5. Long Term Incentive awards
NAB Share Incentive Plan	Non-conditional NAB shares through SIP Trust	6. Freeshare awards

35. Equity based compensation (continued)

National Australia Bank Staff Share Ownership Plan

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 included:

- The upfront and deferred elements of bonus awards where required to comply with the PRA Remuneration Code or the Bank's deferral policy.
- Buyout of evidenced equity from previous employment for senior new hires.

National Australia Bank Performance Rights Plan

Legacy NAB awards made as performance rights over NAB shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards included:

- Deferred elements of bonus awards for members of the Executive Leadership team, where required to comply with the PRA Remuneration Code or the Bank's deferral policy.
- LTIP awards were also subject to performance hurdles (both internal and external) which are measured at the end of a four to five year restriction period. During the restriction period an executive's performance rights will lapse if performance hurdles are not met. A variety of performance measures are used for different grants of long term incentives including Total Shareholder Return (TSR) compared against peer companies, and regional or NAB Group ROE and cash earnings. The measures used depend on the level and impact of the participant's role, the business or region in which they work and the relevant programme. Further details on the measures are included in the CYBG Group Directors' Remuneration Report.

Each performance right is exchanged for one fully paid ordinary share in NAB Limited upon exercise, subject to standard adjustments for capital actions. No exercise price is payable by the holder on exercise of performance rights.

NAB Freeshare awards

Eligible employees in December 2014 were awarded NAB shares, held in the NAB SIP Trust. With the exception of gross misconduct, awards were not subject to service or performance conditions and vested on the date of award. As a result of the demerger, all participants were treated as good leavers from the SIP and their NAB shares were withdrawn from the SIP Trust.

NAB Performance rights related to CYBG Group employees	**2016 number**	**2015 number**
Outstanding at 1 October	281,066	259,093
Granted during the year	-	136,812
Forfeited during the year	(21,995)	(103,965)
Exercised during the year	(19,471)	(10,874)
Outstanding at 8 February 2016	**239,600**	n/a
Exercisable at 8 February 2016	**-**	n/a
Outstanding at 30 September	-	281,066
Exercisable at 30 September	-	18,480

No performance rights lapsed in the period to 8 February 2016 (2015: nil).

Of the performance rights exercised in the period to 8 February 2016, 4,223 related to long term incentive awards (2015: nil).

Notes to the consolidated financial statements (continued)

36. Fair value of financial instruments

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

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

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

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 measurement date. The estimated fair values are based on relevant information available at the reporting date and involve judgement. The methodologies and assumptions used in the fair value estimates are described in the footnotes to the tables.

There are various limitations inherent in this fair value disclosure particularly where prices may not represent the underlying value due to dislocation in the market. Not all of the Group's financial instruments can be exchanged in an active trading market. The Group obtains the fair values for investment securities from quoted market prices where available. Where securities are unlisted and quoted market prices are not available, the Group obtains the fair value by means of discounted cash flows and other valuation techniques that are commonly used by market participants. These techniques address factors such as interest rates, credit risk and liquidity. The difference between carrying value and fair value is relevant in a trading environment, but is not relevant to assets held to maturity or to loans and advances.

Group

	30 September 2016					30 September 2015				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value £m	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets										
Loans and advances to customers	**29,202**	**29,298**	**-**	**1,076**	**28,222**	27,482	27,537	-	1,111	26,426
Financial liabilities										
Due to customers	**27,090**	**27,114**	**-**	**27,114**	**-**	26,407	26,423	-	26,423	-
Due to related entities	**498**	**480**	**-**	**480**	**-**	979	999	-	999	-
Debt securities in issue	**4,021**	**4,133**	**-**	**4,133**	**-**	3,766	3,869	-	3,869	-

Notes to the consolidated financial statements (continued)

36. Fair value of financial instruments (continued)

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

Bank	30 September 2016					30 September 2015				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets										
Investments - held to maturity	**1,447**	**1,446**	**-**	**836**	**610**	1,440	1,448	-	853	595
Loans and advances to customers	**27,683**	**27,789**	**-**	**1,076**	**26,713**	26,208	26,297	-	1,111	25,186
Financial liabilities										
Due to customers	**27,090**	**27,114**	**-**	**27,114**	**-**	26,407	26,423	-	26,423	-
Due to related entities	**5,605**	**5,595**	**-**	**5,595**	**-**	6,087	6,094	-	6,094	-
Debt securities in issue	**708**	**900**	**-**	**900**	**-**	707	831	-	831	-

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

(a) *Investments held to maturity* - the Bank obtains the fair value by means of a discounted cash flow model based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument.

(b) *Loans and advances to customers* - the fair value 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. Certain variable rate loan portfolios are discounted using market rates on similar loans offered by the Group at the valuation date.

(c) *Due to customers* - the fair value of deposits is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(d) *Amounts due to related entities* - the fair value of subordinated debt due to related entities is derived from quoted market prices of the related debt security in issue by CYBG Company after accounting for differences in credit spread. All other amounts due from related entities are redeemable at call and therefore carrying value approximates fair value.

(e) *Debt securities in issue* - the fair value is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

Notes to the consolidated financial statements (continued)

36. 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, using the fair value hierarchy described in note 36(a) above.

Group	Fair value measurement as at 30 September 2016				Fair value measurement as at 30 September 2015			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	585	-	585	-	285	-	285
AFS investments - listed	1,695	-	-	1,695	1,447	-	-	1,447
AFS investments - unlisted	-	-	29	29	-	-	8	8
AFS - other	-	-	7	7	-	-	7	7
Other financial assets at fair value	-	-	750	750	-	-	1,097	1,097
Total financial assets at fair value	1,695	585	786	3,066	1,447	285	1,112	2,844
Financial liabilities								
Derivative financial liabilities	-	598	-	598	-	534	-	534
Other financial liabilities at fair value	-	-	48	48	-	-	67	67
Total financial liabilities at fair value	-	598	48	646	-	534	67	601

Notes to the consolidated financial statements (continued)

36. Fair value of financial instruments (continued)

(b) Fair value of financial instruments recognised on the balance sheet at fair value (continued)

Bank	Fair value measurement as at 30 September 2016				Fair value measurement as at 30 September 2015			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	388	-	388	-	228	-	228
AFS investments - listed	1,695	-	-	1,695	1,447	-	-	1,447
AFS - unlisted	-	-	29	29	-	-	8	8
Other financial assets at fair value	-	-	750	750	-	-	1,097	1,097
Total financial assets at fair value	1,695	388	779	2,862	1,447	228	1,105	2,780
Financial liabilities								
Derivative financial liabilities	-	587	-	587	-	466	-	466
Other financial liabilities at fair value	-	-	48	48	-	-	67	67
Total financial liabilities at fair value	-	587	48	635	-	466	67	533

The Group and Bank's fair values 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 value of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from quoted closing market prices as at the balance sheet date, discounted cash flow models or option pricing models as appropriate.

(b) *Available for sale - investments*

- *Listed* (level 1) - the fair values of listed investments are based on quoted closing market prices.
- *Unlisted* (level 3) - Includes the unlisted equity investment in VocaLink of £25m (2015: £5m) (see note 12). The valuation of these shares is based on offers received for the Group's shareholding as the best indicator of the fair value of these shares at the reporting date. Unlisted (level 3) also includes £2m for the Group's US Dollar denominated convertible preference shares in Visa Inc. (see note 12). The fair value of the preference shares has been calculated by taking the period end NYSE share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity and debt investments, the Group's share of the net asset value or the transaction price respectively, are considered the best representation of the exit price and are the Group's best estimates of fair value.
- *Available for sale - other* (level 3) - The other available for sale financial asset represents deferred consideration receivable and consists of the rights to future commissions. 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.

(c) *Other financial assets and liabilities at fair value* - 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.

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

Notes to the consolidated financial statements (continued)

36. Fair value of financial instruments (continued)

Assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3):

Level 3 movement analysis: Group	**2016** **Financial assets available for sale** **£m**	**Other financial assets at fair value** **£m**	**Other financial liabilities at fair value** **£m**
Balance at the beginning of the year	**15**	**1,097**	**(67)**
Fair value gains/(losses) recognised(1)			
In profit or loss (unrealised)	**-**	**10**	**2**
In profit or loss (realised)	**8**	**-**	**-**
In available for sale reserve (unrealised)	**21**	**-**	**-**
Purchases	**2**	**-**	**-**
Sales	**(8)**	**-**	**-**
Settlements (2)	**(2)**	**(357)**	**17**
Balance at the end of the year	**36**	**750**	**(48)**

Level 3 movement analysis: Group	2015 Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	1,583	(91)
Unrealised gains/(losses) (1)			
In profit or loss	-	2	2
Purchases	8	-	-
Settlements (2)	-	(488)	22
Balance at the end of the year	15	1,097	(67)

Level 3 movement analysis: Bank	**2016** **Financial assets available for sale** **£m**	**Other financial assets at fair value** **£m**	**Other financial liabilities at fair value** **£m**
Balance at the beginning of the year	**8**	**1,097**	**(67)**
Fair value gains/(losses) recognised(1)			
In profit or loss (unrealised)	**-**	**10**	**2**
In profit or loss (realised)	**7**	**-**	**-**
In available for sale reserve (unrealised)	**20**	**-**	**-**
Purchases	**2**	**-**	**-**
Sales	**(8)**	**-**	**-**
Settlements (2)	**-**	**(357)**	**17**
Balance at the end of the year	**29**	**750**	**(48)**

Level 3 movement analysis: Bank	2015 Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	1,583	(91)
Unrealised gains/(losses) (1)			
In profit or loss	-	2	2
Purchases	1	-	-
Settlements (2)	-	(488)	22
Balance at the end of the year	8	1,097	(67)

36. Fair value of financial instruments (continued)

(1) Net gains or losses were recorded in non-interest income, interest income or expense and impairment losses or within the Available for Sale Reserve as appropriate.

(2) Settlements for the year ended 30 September 2016 include a realised loss of £5m (2015: loss of £33m) relating to financial assets that are measured at fair value at the end of each reporting period. Such fair value gains or losses are included in non-interest income (note 6).

There were no transfers into or out of Level 3 in the year ended 30 September 2016 (2015: £Nil).

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.

Qualitative 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 2016.

Group	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Financial assets					
Available for sale - investments - unlisted	**27**	Market value	Offers received	n/a	n/a
Available for sale - investments - unlisted	**2**	Discounted cash flow	Contingent litigation risk	0%	100%
Available for sale - other	**7**	Discounted cash flow	Customer attrition rate	10%	30%
Other financial assets at fair value	**750**	Discounted cash flow	Portfolio lifetime PD	3.3%	11.4%

The Group has £48m (2015: £67m) of financial liabilities at fair value classed as Level 3 which represent a portfolio of term deposits that are directly linked to the customer loans, which are also held at fair value and classed as Level 3. Their relationship to the fair value assets is such that should the liability be settled, the amount payable would be net of the fair value asset.

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 exposure to Level 3 fair value measurements is in respect of the Group's fair value loan portfolio and the most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £5m and vice versa.

As disclosed above, the fair value of the Group's investment in VocaLink is based on the offer set out in the definitive agreement to acquire 92.4% of VocaLink Holdings Limited announced by MasterCard on 21 July 2016. Whilst this transaction is subject to regulatory approval and other customary closing conditions, the Group expects that the sale will be completed under these terms. The sensitivity of fair value to possible changes in the cash offer or the associated future earn-out entitlements (which have a limited range of potential variation) has not therefore been modelled.

The most significant input impacting the carrying value of the available for sale - other asset is the Funds Under Management Attrition rate. If this rate was 30% the carrying value would reduce by £3m, if it was 10% the carrying value would increase by £2m. The Group currently assumes a 15% attrition rate.

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.

Notes to the consolidated financial statements (continued)

37. Pillar 3 disclosures

Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation ('CRR'). The consolidated disclosures of CYBG, for the financial year 2016, can be found at www.cbonline.co.uk.

38. Country by country reporting

The Capital Requirements (country by country reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV. Refer to CYBG PLC's Annual Report & Accounts for country by country reporting disclosures.

Glossary

Term	Definition
90+ DPD to customer loans *	Customer loans that are more than 90 days overdue as a percentage of total customer loans at a given date.
Additional Tier 1 securities ('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.
Bad and doubtful debt charge to average customer loans *	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).
Bank	Clydesdale Bank PLC.
Bank Levy	Applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision ('BCBS') in June 2006 defining how firms should calculate their regulatory capital requirements.
Basel III	Reforms issued by the BCBS in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In Europe the new requirements were implemented by 'CRD IV', on a phased basis from 1 January 2014 with full implementation by 1 January 2019.
Board	Refers to the Clydesbank PLC Board.
Capped Indemnity	The indemnity from NAB in favour of CYBG PLC in respect of certain qualifying conduct costs incurred by CYBG Group, which is capped at the 'Capped Indemnity Amount', subject to the 'Loss Sharing Arrangement', under the terms of the 'Conduct Indemnity Deed'.
Capped Indemnity Amount	An amount equal to £1.58 billion less any 'Pre Covered provision amount'.
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.
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.
Company	Clydesdale Bank PLC
Conduct Indemnity Deed	The deed between NAB and CYBG PLC setting out the terms of: • The 'Capped Indemnity'; and • Certain arrangements for the treatment and management of certain 'Conduct Matters'.
Conduct Matters	In the context of the 'Conduct Indemnity Deed', conduct issues relating to PPI, standalone 'IRHP', voluntary scope TBL's and FRTBL's and other conduct matters in the period prior to the demerger date whether or not known at the 'demerger date'.
Conduct risk	The risk that the Group's behaviours (culture, governance, systems and controls) have led to inappropriate customer outcomes.
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
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.
Common Equity Tier 1 ratio	CET1 capital divided by RWA at a given date.
Counterparty	The other party that participates in a financial transaction; with every transaction requiring a counterparty in order for the transaction to complete.
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 raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also 'Basel III'.

Glossary (continued)

Term	Definition
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
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 eitherinterest bearing, non-interest bearing or term deposits.
Default	A customer is in default when either they have breached a pre-set arrears threshold or are considered unlikely to pay their credit obligations in full without the Group taking actions to secure repayment.
Delinquency	See ‘Arrears’.
Demerger	The demerger of CYBG Group from NAB pursuant to which all of the issued share capital of CYB Investments Limited was transferred to CYBG PLC 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.
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 method (‘EIR’)	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Encumbered assets	Asset 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.
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
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (Level 2 and Level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
Forbearance	The term generally applied to the facilities provided or changes to facilities provided to assist borrowers, both retail and non-retail, who are experiencing, or are about to experience, a period of financial stress.
Forborne performing loans	Loans to which forbearance measures have been granted and which are less than or up to 90 DPD and do not otherwise meet the criteria of forborne non-performing loans.
Forborne non-performing loans	Loans to which forbearance measures have been granted and which are more than 90 DPD, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of DPD.
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.
FINREP	A standardised Financial Reporting framework mandated by the EBA. Its aim is to establish a single rule book to ensure a robust and uniform regulatory framework.
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.
Gross impaired assets to customer loans	Gross impaired assets as a percentage of total customer loans at a given date.
Group	Clydesdale Bank 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.
Housing lending	Mortgages secured by residential properties as collateral
Impaired loans	Loans in arrears with insufficient security to cover principal and arrears of interest revenue or where there is sufficient doubt about the ultimate collectability of principal and interest.
Impairment losses	Where an asset’s recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This can be assessed at either the individual or collective level.

Glossary (continued)

Term	Definition
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be calculated at either the individual or collective level.
Indexed LTV of the mortgage portfolio	The mortgage portfolio weighted by balance and indexed using the Halifax House Price Index at a given date.
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 FRTBL complaints which were not in scope for the FSA notice.
Interest rate risk	The risk to the Group's financial performance and position caused by changes in interest rates.
Internal Capital Adequacy Assessment Process ('ICAAP')	The Group's assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal Liquidity Adequacy Assessment Process ('ILAAP')	The Group's assessment and management of balance sheet risks relating to funding and liquidity.
Internal ratings-based approach ('IRB')	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investment grade	The highest possible range of credit ratings, from 'AAA' to 'BBB', as measured by external credit rating agencies.
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio	This is a regulatory standard ratio proposed by the 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.
Liquidity coverage ratio ('LCR')	Measures the surplus (or deficit) of the a bank's high quality liquid assets relative to weighted net stressed cash outflows over a 30 day period. It assesses whether the bank has sufficient liquid assets to withstand a short term liquidity stress based on cash outflow assumptions provided by regulators.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
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 deposit ratio ('LDR')	Customer loans as a percentage of customer deposits at a given date.
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 Share	The percentage of a provision raised or an increase in a provision which under the 'Conduct Indemnity Deed' CYBG PLC will be responsible for. Fixed at 9.7% at the demerger date.
Loss Sharing Arrangement	The arrangement relating to the 'Capped Indemnity' pursuant to which CYBG PLC will be responsible for the 'Loss Share'.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.

Glossary (continued)

Term	Definition
Net stable funding ratio ('NSFR')	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.
Non-impaired assets 90+ DPD	Consist of well-secured assets that are more than 90 DPD and portfolio-managed facilities that are not well secured and between 90 and 180 DPD.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Overall Liquidity Adequacy Rule ('OLAR')	An FCA 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'.
Past due loans and advances	Loans and advances on which repayments are overdue.
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.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.
Pre Covered provision amount	The amount of any provision(s) relating to 'Conduct Matters' raised or increased by CYBG Group between 31 March 2015 and the 'demerger date' in respect of which NAB has provided specific support at any time after 31 March 2015 but before the 'demerger date'. This was £465m at the 'demerger date'.
Probability of default ('PD')	The probability that a customer will default (usually within a one-year time horizon). although the time horizon will change by September 2018 in line with IFRS 9 requirements.
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA
Residential mortgage-backed securities ('RMBS')	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: - the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non-market extension of principal repayment period); - the Group has previously made a specific provision for the customer and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. See also 'forbearance'.
Retail loans	Lending to individuals rather than institutions. This includes both secured and unsecured lending such as personal loans, residential mortgages, overdrafts and credit card balances.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed
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 counter-party (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Scheme of arrangement	A scheme of arrangement under Part 5.1 of the Corporations Act between NAB and NAB shareholders to effect the demerger
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.

Glossary (continued)

Term	Definition
SME 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.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
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.
Specific provision to gross impaired assets	The specific impairment provision on credit exposures as a percentage of gross impaired assets at a given date
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.
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.
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 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.
Total capital ratio	Total capital resources divided by risk-weighted assets at a given date.
Total provision to customer loans	Total impairment provision on credit exposures as a percentage of total customer loans at a given date.
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
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements

Abbreviations

ALCO	Assets and Liabilities Committee	**FCA**	Financial Conduct Authority	**MRT**	Material Risk Taker
APRA	Australian Prudential Regulatory Authority	**FPC**	Financial Policy Committee	**NAB**	National Australia Bank
ASX	Australian Stock Exchange	**FRC**	Financial Reporting Council	**NIM**	Net interest margin
AT1	Additional Tier 1	**FSCS**	Financial Services Compensation Scheme	**NPS**	Net promotor score
BCA	Business current accounts	**FTE**	Full time equivalent	**NSFR**	Net stable funding ratio
BCBS	Basel Committee on Banking Supervision	**HMRC**	Her Majesty's Revenue and Customs	**NYSE**	New York Stock Exchange
BoE	Bank of England	**IASB**	International Accounting Standards Board	**OLAR**	Overall liquidity adequacy rule
BTL	Buy-to-let mortgages	**IFRS**	International Financial Reporting Standards	**PBT**	Profit before tax
CCB	Capital Conservation Buffer	**ICAAP**	Internal Capital Adequacy Assessment Process	**PCA**	Personal current accounts
CCyB	Countercyclical Capital Buffer	**ILAAP**	Internal Liquidity Adequacy Assessment Process	**PPI**	Payment protection insurance
CET 1	Common Equity Tier 1 Capital	**IPO**	Initial Public Offering	**PRA**	Prudential Regulation Authority
CMA	Competition and Markets Authority	**IRB**	Internal ratings-based	**RMBS**	Residential mortgage-backed securities
CRD	Capital Requirements Directive	**IRHP**	Interest rate hedging products	**ROA**	Return on assets
CRE	Commercial Real Estate	**IRRBB**	Interest rate risk in the banking book.	**RoTE**	Return on Total Equity
CRR	Capital Requirements Regulation	**ISDA**	International Swaps and Derivatives Association	**RWA**	Risk weighted assets
DB	Defined benefit	**LCR**	Liquidity coverage ratio	**SE**	Structured entity
DTR	Disclosure and Transparency Rules	**LDR**	Loan to deposits	**SME**	Small or medium sized entities
EBA	European Banking Authority	**LIBOR**	London Interbank Offered Rate.	**SVR**	Standard variable rate
eCRS	electronic Customer Rating System	**LTIP**	Long term incentive plan	**SRB**	Systemic Risk Buffer
EIR	Effective interest rate	**LTV**	Loan to value	**TCC**	Transactional Credit Committee
EPS	Earnings per share	**MREL**	Minimum Requirement for Own Funds and Eligible Liabilities	**TSA**	Transitional Services Agreements

Other information

Country by Country Reporting ('CBCR')

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 Capital Requirements Directive (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. Refer to CYBG PLC's Annual Report & Accounts for country by country reporting disclosures.

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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', 'believes', 'estimates', 'potential', 'possible', and similar words or phrases. These forward looking statements 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, trends in its operating industry, changes to customer behaviours and covenant, macroeconomic and/or geopolitical factors, changes to law and/or the policies and practices of the BoE, the Financial Conduct Authority and/or other regulatory bodies, inflation, deflation, interest rates, exchange rates, changes in the liquidity, asset position and/or credit ratings of the Group, the status of the UK's membership of the European Union, and future capital expenditures and acquisitions.

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. Neither the Group nor its Directors give 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. 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 its Directors 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.

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