**OFFERING CIRCULAR**

# Virgin Money Holdings (UK) plc
*(incorporated under the laws of England and Wales)*

# Virgin Money plc
*(incorporated under the laws of England and Wales)*

## £3,000,000,000
## Global Medium Term Note Programme

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Under the Global Medium Term Note Programme described in this Offering Circular (the "**Programme**"), Virgin Money Holdings (UK) plc ("**HoldCo**") and Virgin Money plc (the "**Bank**") (each an "**Issuer**" and together, the "**Issuers**"), subject to compliance with all relevant laws, regulations and directives, may from time to time issue notes (the "**Notes**"). The aggregate nominal amount of Notes outstanding under the Programme will not at any time exceed £3,000,000,000 (or the equivalent in other currencies), subject to any increase as provided herein.

This Offering Circular has been approved by the United Kingdom Financial Conduct Authority (the "**FCA**") in its capacity as competent authority under the Financial Services and Markets Act 2000, as amended ("**FSMA**"). This Offering Circular comprises listing particulars given in compliance with the United Kingdom Listing Authority's listing rules under Part VI of the FSMA ("**Listing Particulars**").

Applications have been made for Notes issued under the Programme (other than Exempt Notes (as defined below)) to be admitted during the period of twelve months after the date hereof to listing on the Official List of the FCA (the "**Official List**") and to trading on the Professional Securities Market (the "**PSM**") of the London Stock Exchange plc (the "**London Stock Exchange**"). The PSM is not a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments. References in this Offering Circular to "**Exempt Notes**" are to Notes for which no Listing Particulars are required to be published under the FSMA. The Programme permits Exempt Notes to be issued on the basis that they will not be admitted to listing, trading and/or quotation by any competent authority, stock exchange and/or quotation system or that they will be admitted to listing, trading and/or quotation by such other or further competent authorities, stock exchanges and/or quotation systems as may be agreed with the relevant Issuer. Information contained in this Offering Circular regarding Exempt Notes shall not be deemed to form part of this Offering Circular and the FCA has neither approved nor reviewed information contained in this Offering Circular in connection with any Exempt Notes.

Notes issued under the Programme may be rated or unrated. Where a Tranche of Notes is rated, such rating will be specified in the applicable Final Terms (as defined below). **A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.**

Investing in Notes issued under the Programme involves certain risks. The principal risk factors that may affect the abilities of the Issuers to fulfil their respective obligations under the Notes are discussed under "*Risk Factors*" below.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended ("**Securities Act**") or with any securities regulatory authority of any state or other jurisdiction of the United States and the Notes in bearer form are subject to U.S. tax law requirements. The Notes may not be offered, sold or (in the case of Notes in bearer form) delivered within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act ("**Regulation S**")) except in certain transactions exempt from the registration requirements of the Securities Act and applicable United States state securities laws. The Notes may be offered and sold (a) in bearer form or registered form outside the United States to persons that are not U.S. persons in reliance of Regulation S and (b) in registered form within the United States to "qualified institutional buyers" (as defined in Rule 144A under the Securities Act ("**Rule 144A**")) in reliance on Rule 144A. Prospective purchasers who are QIBs are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. See "*Subscription and Sale*" and "*Transfer Restrictions*".

**Arranger**

**BARCLAYS**

**Dealers**

**BARCLAYS**
**BOFA MERRILL LYNCH**
**DEUTSCHE BANK**
**MORGAN STANLEY**
**BNP PARIBAS**
**CITIGROUP**
**HSBC**
**THE ROYAL BANK OF SCOTLAND**

14 April 2016

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## IMPORTANT NOTICES

***Responsibility for this Offering Circular***

Each of the Issuers accepts responsibility for the information contained in this Offering Circular and any Final Terms (as defined below) and declares that, having taken all reasonable care to ensure that such is the case, the information contained in this Offering Circular (or the Final Terms) is, to the best of its knowledge, in accordance with the facts and contains no omission likely to affect its import.

***Final Terms/Drawdown Offering Circular***

Each Tranche (as defined herein) of Notes will be issued on the terms set out herein under "*Terms and Conditions of the Notes*" (the "**Conditions**") as completed by a document specific to such Tranche called final terms (the "**Final Terms**") or in a separate offering circular specific to such Tranche (the "**Drawdown Offering Circular**"), as described under "*Final Terms and Drawdown Offering Circulars*" below.

***Other relevant information***

This Offering Circular must be read and construed together with any supplements hereto and with any information incorporated by reference herein and, in relation to any Tranche of Notes which is the subject of Final Terms, must be read and construed together with the relevant Final Terms. In the case of a Tranche of Notes which is the subject of a Drawdown Offering Circular, each reference in this Offering Circular to information being specified or identified in the relevant Final Terms shall be read and construed as a reference to such information being specified or identified in the relevant Drawdown Offering Circular unless the context requires otherwise.

Each of the Issuers has confirmed to the Dealers named under "*Subscription and Sale*" below that this Offering Circular contains all information which is (in the context of the Programme and the issue, offering and sale of the Notes) material; that such information is true and accurate in all material respects and is not misleading in any material respect; that this Offering Circular does not omit to state any material fact necessary to make such information (in the context of the Programme and the issue, offering and sale of the Notes) not misleading in any material respect; and that all proper enquiries have been made to verify the foregoing.

**Unauthorised information**

No person has been authorised to give any information or to make any representation not contained in or not consistent with this Offering Circular or any information supplied by the Issuers and, if given or made, such information or representation should not be relied upon as having been authorised by the Issuers or any Dealer.

None of the Dealers, the Trustee nor any of their respective affiliates have authorised the whole or any part of this Offering Circular and none of them makes any representation or warranty or accepts any responsibility as to the accuracy or completeness of the information contained in this Offering Circular. Each Dealer and the Trustee accordingly disclaims all and any liability whether arising in tort or contract or otherwise which it might otherwise have in respect of this Offering Circular. Neither the delivery of this Offering Circular nor any Final Terms nor the offering, sale or delivery of any Note shall, in any circumstances, create any implication that the information contained in this Offering Circular is true subsequent to the date hereof or the date upon which this Offering Circular has been most recently supplemented or that there has been no adverse change, or any event reasonably likely to involve any adverse change, in the prospects or financial or trading position of either Issuer since the date hereof or, if later, the date upon which this Offering Circular has been most recently supplemented or that any other information supplied in connection with the Programme is correct at any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same. The Dealers and the Trustee expressly do not undertake to review the financial condition or affairs of the Issuers during the life of the Programme nor to advise any investor or potential investor in the Notes of any information coming to the attention of any of the Dealers or the Trustee. Investors should review, *inter alia*, the most recent published financial statements of the relevant Issuer when evaluating the Notes.

**Restrictions on distribution**

The distribution of this Offering Circular and any Final Terms, and the offering, sale and delivery of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular or any Final Terms comes are required by the Issuers and the Dealers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of Notes and on the distribution of this Offering Circular or any Final Terms and other offering material relating to the Notes, see "*Subscription and Sale*" and "*Transfer Restrictions*".

In particular, the Notes have not been, and will not be, registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States, and Notes in bearer form are subject to U.S. tax law requirements. The Notes may not be offered, sold or (in the case of Notes in bearer form) delivered within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S) except in certain transactions exempt from the registration requirements of the Securities Act.

The Notes may be offered and sold (A) in bearer form or registered form outside the United States to non-U.S. persons in reliance on Regulation S and (B) in registered form within the United States to qualified institutional buyers (as defined in Rule 144A) (each, a "**QIB**") in reliance on Rule 144A. Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of these and certain further restrictions on offers, sales and transfers of Notes, see "*Subscription and Sale*" and "*Transfer Restrictions*".

**NEITHER THE PROGRAMME NOR THE NOTES HAVE BEEN APPROVED OR DISAPPROVED BY THE U.S. SECURITIES AND EXCHANGE COMMISSION (THE "SEC"), ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER U.S. REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF ANY OFFERING OF NOTES OR THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.**

None of this Offering Circular, any Final Terms or any document incorporated by reference herein constitutes an offer or an invitation to subscribe for or purchase any Notes and should not be considered as a recommendation by the Issuers, the Dealers or any of them that any recipient of this Offering Circular or any Final Terms should subscribe for or purchase any Notes. Neither this Offering Circular nor any other financial statements are intended to provide the basis of any credit or other evaluation. Each recipient of this Offering Circular or any Final Terms shall be taken to have made its own investigation and appraisal of the condition (financial or otherwise) of the Issuers.

Each potential investor in any Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

(i) have sufficient knowledge and experience to make a meaningful evaluation of the relevant Notes, the merits and risk of investing in the relevant Notes and the information contained or incorporated by reference in this Offering Circular or any applicable supplement;

(ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the relevant Notes and the impact such investment will have on its overall investment portfolio;

(iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the relevant Notes or where the currency for principal or interest payments is different from the currency in which such investor's financial activities are principally denominated;

(iv) understand thoroughly the terms of the relevant Notes and be familiar with the behaviour of any relevant indices and financial markets; and

(v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Notes are complex financial instruments and such instruments may be purchased by investors as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Notes which are complex financial instruments unless it has the expertise (either alone or with the help of a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of such Notes and the impact this investment will have on the potential investor's overall investment portfolio.

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent: (i) Notes are legal investments for it; (ii) Notes can be used as collateral for various types of borrowing; and (iii) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of Notes under any applicable risk-based capital or similar rules.

## SERVICE OF PROCESS AND ENFORCEMENT OF LIABILITIES

Each of the Issuers is duly incorporated under the laws of England and Wales. Substantially all of each Issuer's directors and executive officers are non-residents of the United States. A substantial portion of the assets of each Issuer and of their respective directors and officers are located outside the United States. As a result, it may not be possible for an investor to effect service of process within the United States upon those persons or to enforce against them judgements of U.S. courts based upon the civil liability provisions of the federal securities laws of the United States.

## FORWARD-LOOKING STATEMENTS

Certain information contained in this Offering Circular and any documents incorporated by reference, including any information as to Virgin Money's strategy, market position, plans or future financial or operating performance, constitutes "forward looking statements". All statements, other than statements of historical fact, are forward looking statements. These forward looking statements may be identified by the use of forward looking terminology, including the terms "believe", "expect", "anticipate", "contemplate", "target", "plan", "intend", "continue", "budget", "project", "aim", "estimate", "may", "will", "could", "should", "seeks", "predicts", "schedule" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plan, objectives, goals, future events or intentions.

Forward looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by Virgin Money, are inherently subject to significant business, economic and competitive uncertainties and contingencies. Known and unknown factors could cause actual results to differ materially from those projected in the forward looking statements. Such factors include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; changes to an Issuer's credit ratings; changing demographic developments, including mortality and changing customer behaviour, including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes; natural and other disasters, adverse weather and similar contingencies outside Virgin Money's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside Virgin Money's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union, the US or elsewhere; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write downs caused by depressed asset valuations, market disruptions and illiquid markets; market relating trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non bank financial services and lending companies; and the success of Virgin Money in managing the risks of the foregoing.

Investors are cautioned that forward looking statements are not guarantees of future performance. Forward looking statements may, and often do, differ materially from actual results. Any forward looking statements in this Offering Circular speak only as of the date they are made, reflect the Issuers' Boards' view as of the date they are made with respect to future events and are subject to risks relating to future events and other risks, uncertainties and assumptions relating to Virgin Money's operations, results of operations, strategy, capital and leverage ratios and the availability of new funding. Investors should specifically consider the factors identified in this Offering Circular that could cause actual results to differ before making an investment decision. All of the forward looking statements made in this Offering Circular are qualified by these cautionary statements.

Except as required by the Prudential Regulation Authority (the "**PRA**"), the FCA, the London Stock Exchange or applicable law, Virgin Money explicitly disclaims any intention or obligation or undertaking publicly to release the result of any revisions to any forward looking statements in this Offering Circular that may occur due to any change in Virgin Money's expectations or to reflect events or circumstances after the date of it.

***Programme limit***

The maximum aggregate principal amount of Notes outstanding at any one time under the Programme will not exceed £3,000,000,000 (and for this purpose, any Notes denominated in another currency shall be translated into pounds sterling at the date of the agreement to issue such Notes (calculated in accordance with the provisions of the Dealer Agreement)). The maximum aggregate principal amount of Notes which may be outstanding at any one time under the Programme may be increased from time to time, subject to compliance with the relevant provisions of the Dealer Agreement as defined under "*Subscription and Sale*".

**Certain definitions**

In this Offering Circular, unless otherwise specified, references to a "**Member State**" are references to a Member State of the European Economic Area (the "**EEA**"), references to "**£**", "**GBP**" or "**pounds sterling**" are to the lawful currency for the time being of the United Kingdom, references to "**EUR**" or "**euro**" are to the currency introduced at the start of the third stage of European economic and monetary union, and as defined in Article 2 of Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro, as amended and references to "**U.S.$**", "**U.S. dollars**" or "**dollars**" are to United States dollars.

In this Offering Circular, references to "**Virgin Money**" and to the "**Virgin Money Group**" are to HoldCo and its subsidiaries, taken as a whole. The terms "**HoldCo Group**" and "**Bank Group**" have the meanings given to them in Condition 2(a) (*Definitions and Interpretation – Definitions*).

In this Offering Circular, references to the "**Issuer**" are to HoldCo or the Bank, as the case may be, as the Issuer of the Notes under the Programme and references to the "**relevant Issuer**" shall be construed accordingly.

Certain figures included in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

**Ratings**

The Long Term Issuer Default Rating (IDR) of the Bank assigned by Fitch Ratings Limited ("**Fitch**") is currently BBB+. The Senior Programme Rating (SPR) assigned by Fitch is currently BBB+, such rating applies only to the issuance of senior unsecured Notes issued under the Programme by the Bank. Fitch is established in the EEA and registered under Regulation (EU) No. 1060/2009, as amended (the "**CRA Regulation**").

Tranches of Notes issued under the Programme will be rated or unrated. Where a Tranche of Notes is rated, such rating will not necessarily be the same as the rating(s) (if any) assigned to an Issuer or the rating(s) assigned to Notes already issued. Where a Tranche of Notes is rated, the applicable rating(s) will be specified in the relevant Final Terms. Whether or not each credit rating applied for in relation to a relevant Tranche of Notes will be (1) issued by a credit rating agency established in the EEA and registered under the CRA Regulation, or (2) issued by a credit rating agency which is not established in the EEA but will be endorsed by a CRA which is established in the EEA and registered under the CRA Regulation or (3) issued by a credit rating agency which is not established in the EEA but which is certified under the CRA Regulation, will be disclosed in the Final Terms.

**Stabilisation**

**In connection with the issue of any Tranche of Notes, the Dealer or Dealers (if any) named as the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Final Terms may over allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the relevant Tranche of Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Notes and 60 days after the date of the allotment of the relevant Tranche of Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager(s) (or person(s) acting on behalf of any Stabilising Manager(s)) in accordance with all applicable laws and rules.**

**Market, economic and industry data**

This Offering Circular contains information regarding Virgin Money's business and the industry in which it operates and competes, some of which Virgin Money has obtained from third-party sources. Virgin Money and other institutions operating in the financial services industry make available a wide range of financial and operational information to regulatory and market bodies, including the Bank of England and the Council of Mortgage Lenders. These bodies use the data supplied to publish market share statistics relating to retail mortgage lending and savings, among other matters. However, no assurance can be made that the information reported to these bodies by different market participants is, in all cases, directly comparable.

In some cases, independently determined industry data is not available. In these cases, any Virgin Money market share included in this Offering Circular is referred to as having been estimated. All such estimates have been made by Virgin Money using its own information and other market information which is publicly available. All such estimations have been made in good faith based on the information available and Virgin Money's knowledge of the market within which it operates.

Where third-party information has been used in this Offering Circular, the source of such information has been identified. With respect to such third-party information, this information has been accurately reproduced and so far as the Issuers are aware and able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. In the case of the presented economic and statistical information, similar information may be obtainable from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source.

Where information has not been independently sourced, it is Virgin Money's own information.

**No incorporation of website information**

Virgin Money's website is www.virginmoney.com. The information on this website or any website directly or indirectly linked to this website has not been verified and is not incorporated by reference into this Offering Circular and investors should not rely on it.

## OVERVIEW OF THE PROGRAMME

*The following overview is a general description of the Programme, must be read as an introduction to this Offering Circular, and is qualified in its entirety by the remainder of this Offering Circular (and, in relation to the terms and conditions of any particular Tranche of Notes, the applicable Final Terms or Drawdown Offering Circular). Words and expressions defined elsewhere in this Offering Circular shall have the same meaning in this overview unless otherwise defined herein.*

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| **Issuers:** | Virgin Money Holdings (UK) plc ("**HoldCo**")<br>Virgin Money plc (the "**Bank**") |
| **Arranger:** | Barclays Bank PLC |
| **Dealers:** | Barclays Bank PLC<br>BNP Paribas<br>Citigroup Global Markets Limited<br>Deutsche Bank AG, London Branch<br>HSBC Bank plc<br>Merrill Lynch International<br>Morgan Stanley & Co. International plc<br>The Royal Bank of Scotland plc<br><br>and any other Dealer appointed from time to time by the relevant Issuer either generally in respect of the Programme or in relation to a particular Tranche of Notes. |
| **Trustee:** | Citicorp Trustee Company Limited |
| **Principal Paying Agent:** | Citibank, N.A., London Branch |
| **Registrar and Transfer Agent:** | Citibank, N.A., London Branch |
| **Final Terms or Drawdown Offering Circular:** | Notes issued under the Programme may be issued either (1) pursuant to this Offering Circular and associated Final Terms or (2) pursuant to a Drawdown Offering Circular. The terms and conditions applicable to any particular Tranche of Notes will be the Conditions as completed by the relevant Final Terms or, as the case may be, as supplemented, amended and/or replaced by the relevant Drawdown Offering Circular. |
| **Listing and Trading:** | Applications have been made for Notes (other than Exempt Notes) to be admitted during the period of twelve months after the date hereof to listing on the Official List and to trading on the PSM. The Programme also permits Exempt Notes to be issued on the basis that they will not be admitted to listing, trading and/or quotation by any competent authority, stock exchange and/or quotation system or to be admitted to listing, trading and/or quotation by such other or further competent authorities, stock exchanges and/or quotation systems as may be agreed with the relevant Issuer. |
| **Clearing Systems:** | Euroclear Bank SA/NV ("**Euroclear**") and/or Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**" and together with Euroclear, the "**ICSDs**") and/or (in the case of Registered Notes represented by a Restricted Global Note Certificate only) The Depository Trust Company ("**DTC**") and/or, in relation to any Tranche of Notes, any other clearing system as may be specified in the relevant Final Terms. |

**Initial Programme Amount:** Up to £3,000,000,000 (or the equivalent in other currencies) aggregate principal amount of Notes outstanding at any one time. The Issuers may increase the amount of the Programme in accordance with the terms of the Dealer Agreement.

**Issuance in Series:** Notes will be issued in Series. Each Series may comprise one or more Tranches issued on different issue dates. The Notes of each Series will all be subject to identical terms, except that the issue date and the amount of the first payment of interest may be different in respect of different Tranches. The Notes of each Tranche will all be subject to identical terms in all respects save that a Tranche may comprise Notes of different denominations.

**Forms of Notes:** Notes may be issued in bearer form ("**Bearer Notes**") or in registered form ("**Registered Notes**"). Bearer Notes will not be exchangeable for Registered Notes and Registered Notes will not be exchangeable for Bearer Notes. No single Series or Tranche may comprise both Bearer Notes and Registered Notes.

Each Tranche of Bearer Notes will initially be in the form of either a Temporary Global Note or a Permanent Global Note, in each case as specified in the relevant Final Terms. Each Global Note which is not intended to be issued in new global note form (a "**Classic Global Note**" or "**CGN**"), as specified in the relevant Final Terms, will be deposited on or around the relevant issue date with a depositary or a common depositary for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system. Each Global Note which is intended to be issued in new global note form (a "**New Global Note**" or "**NGN**"), as specified in the relevant Final Terms, will be deposited on or around the relevant issue date with a common safekeeper for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system. Each Temporary Global Note will be exchangeable for a Permanent Global Note or, if so specified in the relevant Final Terms, for Definitive Notes. If the TEFRA D Rules are specified in the relevant Final Terms as applicable, certification as to non-U.S. beneficial ownership will be a condition precedent to any exchange of an interest in a Temporary Global Note or receipt of any payment of interest in respect of a Temporary Global Note. Each Permanent Global Note will be exchangeable for Definitive Notes in accordance with its terms. Definitive Notes will, if interest-bearing, have Coupons attached and, if appropriate, a Talon for further Coupons.

Each Tranche of Registered Notes will be represented by either:

(i) Individual Note Certificates; or

(ii) one or more Unrestricted Global Note Certificates in the case of Registered Notes sold outside the United States to non-U.S. persons in reliance on Regulation S and/or one or more Restricted Global Note Certificates in the case of Registered Notes sold to QIBs in reliance on Rule 144A,

in each case as specified in the relevant Final Terms.

Each Note represented by an Unrestricted Global Note Certificate will either be: (a) in the case of an Unrestricted Global Note Certificate which is not to be held under the new safekeeping structure, registered in the name of a common depositary (or its nominee) for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system and the relevant Unrestricted Global Note Certificate will be deposited on or about the issue date with the common depositary; or (b) in the case of an Unrestricted Global Note Certificate to be held under the new safekeeping structure ("**New Safekeeping Structure**" or "**NSS**"), be registered in the name of a common safekeeper (or its nominee) for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system and the relevant Unrestricted Global Note Certificate will be deposited on or about the issue date with the common safekeeper for Euroclear and/or Clearstream, Luxembourg.

Each Note represented by a Restricted Global Note Certificate will be registered in the name of Cede & Co. as nominee for DTC and the relevant Restricted Global Note Certificate will be deposited on or about the issue date with the DTC Custodian. Beneficial interests in Notes represented by a Restricted Global Note Certificate may only be held through DTC at any time.

**Currencies:** Notes may be denominated in pounds sterling, euro, U.S. dollars or in any other currency or currencies, subject to compliance with all applicable legal and/or regulatory and/or central bank requirements.

**Status of Senior Notes:** The Senior Notes (and the Coupons relating thereto, if any) constitute direct, unconditional, unsecured and unsubordinated obligations of the relevant Issuer which will at all times rank *pari passu* among themselves and *pari passu* with all other present and future unsecured and unsubordinated obligations of the relevant Issuer, save for such obligations as may be preferred by provisions of law.

**Status of Tier 2 Capital Notes:** The Tier 2 Capital Notes (and the Coupons relating thereto, if any) constitute direct, unsecured and subordinated obligations of the relevant Issuer ranking *pari passu* without any preference among themselves. In the event of the winding up or administration of the relevant Issuer, the claims of the Trustee (on behalf of the Noteholders but not the rights and claims of the Trustee in its personal capacity under the Trust Deed) and the Holders of Tier 2 Capital Notes and any related Coupons against the relevant Issuer in respect of such Notes and Coupons (including any damages or other amounts (if payable)) shall (i) be subordinated to the claims of all Senior Creditors (as defined in the Conditions); (ii) rank at least *pari passu* with the claims of all other subordinated creditors of the relevant Issuer which in each case by law rank, or by their terms are expressed to rank, *pari passu* with the Tier 2 Capital Notes (including holders of instruments of the relevant Issuer that qualify as Tier 2 instruments in accordance with the Capital Regulations); and (iii) rank senior to the relevant Issuer's ordinary shares, preference shares and any junior subordinated obligations or other securities of the relevant Issuer which by law rank, or by their terms are expressed to rank, junior to the Tier 2 Capital Notes.

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| **Issue Price:** | Notes may be issued at any price. The price and amount of Notes to be issued under the Programme will be determined by the relevant Issuer and the relevant Dealer(s) at the time of issue in accordance with prevailing market conditions. |
| **Maturities:** | Any maturity, subject to compliance with all applicable legal and/or regulatory and/or central bank requirements.<br><br>Any Notes issued by HoldCo having a maturity of less than one year must (a) have a minimum redemption value of £100,000 (or the equivalent in other currencies) and be issued only to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses; or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses or (b) be issued in other circumstances which do not constitute a contravention of section 19 of the FSMA by HoldCo. |
| **Interest:** | Notes may be interest bearing or non interest bearing. Interest (if any) may accrue at a fixed rate, a resetting rate or a floating rate (or a fixed/floating or floating/fixed rate). |
| **Fixed Rate Notes:** | Fixed Rate Notes will bear interest at the fixed rate(s) of interest specified in the applicable Final Terms. Such interest will be payable in arrear on the Interest Payment Date(s) specified in the applicable Final Terms or determined pursuant to the Conditions. |
| **Reset Notes**: | Reset Notes will, in respect of an initial period, bear interest at the Initial Rate of Interest specified in the applicable Final Terms. Thereafter, the fixed rate of interest will be reset on one or more date(s) specified in the applicable Final Terms by reference to a mid-swap rate for the relevant Specified Currency or a benchmark gilt rate, and for a period equal to the relevant reset period, as adjusted for any applicable margin, in each case as may be specified in the applicable Final Terms. Such interest will be payable in arrear on the Interest Payment Date(s) specified in the applicable Final Terms or determined pursuant to the Conditions. |
| **Floating Rate Notes:** | Floating Rate Notes will bear interest determined separately for each Series as follows:<br><br>(i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2006 ISDA Definitions published by the International Swaps and Derivatives Association, Inc.; or<br><br>(ii) by reference to a reference rate appearing on the agreed screen page of a commercial quotation service,<br><br>in any such case as adjusted for any applicable margin specified in the applicable Final Terms.<br><br>Floating Rate Notes may also have a maximum interest rate, a minimum interest rate, or both. |
| **Zero Coupon Notes:** | Zero Coupon Notes may be issued at their nominal amount or at a discount to their nominal amount and will not bear |

interest.

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| **Redemption:** | Unless previously redeemed or purchased and cancelled, Notes will be redeemed at their Final Redemption Amount (as specified in the relevant Final Terms) on the Maturity Date. |
| **Optional Redemption:** | Notes may be redeemed before the Maturity Date at the option of the relevant Issuer (as described in Condition 10(b) (*Redemption and Purchase – Redemption at the option of the Issuer*)), to the extent (if at all) specified in the relevant Final Terms, subject (in the case of Tier 2 Capital Notes) to obtaining Regulatory Approval and complying with the Regulatory Preconditions (see Condition 10(k) (*Redemption and Purchase – Restriction on Early Redemption of Tier 2 Capital Notes*)).<br><br>To the extent (if at all) specified in the relevant Final Terms, Senior Notes may be redeemed before the Maturity Date at the option of the Noteholders (as described in Condition 10(e) (*Redemption and Purchase – Redemption at the option of Noteholders*)). |
| **Early Redemption:** | Except as described in "*Optional Redemption*" above, early redemption will only be permitted for tax reasons, as described in Condition 10(c) (*Redemption and Purchase – Redemption for tax reasons*), and, in the case of Tier 2 Capital Notes, regulatory reasons, as described in Condition 10(d) (*Redemption and Purchase – Regulatory Event Redemption of Tier 2 Capital Notes*), subject (in the case of Tier 2 Capital Notes) to obtaining Regulatory Approval and complying with the Regulatory Preconditions (see Condition 10(k) (*Redemption and Purchase – Restriction on Early Redemption of Tier 2 Capital Notes*)). |
| **Denominations:** | The Notes will be issued in such denominations as may be agreed between the relevant Issuer and the relevant Dealer(s) (subject to compliance with all applicable legal and/or regulatory and/or central bank requirements), save that the minimum denomination of each Note will be €100,000 (or the equivalent in any other currency). |
| **Taxation:** | All payments of principal and interest in respect of the Notes and the Coupons by or on behalf of the relevant Issuer shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision therein or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments, or governmental charges is required by law. In that event, the relevant Issuer shall pay such additional amounts as will result in receipt by the Noteholders and the Couponholders after such withholding or deduction of such amounts as would have been received by them had no such withholding or deduction been required, subject to certain exceptions as described in Condition 13 (*Taxation*). |
| **Ratings:** | As at the date of this Offering Circular, the Long Term Issuer Default Rating (IDR) of the Bank assigned by Fitch is currently BBB+. The Senior Programme Rating (SPR) |

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| | assigned by Fitch is currently BBB+, such rating applies only to the issuance of senior unsecured Notes issued under the Programme by the Bank. Tranches of Notes issued under the Programme will be rated or unrated. Where a Tranche of Notes is rated, such rating will not necessarily be the same as the rating(s) (if any) assigned to an Issuer or the rating(s) assigned to Notes already issued. Where a Tranche of Notes is rated, the applicable rating(s) will be specified in the relevant Final Terms. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. |
| **Substitution:** | Subject to Condition 18(d) (*Supervisory Authority notice or consent*), the Trustee may in certain circumstances, without the consent of the Noteholders, agree to the substitution of either Issuer, as described in Condition 18(c) (*Meetings of Noteholders; Modification and Waiver; Substitution – Substitution*). |
| **Governing Law:** | English law. |
| **Selling Restrictions:** | For a description of certain restrictions on offers, sales and deliveries of Notes and on the distribution of offering material in the United States of America, the United Kingdom and Japan, see "*Subscription and Sale*" below. |

# RISK FACTORS

*Any investment in the Notes is subject to a number of risks. Prior to investing in the Notes, prospective investors should carefully consider risk factors associated with any investment in the Notes, the business of the Issuers and the industry(ies) in which each of them operates together with all other information contained in this Offering Circular, including, in particular the risk factors described below. Words and expressions defined in the "Terms and Conditions of the Notes" below or elsewhere in this Offering Circular have the same meanings in this section.*

*Prospective investors should note that the following is not an exhaustive list or explanation of all risks which investors may face when making an investment in the Notes and should be used as guidance only. The Issuers have described only those risks relating to their ability to fulfil their respective obligations under the Notes that they consider to be material. Additional risks and uncertainties relating to the Issuers that are not currently known to the Issuers, or that either currently deems immaterial, may individually or cumulatively also have a material adverse effect on the business, financial condition, results of operations and/or prospects of the Issuers and, if any such risk should occur, the price of the Notes may decline and investors could lose all or part of their investment. Investors should consider carefully whether an investment in the Notes is suitable for them in light of the information in this Offering Circular and their personal circumstances.*

## Factors that may affect the Issuer's ability to fulfil its obligations under Notes issued under the Programme

***Virgin Money's business and financial performance have been and will continue to be affected by general economic conditions in the United Kingdom (the "UK") and elsewhere, and any adverse developments in the UK or global financial markets could cause its earnings and profitability to decline.***

As Virgin Money's customer revenue is derived almost entirely from customers based in the UK, Virgin Money is directly and indirectly subject to the inherent risks arising from general economic conditions in the UK, other economies which impact the UK economy and the state of the global financial markets both generally and as they specifically affect financial institutions.

The outlook for the UK economy is uncertain. If the UK's economic conditions weaken, resulting in a fall in demand for Virgin Money's products, or if there is a fall in the level of customers' disposable income, or if financial markets exhibit uncertainty and/or volatility, this could have a material adverse impact on Virgin Money's business, financial condition, results of operations and/or prospects.

In addition, a deterioration in economic conditions in the Eurozone, including a return to macroeconomic or financial market instability may pose a risk to Virgin Money's business, despite the fact that Virgin Money has limited direct financial exposure to the Eurozone. Should the economic conditions in the Eurozone deteriorate, the macroeconomic risks faced by Virgin Money would be exacerbated given the influence the Eurozone has on the UK's economic performance, and may have an adverse impact on consumer confidence, spending and demand for credit in the UK, any of which could have material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects. Market volatility has a material adverse impact on the ability of financial institutions to access the wholesale funding markets which, if such access becomes difficult, may have a material adverse impact on Virgin Money.

As the global economy continues to recover, central banks in advanced economies have maintained supportive policies, including historically low or negative levels of global interest rates. The Bank of England base rate has remained at 0.5 per cent. since March 2009, having fallen from 5.5 per cent. in December 2007. In the 30 years preceding December 2007, the lowest level of the base rate was 3.5 per cent. This low interest rate environment has put pressure on net interest income and margins throughout the UK banking industry, including at Virgin Money. In addition, the UK Government has provided support to UK financial institutions to support lending in the UK economy. These policies have helped to support demand at a time of pronounced fiscal tightening and balance sheet repair for most major financial institutions. Decreased levels of support for UK lending by the Bank of England and the UK Government could have a material adverse effect on Virgin Money's business.

Should the economy fail to recover or deflation emerge, the Bank of England may increase its level of support for the economy further by maintaining the historically low base rate for longer than anticipated or lowering the base rate further, possibly setting a negative base rate similar to several European central banks. Such a scenario may have a material adverse effect on Virgin Money’s margins as the interest rate it might earn on its customer assets may be less than the rate it pays for customer deposits and on other funding sources.

Higher interest rates could adversely impact the credit quality of Virgin Money's customers and counterparties. Conversely, a deflationary economic environment could also lead to an adverse impact on the credit quality of Virgin Money's customers and counterparties, through a deferral of domestic consumption leading to higher unemployment and an appreciation of debt in real terms. Both scenarios, coupled with a decline in collateral values, could lead to a reduction in recoverability and value of Virgin Money's assets resulting in a requirement to increase the Virgin Money's level of impairment allowance. Any increase in impairment resulting from, for example, higher charge-offs to recovery in the retail book and write-offs could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

***Virgin Money's earnings are exposed to the mortgages and savings market and Virgin Money is exposed to risks relating to the housing market***

During the financial year ended 31 December 2015, 69 per cent. of Virgin Money's total income was derived from its mortgage and savings business. The UK mortgage market was severely affected by the global financial crisis, with gross residential mortgage lending in the UK falling from £363 billion in 2007 to a low of £135 billion in 2010 before recovering slightly to £220 billion in 2015, according to data from the Bank of England. UK Government intervention in the housing market includes both direct intervention through its Help to Buy programme and indirect intervention through provision of liquidity to the banking sector under the Bank of England's Funding for Lending Scheme (the "**FLS**"). Although the mortgage market has benefited from stimulus provided by the UK Government's Help to Buy scheme, the guarantee element of the scheme is due to be withdrawn in December 2016 which could have a material adverse effect on mortgage demand across the industry.

In addition, the new FCA rules which came into force in April 2014 following the Mortgage Market Review (and had a limited direct effect on Virgin Money) taken alongside other regulatory changes (such as the Financial Policy Committee cap on high income multiples) may temper overall demand in the mortgage market.

Average house prices in the UK have generally been on the upward trend since February 2009, but the annual rate of house price growth has generally slowed since the end of 2014. If UK house prices were, in the future, to begin to follow a falling trend or if house prices in those regions to which Virgin Money has significant exposure begin to follow a falling trend, in particular the South East of England and London, this would be likely to result in an increase in Virgin Money's residential mortgage loan impairment charges as the value of the security underlying its mortgage loans is eroded. Higher impairment charges could reduce Virgin Money's profitability, capital and its ability to engage in lending and other income generating activities and, therefore, could have a material adverse effect on Virgin Money's business and potentially on its ability to implement its strategy. A significant increase in house prices over a short period of time could also have a negative effect on Virgin Money by reducing the number of customers that could afford to purchase a house and therefore causing a reduction in demand for new mortgages.

In addition, Virgin Money is exposed to the UK savings market as its principal source of funding for its mortgage lending. As a result, there is a risk that a temporary or permanent fall in the UK savings ratio (being the amount UK households save as a proportion of disposable income) may have a material adverse effect on the ability of Virgin Money to fund its mortgage lending activity and affect Virgin Money's ability to deliver its strategic income targets and its financial performance.

There are risks that competition for customers among financial institutions may increase the cost to Virgin Money of acquiring the new customers it needs, through, for example, higher interest rates on its retail savings products. Savings products with higher rates without any corresponding lending rate increases could have the effect of reducing Virgin Money's margins and therefore affecting Virgin Money's ability to deliver its strategic income targets and its financial performance.

***Negative fair value adjustments could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects***

Through its treasury operations, Virgin Money holds liquid assets portfolios for its own account, exposing Virgin Money to interest rate risk, basis risk and credit spread risk. To the extent that volatile market conditions occur, the fair value of Virgin Money's liquid asset portfolios could fall more than estimated and cause Virgin Money to record mark to market losses. In a distressed economic or market environment, the fair value of certain of Virgin Money's exposures may be volatile and more difficult to estimate because of market illiquidity. Valuations in future periods, reflecting the then prevailing market conditions, may result in significant negative changes in the fair value of Virgin Money's exposures, which could have a material adverse impact on Virgin Money's business, financial condition, results of operations and/or prospects.

Virgin Money has a portfolio of listed available for sale investment securities and there can be no assurance that fair valuations of Virgin Money's investment securities in future periods will not result in other comprehensive losses or impairments which could be material. In addition, the value that Virgin Money ultimately realises for its investment securities may be lower than their current fair value, resulting in losses being recorded in its income statement, which losses could be material. Any of these factors could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

***Volatility in the wholesale funding markets may have an adverse effect on Virgin Money***

During the global financial crisis, wholesale funding markets were severely restricted, which led to material liquidity challenges for banks heavily reliant on that source of funding. As a result, UK banks significantly increased their demand for retail deposits as a source of funding, leading to increased competition and higher customer interest rates. Whilst wholesale funding markets have recovered significantly in recent years, a continued focus on retail funding, as evidenced by the reduced loan to deposit ratios of the major UK retail banks, means that competition for retail deposits may continue to be elevated even in periods of benign wholesale funding markets. If Virgin Money is not able to attract sufficient retail deposits, its ability to meet its lending targets may be constrained which could have a material adverse effect on Virgin Money's financial and operational performance.

Virgin Money sources a proportion of its funding in the wholesale markets, primarily through securitisation programmes which it principally uses for medium term funding, although retained notes can also be used for short term repo funding purposes. Virgin Money also has access to the wholesale funding markets through this Global Medium Term Note programme which was established during 2015. While Virgin Money does not currently rely heavily on wholesale funding, it may need to access wholesale markets where there is a residual funding requirement over and above funds held from, among other sources, personal current accounts and other customer deposits. The availability of wholesale funding depends on a variety of factors including market conditions, the general availability of credit, Virgin Money's ability to raise funding through sources other than securitisation, the volume of trading activities, the overall availability of credit to the financial services industry, and rating agencies' and funding markets' assessment of Virgin Money's credit strength. These and other factors may limit Virgin Money's ability to raise funding in wholesale markets which could, in turn, result in a significant increase in its cost of funding or result in other material adverse effects on its business, financial condition, results of operations and/or prospects.

***Rating downgrade and/or market sentiment with respect to Virgin Money, the sector, the UK and/or other sovereign issuers may have an adverse effect on Virgin Money***

If sentiment towards the financial institutions operating in the UK (including Virgin Money) or in the Eurozone were to deteriorate, or if the UK's sovereign rating, the Bank's ratings and/or the ratings of the major financial institutions operating within the UK or beyond were to be adversely affected, this may have a materially adverse impact on Virgin Money and restrict its ability to source liquidity and funding in the longer term. In addition, any such change in sentiment or reduction in ratings could result in an increase in the costs of, and a reduction in the availability of, wholesale market funding across the financial sector which could have a material adverse effect on the liquidity and funding of all UK financial services institutions, including Virgin Money.

The Bank is currently rated BBB+ long term by Fitch. The rating is on positive outlook. Any future declines in those aspects of Virgin Money's business identified by Fitch as significant or otherwise could adversely affect Fitch's perception of Virgin Money's credit and cause it to take negative ratings actions. Any downgrade in the Bank's credit rating by Fitch could:

- adversely affect Virgin Money's liquidity and competitive position, particularly through cash outflows to meet collateral requirements on existing contracts;
- undermine confidence in Virgin Money;
- increase Virgin Money's borrowing costs; or
- limit Virgin Money's access to the capital markets or limit the range of counterparties willing to enter into transactions with Virgin Money, as many institutions require their counterparties to satisfy minimum ratings requirements.

The Bank's credit rating is subject to change and could be downgraded by Fitch as a result of many factors, including any failure by Virgin Money to implement its strategies successfully. A downgrade of the Bank's credit rating could also lead to a loss of customers and counterparties.

***Competition in the United Kingdom personal financial services markets may adversely affect Virgin Money's operations***

Virgin Money operates in an increasingly competitive UK personal financial services market. Virgin Money competes mainly with other providers of personal financial services, including banks, building societies and insurance companies, some of which have greater scale and financial resources, broader product offerings and more extensive distribution networks than Virgin Money.

Competition may intensify further in response to competitor behaviour, consumer demand, technological changes, the impact of market consolidation and new market entrants, regulatory actions (including the European Mortgage Credit Directive 2014/17/EU (the "**Mortgage Credit Directive**") and any action taken by the Competition and Markets Authority (the "**CMA**") in connection with its market investigation reference in relation to both personal current accounts ("**PCAs**") and aspects of small and medium-sized enterprise ("**SME**") banking), outputs from various market studies by the FCA including their cash savings and credit card market studies and the wider political environment, which is seeking to increase the level of competition in the UK retail banking market, together with other factors. If increased competition occurs as a result of these or other factors, Virgin Money's business, financial condition, results of operations and/or prospects could be materially adversely affected.

Each of the main personal financial services markets in which Virgin Money operates is mature and slow growing, so that material growth requires taking market share from competitors. The mortgages, savings, credit cards and PCA markets in particular are very concentrated. Some of Virgin Money's competitors have publicly commented that they intend to grow their market share. Such banks may engage in enhanced marketing activities which may result in customers switching their products to such competitors or may limit Virgin Money's ability to attract new customers. This may place elevated focus on price, service and other competitive factors as the key differentiators, each of which carries a cost to the provider. If Virgin Money is unable to match the efficiency or the marketing impact of its competitors, it risks being disadvantaged and being unable to meet its strategic growth aspirations.

The credit card issuing business is highly competitive. Virgin Money competes with other credit card issuers on the basis of a number of factors, including products and services, brand, network, reputation and pricing. This competition affects Virgin Money's ability to obtain applicants for credit cards, encourage card members to use Virgin Money's credit cards, maximise the revenue generated by card usage and generate card member loyalty and satisfaction so as to minimise the number of card members switching to other credit card brands. If Virgin Money is unable to compete successfully, Virgin Money's business, financial condition, results of operations and/or prospects could be materially adversely affected.

If Virgin Money's customer service levels were perceived by the market to be only in line with, or materially below, those of competitor UK financial institutions, Virgin Money could lose existing and potential new business. If Virgin Money is not successful in retaining and strengthening customer relationships, it may lose market share, incur losses on some or all of its activities or fail to attract new business or retain existing business, which could have a material adverse effect on its business, financial condition, results of operations and/or prospects.

A feature of the market in which Virgin Money operates is competition among lenders on credit standards. Should Virgin Money's competitors lower their credit standards, Virgin Money may lose market share of the sub sectors in which it operates in order to protect its risk appetite, which may materially adversely affect Virgin Money's financial and operational performance.

***Financial Risk (Liquidity, Market and Credit)***

*Liquidity*

Financial institutions, such as Virgin Money, are subject to liquidity risk as an inherent part of their business. Liquidity risk is the risk that an institution may not have sufficient liquid funds at any time to make full payment in respect of liabilities falling due at that time. Virgin Money raises funds principally through accepting retail deposits and, to a lesser extent, in the wholesale funding market. It also has a core portfolio of liquid investments as well as a range of other assets which are a further source of liquidity to it. However, if access to liquidity is constrained for a prolonged period of time, Virgin Money's cost of funding would increase as competition for retail deposits intensified, the cost of accessing the wholesale markets would rise and Virgin Money's ability to realise its liquid investments would be constrained. This would have a material adverse effect on Virgin Money's profitability.

These funding risks can be exacerbated by enterprise specific factors, such as over reliance on a particular source of funding or changes in credit ratings, or by market wide phenomena, such as market dislocation or a major disaster. There is also a risk that the funding structure employed by Virgin Money may prove to be inefficient, giving rise to a level of funding cost that is not sustainable in the long term for Virgin Money to grow its business or even maintain it at current levels. Virgin Money's ability to access retail and wholesale funding sources on satisfactory economic terms is subject to a variety of factors, including a number of factors which are outside its control.

Failure to manage these or any other risks relating to the cost and availability of liquidity and funding could compromise Virgin Money's ability to deliver its growth strategy and, consequently, have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

*Market*

Market risk is the risk that the value of, or net income arising from, Virgin Money's assets and liabilities changes as a result of changes to market forces, specifically interest rates, exchange rates or equity prices. Principally, the market risks that Virgin Money faces are interest rate risk, basis risk, foreign exchange risk, bond and equity index price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs.

The performance of financial markets may cause changes in the value of its investment portfolios. Although Virgin Money has implemented risk management methods to seek to mitigate and control these and other market risks to which it is exposed and its exposures are constantly measured and monitored, there can be no assurance that these risk management methods will be effective, particularly in unusual or extreme market conditions. It is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on Virgin Money's financial performance and business operations.

*Credit*

Credit risk is the risk that a borrower or counterparty fails to pay interest or to repay the principal on a loan or other financial instrument. Virgin Money's credit risk principally arises from its secured and unsecured loans and advances to customers, including its commitments to make such loans, from the investments in which its liquid assets are placed and from its hedging exposures. At 31 December 2015, retail secured credit accounted for 85 per cent. of Virgin Money's maximum exposure to credit risk before taking account of any collateral held or other credit enhancements and before provisions for impairment (this excludes off balance sheet loan commitments). For example, Virgin Money is exposed to the risk that the outstanding principal balance on interest-only or part capital repayment and part interest-only loans is not repaid in full at the contractual maturity date. Virgin Money provides a variety of solutions to support customers in such instances, but these solutions may not always result in customers being able to repay their loans or to continue to service the interest payments where the capital sum remains outstanding. Where the solutions are unsuccessful in terms of their estimated impact, this could lead to an increase in impairment charges on Virgin Money's residential mortgage portfolio and therefore could have a material adverse effect on its profitability.

In addition, Virgin Money has large individual exposures to single name counterparties. The default of obligations by such counterparties could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

***Operational Risk***

*General*

Virgin Money is exposed to many types of operational risk, including fraudulent and other criminal activities (both internal and external), the risk of breakdowns in processes, controls or procedures (or their inadequacy relative to the size and scope of Virgin Money's business) information security risks arising from information leakage, loss or theft and systems failure or non-availability. Virgin Money is also subject to the risk of disruption of its business arising from events that are wholly or partially beyond its control (for example natural disasters, acts of terrorism, epidemics and transport or utility failures) which may give rise to losses or reductions in service to customers and/or economic loss to Virgin Money. The operational risks that Virgin Money is exposed to could change rapidly and there is no guarantee that Virgin Money's processes, controls, procedures and systems are sufficient to address, or could adapt promptly to, such changing risks. All of these risks are also applicable where Virgin Money relies on outside suppliers or vendors to provide services to it and its customers (for example service disruption caused by the failure of a third party, corporate partner or strategic supplier).

*Cyber-crime*

Virgin Money continues to invest in its information security awareness, analysis and controls in response to emerging threats, and to ensure controls for known threats remain robust. The risks associated with cyber-attacks, where an individual or group seeks to exploit vulnerabilities in IT systems for financial gain or to disrupt services, are recognised as being a material risk to the financial system. Virgin Money has a robust IT infrastructure and its information security controls are designed to protect assets behind a layered series of defences. It cannot, however, be certain that its infrastructure and controls will prove effective in all circumstances. Any failure of the controls could result in significant financial losses and a material adverse effect on Virgin Money's operational performance and reputation.

*Retain/recruit key talent*

The successful management and operations of Virgin Money are reliant upon the contributions of the board members of HoldCo and the Bank, the senior management teams of HoldCo and the Bank and other key personnel who are key to Virgin Money's business. In addition, Virgin Money's performance is largely dependent on the talents and efforts of highly skilled individuals. Virgin Money's continued ability to compete effectively depends on its ability to attract new employees and to retain and motivate its existing employees. Although Virgin Money takes steps to protect itself in relation to the loss of key personnel (such as the inclusion of restrictive covenants and/or 'gardening leave' provisions in the employment contracts of key personnel), the loss of service of any of Virgin Money's senior management team or other key personnel, or an inability of Virgin Money to attract new personnel, could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

*Critical accounting estimates and judgements*

Accounting policies and methods are fundamental to how Virgin Money records and reports its financial condition and results of operations. Management must exercise judgement in selecting and applying many of these accounting policies and methods so that they comply with the International Financial Reporting Standards ("**IFRS**"). Virgin Money's financial accounts carry an inherent reliance on Management's judgement. Virgin Money has identified certain accounting policies in the notes to the Virgin Money Group's financial statements in respect of which significant judgement is required in determining appropriate assumptions and estimates when valuing assets, liabilities, commitments and contingencies. There is a risk that the judgements exercised by Virgin Money's Management team are erroneous and this could lead to inaccuracies in the reported financial position and performance of Virgin Money. As a result, Virgin Money cannot guarantee that it will not be required to make changes in accounting estimates or restate prior period financial statements in the future and any such changes or restatements could be material in nature.

Notwithstanding the above, these risk factors should not be taken to imply that HoldCo or any other company in the Virgin Money Group, as applicable, is unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated under the FSMA.

***Changes in Virgin Money's accounting policies or in accounting standards could materially affect how it reports its financial condition and results of operations***

From time to time, the International Accounting Standards Board (the "**IASB**") and/or the European Union change the IFRS that govern the preparation of Virgin Money's financial statements. These changes can be difficult to predict and could materially affect how Virgin Money records and reports its financial condition and results of operations. In some cases, Virgin Money could be required to apply a new or revised standard retrospectively, resulting in restating prior period financial statements.

For example, changes to IFRS 9, Financial Instruments: Recognition and Measurement, are expected to impact all UK retail banks, including Virgin Money, and are expected to have a material effect on Virgin Money's financial statements, but this effect has not yet been quantified as revisions to the standard are still being proposed and no mandatory effective date has been set.

The IASB may make other changes to financial accounting and reporting standards that govern the preparation of Virgin Money's financial statements, which Virgin Money may adopt prior to the date on which such changes become mandatory if determined to be appropriate, or which Virgin Money may be required to adopt. Any such change in Virgin Money's accounting policies or accounting standards could materially affect its reported financial condition and results of operations.

***Virgin Money is exposed to risks relating to relationships with key corporate partners and strategic suppliers***

Virgin Money relies on a number of corporate partners and strategic suppliers which exposes it to the risk of deterioration of the commercial, financial or operational soundness of those organisations. In general, any failure by a key third party has the potential to cause:

- pressure on revenue;
- deterioration in customer service; and
- a negative impact on the Virgin Money brand and investor confidence.

One of Virgin Money's key relationships is with its network of professional mortgage intermediaries, of which over 12,500 were actively engaged in business with Virgin Money in 2015. The key risk associated with a major intermediary partner going out of business or switching allegiance to other lenders is the potential negative effect on Virgin Money's lending volume. In addition, Virgin Money may be exposed to many of the risks inherent in dealing with intermediaries. For example, Virgin Money will have limited oversight of the intermediaries' interactions with prospective customers and, consequently, Virgin Money faces certain risks related to the conduct of the mortgage intermediaries with which it does business. The intermediaries' incentives may not always align with Virgin Money's, which could lead to a deterioration in the quality and performance of Virgin Money's mortgage book. If mortgage intermediaries are found to have violated applicable conduct regulations or standards in the sale of Virgin Money's mortgage products, Virgin Money's brand and/or reputation could be harmed as a result. In addition, the structure of the intermediary market is also subject to change, for example, there may be a change in customer sentiment or regulation which favours customers dealing directly with financial institutions which would reduce the flow of business from intermediaries which may have an adverse impact on Virgin Money if this business cannot be substituted. Also, there may be consolidation in the intermediary market which may change the behaviour of the residual intermediaries in ways which may adversely impact Virgin Money. Any of these factors could have a negative impact on Virgin Money's ability to meet its strategic objectives for its asset base and, consequently, its business, financial condition, results of operations and/or prospects.

The credit card business is reliant on a number of Virgin Money's key relationships, including with Total System Services, Inc. ("**TSYS**") (which provides customer servicing capabilities). Virgin Money's ability to issue credit cards and service customers could be impaired in the event of:

- the failure of third party systems or technology platforms, which could cause temporary service outage, adversely affect customers and negatively impact Virgin Money's reputation; and

- any complete corporate failure of a third party, which could more significantly impact customers and Virgin Money's reputation and, potentially, give rise to claims by customers for financial loss experienced and/or regulatory sanctions.

A key corporate relationship for Virgin Money is with International Financial Data Services ("**IFDS**"), which supports Virgin Money's investment and pensions business. Virgin Money's ability to administer its investment and pension products and the funds under management held by Virgin Money Unit Trust Managers Limited ("**VMUTM**", a subsidiary of HoldCo) could be impaired if IFDS or other parties involved in fund management, fund accounting and pricing, custody or administration of Virgin Money's investment and pensions products were to fail in their obligations regarding safeguarding of client assets, suffer from serious financial difficulties, suffer a disaster at a key site or fail to ensure appropriate pricing. In general, a failure by IFDS has the potential to cause:

- deterioration of both new customer acquisition processes and existing customer services;

- inability for customers to transact at a time that suits them with the potential for financial loss if the market moves;

- a negative impact on Virgin Money's brand and reputation through decreased service levels;

- a detrimental impact on income from this business line generated by VMUTM; and

- failure to comply with regulations resulting in the risk of regulatory censure.

Virgin Money also partners with a range of companies for the provision of insurance products and services. Any material disruption has the potential to negatively impact:

- Virgin Money's brand and reputation through product/service unavailability and/or decreased service levels; and

- commission income generated by Virgin Money Personal Financial Service Limited (a subsidiary of HoldCo) from these products and services.

***Virgin Money is reliant on its brand and therefore there are reputational risks which could cause harm to Virgin Money and its business prospects***

Virgin Money's reputation is one of its most important assets and its ability to attract and retain customers and staff and conduct business with its counterparties could be materially adversely affected to the extent that its reputation or the reputation of its brand is damaged. Failure to address, or appearing to fail to address, various issues that could give rise to reputational risk could cause harm to Virgin Money and its business prospects. Reputational issues include, but are not limited to:

- poor customer service or technology failures that impact upon customer services and accounts, see, for example, "*Operational Risk; Cyber-crime*" above;

- failing to address potential conflicts of interest appropriately;

- breaching or facing allegations of having breached legal and regulatory requirements in respect of the business it has originated or in respect of the business it has acquired, including Northern Rock plc. These requirements include, but are not limited to, conduct requirements, data protection, money laundering and anti-terrorism financing requirements;

- acting or facing allegations of having acted unethically including having adopted inappropriate sales and trading practices;
- failing or facing allegations of having failed to maintain appropriate standards of customer privacy, customer service and record keeping;
- failing to properly identify legal, reputational, credit, liquidity and market risks inherent in products offered by Virgin Money;
- intermediaries and other third parties on whom Virgin Money relies, such as clearing banks, TSYS for credit cards and third party mortgage servicing agents, failing to provide the necessary services; and
- generally poor business performance.

A failure to address these or any other relevant issue appropriately could make customers, depositors and investors less willing to do business with Virgin Money, which may materially adversely affect its business, financial condition, results of operations and/or prospects, and could damage its relationships with its regulators. As a result Virgin Money cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

Virgin Money is also exposed to reputational risk through its reliance on the Virgin brand. The Virgin brand is used in a wide range of different economic sectors in the UK and internationally. Adverse publicity in relation to others associated with the Virgin brand (including Sir Richard Branson) could result in an adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

***Recent legislative and regulatory changes and future legislative and regulatory changes are imposing or could impose operational restrictions on Virgin Money, require Virgin Money to raise further capital, increase Virgin Money's expenses and/or otherwise have a material adverse effect on its business, financial condition, results of operations and/or prospects***

As a financial services firm, Virgin Money is subject to extensive and comprehensive regulations. The Issuers conduct their business subject to ongoing regulation by the FCA and the PRA. The regulatory regime requires Virgin Money to be in compliance across many aspects of its activity, including the training, authorisation and supervision of personnel, systems, processes and documentation. If Virgin Money fails to comply with any relevant regulations, there is a risk of a material adverse effect on its business due to sanctions, fines or other action imposed by the regulatory authorities.

There is an increased focus by regulators on the appropriateness and sustainability of business models of regulated firms, with the regulators having the power to restrict a firm's ability to develop existing products, enter into new product areas or make acquisitions. The regulators no longer focus exclusively on the financial strength of a regulated firm, but also consider non financial resources available to the firm in assessing whether a firm continues to meet the threshold conditions. If the regulators were to believe that Virgin Money does not meet threshold conditions, they can remove or restrict Virgin Money's permissions.

Regulators and other policy making bodies in the UK and worldwide have produced and, in many cases, adopted a range of legislative and regulatory proposals and changes which have and could impose operational restrictions on Virgin Money, cause Virgin Money to raise further capital, increase Virgin Money's expenses and/or otherwise have a material adverse effect on its business, financial condition, results of operations and/or prospects. Future changes in regulation, and/or fiscal or other policies, are unpredictable and beyond Virgin Money's control and could have a material effect on its business or operations. In particular:

- the Financial Services (Banking Reform) Act 2013 (the "**Banking Reform Act**") has enacted a number of reforms primarily related to the UK banking sector, including the ring-fencing of certain activities. The secondary legislation setting out the detail of the ring-fencing regime exempts from ring-fencing those banks whose 'core deposits' (as defined in the secondary legislation and assessed on a group-wide basis) do not exceed £25 billion as a rolling average over a three-year period. Whilst the Bank does not currently meet these criteria, potential growth in the Bank's deposit levels would, based on Virgin Money's current understanding of the regulations, bring the Bank within the scope of application of the ring-fence in the future (the Bank currently expects to become a wholly ring-fenced bank by 2019);

- the Bank Recovery and Resolution Directive ("**BRRD**") established an EU-wide framework for the recovery and resolution of credit institutions and investment firms. The rules implementing BRRD require the Bank to maintain a minimum amount of 'bail-in-able' liabilities expressed as a percentage of its total liabilities on its balance sheet. Accordingly, if the Bank does not meet the minimum requirements it will need to issue and find buyers for such bail-in-able debt. Until the required level of 'bail-in-able' liabilities that the Bank will need to hold has been finalised, the full impact of BRRD on Virgin Money cannot be ascertained. See "*Regulatory action in the event a bank or investment firm in the Virgin Money Group is failing or is likely to fail could materially adversely affect the value of the Notes* below;

- the Mortgage Credit Directive ("**MCD**") asserts that Member States shall require creditors, credit intermediaries or appointed representatives (as applicable), among other things, to provide consumers with certain personalised pre-contractual information and to adhere to business conduct rules. The directive also requires calculation of the annual percentage rate of charge in accordance with a prescribed formula, imposes a ban on certain tying practices (i.e. offering or selling a credit agreement in a package of products, where the credit agreement is not also made available to the consumer separately) and requires that a consumer has a right to make early repayment. The MCD is broader in scope than previous UK mortgage regulation and applies a standard approach to certain niche mortgage markets that the FCA did not previously regulate, including buy-to-let mortgages. The MCD provides Member States with the option not to apply the directive to buy-to-let mortgage lending, where an alternative appropriate framework for the regulation of this type of credit has been established. The UK government is utilising this option and has established a framework, set out in the Mortgage Credit Directive Order 2015 (SI 2015/910) (the "**MCD Order**"), that is supervised and enforced by the FCA. The MCD Order states that firms carrying on certain regulated activities must register with the FCA as a consumer buy-to-let mortgage firm before providing buy-to-let mortgage business. A registered consumer buy-to-let mortgage firm must comply with the detailed obligations and record-keeping requirements set out in the MCD Order. This is likely to result in an increase in Virgin Money's compliance costs associated with Virgin Money's mortgage business. In addition, as a result of the MCD Order, second charge mortgage lending will be brought into the FCA's regime for mortgage lending. The FCA is achieving this by ensuring that the FCA's Mortgages and Home Finance: Conduct of Business ("**MCOB**") sourcebook rules apply to second charge lending. Consequently, second charge firms must comply with a number of requirements set out in MCOB, including in relation to disclosures and fees. Virgin Money's mortgage business is central to its strategy and, as a result, regulatory developments in respect of mortgage lending present considerable risk to Virgin Money and it is anticipated that the implementation of the MCD would have a material impact on Virgin Money;

- in November 2014, the FCA published the terms of reference for its credit card market study. The study focuses on the offering of credit card services to retail customers and looks at three main areas: (i) the extent to which consumers shop around and switch providers; (ii) how firms recover their costs across different cardholder groups; and (iii) the extent of unaffordable credit card debt. To date, the interim findings of the FCA's study are that consumers do shop around and that consumers value the flexibility offered by credit cards. The FCA has also found that firms are not targeting particular groups of consumers in order to cross-subsidise other groups. However, while firms are active in contacting consumers who miss payments, the FCA has found that firms do not routinely intervene in circumstances where consumers with persistent levels of debt make only minimum payments. The FCA expects to publish its final report in spring 2016. Until the report is finalised, it is not clear what operational or regulatory impacts the credit card market study will have on Virgin Money's business;

- on 6 November 2014, the CMA announced that it was commencing a market investigation in relation to both PCAs and aspects of SME banking. On 22 October 2015, the CMA published its initial findings which stated that a combination of certain features in the provision of PCAs (including barriers to switching PCA and low levels of customer engagement) give rise to an adverse effect on competition. The CMA's investigation into the retail banking market is ongoing and is likely to be extended. On 7 March 2016, the CMA announced that the investigation would be extended to a new deadline of 12 August 2016. The outcome of this investigation could have an impact on Virgin Money's operations, including areas of its business which are materially important to Virgin Money's strategy, such as the retail deposit business, the credit card business and the features of banking products it offers to customers. Should the outcome of the CMA market investigation reference lead to restrictions on what Virgin Money can offer its customers, particularly in terms of PCA offering, Virgin Money's strategic position may be adversely affected. In addition, the CMA market investigation may lead to higher costs of compliance for key areas of Virgin Money's business such as PCA. Until the findings of the CMA's market investigation are finalised, the impact on Virgin Money cannot be ascertained, but given the small volume of PCAs that Virgin Money has, the adverse impact is not expected to be more substantial than that outlined above;

- in March 2015, the FCA, published the final findings from its retirement income market study. The study concluded that competition in this market was not working well and proposed a number of remedies aimed at improving consumer choice, including requiring firms to provide annuity quotation rankings in order for consumers to easily identify whether they are getting the best deal. The FCA is continuing to monitor this market. Future rule changes may have operational or regulatory implications for the market that could affect Virgin Money's unit trust management business; and

- the directive and associated regulation on markets in financial instruments (together "**MiFID II/MiFIR**") entered into force on 2 July 2014, with the majority of provisions originally set to apply from 3 January 2017. However, on 10 February 2016, the European Commission announced a proposal to extend the entry into application of MiFID II by one year. MiFID II/MiFIR bans firms who provide investment advice on an independent basis or who provide portfolio management from accepting or receiving fees, commissions or any other monetary or non-monetary benefits paid or provided by any third party (unless such non-monetary benefit is minor and meets certain additional criteria). MiFID II/MiFIR overlaps with the UK retail distribution rules (the "**RDR**") which restrict commission payments to all investment advisers and not only "independent" investment advisers. The FCA has noted that the main impact of the MiFID II/MiFIR restrictions on inducements is on portfolio managers. Both the RDR and the MiFID II/MiFIR rules on inducements may affect Virgin Money's financial product investment business' profitability. MiFID II/MiFIR also introduced investor protection measures which include product governance requirements and enhanced suitability requirements. These requirements could increase the cost of distributing financial products to retail clients and increase the risk of non-compliance.

Furthermore, the PRA has published rules implementing the Financial Policy Committee (the "**FPC**") recommendations on loan to income ratios in the UK residential mortgage market. The rules, set out in the Housing Part of the PRA Rulebook, require a firm to ensure that it limits the number of mortgage loans made at or greater than 4.5 times loan to income to no more than 15 per cent. of their total number of new mortgage loans entered into in a calendar quarter. This measure is designed to reduce household indebtedness and to attempt to ensure that house prices do not rise faster than household income, as high levels of household indebtedness are associated with a high probability of household distress which can cause a sharp fall in consumer spending, which can weigh on wider economic activity. In addition, following discussion at the FPC's meeting on 26 September 2014, the FPC recommended that Her Majesty's Treasury ("**HM Treasury**") exercise its statutory power to enable the FPC to direct, if necessary to protect and enhance financial stability, the PRA and the FCA to require regulated lenders (which would include the Bank) to place limits on owner-occupied residential mortgage lending by reference to: (a) loan to value ratios; and (b) debt to income ratios. In order to give effect to the FPC recommendations, the Bank of England 1998 (Macro-prudential Measures) Order 2015 came into force on 6 April 2015. It is possible that these changes, or any of the further recommendations which the FPC may issue, may affect the UK mortgage market, reduce the demand for Virgin Money's mortgage products or have a material adverse impact on Virgin Money's ability to meet its strategic lending targets.

There is also a risk that the recent restructuring of regulatory bodies and, in particular, the creation of multiple regulators in the UK and the transfer of the responsibility for regulation of consumer credit in the UK from the UK Office of Fair Trading to the FCA in April 2014 could lead to a lack of co ordination and the emergence of inconsistencies between the different regulatory bodies. Any such development may have a material adverse impact on Virgin Money's ability to manage its business efficiently and subject it to increased costs through managing an increasingly complex compliance burden.

In addition, it is possible that regulatory and/or legislative changes could prompt the development of new rules to, among other things, increase competition in the markets, or analogous or competing markets, in which Virgin Money operates. This could result in a material adverse impact or increased operational and compliance costs to the industry and therefore on Virgin Money. It is impossible to predict the effect that any of the proposed changes will have on Virgin Money's business, financial condition, results of operations and/or prospects or how any of the proposals discussed above will be implemented in light of the fundamental changes to the regulatory environment proposed by the UK Government and the European Commission. Depending on the specific nature of the requirements and how they are enforced, such changes could have a significant impact on Virgin Money's operations, structure, costs and/or capital requirements. Accordingly, Virgin Money cannot ensure that the implementation of any of the foregoing matters or any other regulatory or legislative changes that may be proposed will not have a material adverse effect on its business, financial condition, results of operations and/or prospects.

***Virgin Money is required to pay levies under the Financial Services Compensation Scheme and is exposed to future increases of such levies, which might impact its profits***

The regulatory response in the UK to the financial crisis of 2008 includes the imposition of levies by the Financial Services Compensation Scheme ("**FSCS**"). The FSCS pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. The amount provided for in Virgin Money's accounts to meet its obligations to the FSCS was £6.6 million as at 31 December 2015 (compared to £8.7 million at 31 December 2014). While it is anticipated that the substantial majority of claims will be repaid wholly from recoveries from the institutions concerned, there is the risk of a shortfall, such that the FSCS may place additional levies on all FSCS participants. Any such levies may be significant amounts that may, as a result, have a material effect on Virgin Money's profits. In common with other financial institutions which are subject to the FSCS, Virgin Money also has a potential exposure to future levies resulting from the failure of other financial institutions and claims which arise against the FSCS as a result of such failure. Historically, compensation scheme levies similar to the FSCS have tended to increase over time (especially during and in the aftermath of periods of economic crisis), and there can also be no assurance that there will not be any further claims against the FSCS and subsequent increased FSCS levies payable by Virgin Money. Any such increases in Virgin Money's costs and liabilities related to the levy may have a material adverse effect on its results of operations.

In April 2014, the recast EU directive on deposit guarantee schemes ("**DGSD2**") was adopted and was published in the Official Journal of the European Union on 12 June 2014. Member States had until 3 July 2015 to transpose the majority of the DGSD2 provisions into national law. DGSD2 introduced financing requirements on banks to contribute to their national deposit guarantee scheme at least annually. In addition, by 3 July 2024 Member States are required to ensure that the available financial means of a deposit guarantee scheme have reached a target pre-funded level of at least 0.8 per cent. of the amount of covered deposits that are held by the deposit guarantee scheme's member. This is a change from the previous operation of the UK financing scheme where fees were required after a payment to depositors had occurred. In cases where this pre-funded level is insufficient to cover payments to depositors, the deposit guarantee scheme can collect immediate post event contributions from the banking sector and, as a last resort, it can have access to alternative funding arrangements such as loans from third parties. In the UK, DGSD2 was transposed into law and regulation by HM Treasury and the PRA. The PRA's rules implementing DGSD2 are set out in the Depositor Protection Part of the PRA Rulebook ("**DPRs**"). The majority of the rules in the DPRs (including in relation to the funding of the deposit guarantee scheme) began to apply from 3 July 2015. In addition to a compensation costs levy, the DPRs permit management expenses levies and legacy costs levies to be imposed on deposit guarantee scheme members. It is therefore possible, as a result of DGSD2 and the DPRs, that future FSCS levies on the Bank may differ from those at present, and such reforms could result in Virgin Money incurring additional costs and liabilities, which may have a material adverse effect on its profitability.

***Regulatory action in the event a bank or investment firm in the Virgin Money Group is failing or is likely to fail could materially adversely affect the value of the Notes***

The BRRD provides an EU-wide framework for the recovery and resolution of credit institutions and investment firms, their subsidiaries and certain holding companies. The BRRD (including the bail-in tool), together with the majority of associated FCA and PRA rules, was implemented in the UK in January 2015. The final PRA rules on contractual recognition of bail-in for liabilities came into force on 1 January 2016. The majority of the requirements of the BRRD (including the bail-in tool) were implemented by way of amendments to the Banking Act 2009, as amended (the "**Banking Act**"). For more information on the bail-in tool, see "*The relevant UK resolution authority may exercise the bail-in tool in respect of the relevant Issuer and the Notes, which may result in holders of the Notes losing some or all of their investment*" below.

*The Banking Act confers substantial powers on a number of UK authorities designed to enable them to take a range of actions in relation to UK banks or investment firms and certain of their affiliates in the event a bank or investment firm in the same group is considered to be failing or likely to fail. The exercise of any of these actions in relation to the relevant Issuer could materially adversely affect the value of any Notes.*

Under the Banking Act, substantial powers are granted to the Bank of England (or, in certain circumstances, HM Treasury), in consultation with the PRA, the FCA and HM Treasury, as appropriate as part of a special resolution regime (the "**SRR**"). These powers enable the relevant UK resolution authority to implement resolution measures with respect to a UK bank or investment firm and certain of its affiliates that meet the definition of a "banking group company" (currently including HoldCo) (each a "**relevant entity**") in circumstances in which the relevant UK resolution authority is satisfied that the resolution conditions are met. Such conditions include that a UK bank or investment firm or a UK banking group company is failing or are likely to fail to satisfy the FSMA's threshold conditions (within the meaning of section 55B FSMA).

The SRR consists of five stabilisation options: (a) private sector transfer of all or part of the business or shares of the relevant entity; (b) transfer of all or part of the business of the relevant entity to a "bridge bank" established by the Bank of England; (c) transfer to an asset management vehicle wholly or partly owned by HM Treasury or the Bank of England; (d) the bail-in tool (as described below); and (e) temporary public ownership (nationalisation).

The Banking Act also provides for two new insolvency and administration procedures for relevant entities. Certain ancillary powers include the power to modify contractual arrangements in certain circumstances (which could include a variation of the terms of the Notes), powers to suspend enforcement or termination rights that might be invoked as a result of the exercise of the resolution powers and powers for the relevant UK resolution authority to disapply or modify laws in the UK (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively.

A holder of the Notes should assume that, in a resolution situation, financial public support will only be available to a relevant entity as a last resort after the relevant UK resolution authorities have assessed and exploited, to the maximum extent practicable, the resolution tools, including the bail-in tool.

The exercise of any resolution power or any suggestion of any such exercise could materially adversely affect the value of any Notes and could lead to Noteholders losing some or all of the value of their investment in the Notes.

*The SRR is designed to be triggered prior to insolvency of the relevant Issuer, and holders of the Notes may not be able to anticipate the exercise of any resolution power by the relevant UK resolution authority*

The stabilisation options are intended to be used prior to the point at which any insolvency proceedings with respect to the relevant entity could have been initiated. The purpose of the stabilisation options is to address the situation where all or part of a business of a relevant entity has encountered, or is likely to encounter, financial difficulties, giving rise to wider public interest concerns.

Although the Banking Act provides specific conditions to the exercise of any resolution powers and, furthermore, European Banking Authority (the "**EBA**") guidelines published in May 2015 set out the objective elements for the resolution authorities to apply in determining whether an institution is failing or likely to fail, it is uncertain how the relevant UK resolution authority would assess such conditions in any particular pre-insolvency scenario affecting the relevant Issuer and/or other members of the Virgin Money Group and in deciding whether to exercise a resolution power. The relevant UK resolution authority is also not required to provide any advance notice to holders of the Notes of its decision to exercise any resolution power. Therefore, holders of the Notes may not be able to anticipate a potential exercise of any such powers nor the potential effect of any exercise of such powers on the relevant Issuer, the Virgin Money Group and the Notes.

*Noteholders may have only very limited rights to challenge the exercise of any resolution powers by the relevant UK resolution authority*

Noteholders may have only very limited rights to challenge and/or seek a suspension of any decision of the relevant UK resolution authority to exercise its resolution powers or to have that decision reviewed by a judicial or administrative process or otherwise.

*The relevant UK resolution authority may exercise the bail-in tool in respect of the relevant Issuer and the Notes, which may result in holders of the Notes losing some or all of their investment*

Where the relevant statutory conditions for use of the bail-in tool have been met, the relevant UK resolution authority would be expected to exercise these powers without the consent of the Noteholders. Any such exercise of the bail-in tool in respect of the relevant Issuer and the Notes may result in the cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the Notes and/or the conversion of the Notes into shares or other securities or other obligations of the relevant Issuer or another person, or any other modification or variation to the terms of the Notes.

The Banking Act specifies the order in which the bail-in tool should be applied, reflecting the hierarchy of capital instruments under CRD IV and otherwise respecting the hierarchy of claims in an ordinary insolvency. In addition, the bail-in tool contains an express safeguard (known as 'no creditor worse off') with the aim that shareholders and creditors do not receive a less favourable treatment than they would have received in ordinary insolvency proceedings of the relevant entity.

The exercise of the bail-in tool in respect of the relevant Issuer and the Notes or any suggestion of any such exercise could materially adversely affect the rights of the Noteholders, the price or value of their investment in the Notes and/or the ability of the relevant Issuer to satisfy its obligations under the Notes and could lead to Noteholders losing some or all of the value of their investment in such Notes.

*As insured deposits are excluded from the scope of the bail-in tool and other preferred deposits (and insured deposits) rank ahead of any Notes issued by the Bank, such Notes would be more likely to be bailed-in than certain other unsubordinated liabilities of the Bank (such as other preferred deposits)*

As part of the reforms required by the BRRD, amendments have been made to relevant legislation in the UK (including the Insolvency Act 1986) to establish a preferential ranking on insolvency for certain deposits that are eligible for protection by the UK deposit guarantee scheme and the uninsured element of such deposits and, in certain circumstances, deposits made in non-EEA branches of EEA credit institutions). In addition, the UK implementation of the EU Deposit Guarantee Scheme Directive increased, from July 2015, the nature and quantum of insured deposits to cover a wide range of deposits, including corporate deposits (unless the depositor is a public sector body or financial institution) and some temporary high value deposits. The effect of these changes is to increase the size of the class of preferred creditors. All such preferred deposits will rank in the insolvency hierarchy ahead of all other unsecured senior creditors of the Bank, including the holders of the Notes. Furthermore, insured deposits are excluded from the scope of the bail-in tool. As a result, if the bail-in tool were exercised by the relevant UK resolution authority, the Notes would be more likely to be bailed-in than certain other unsubordinated liabilities of the Bank such as other preferred deposits.

*Mandatory write-down and conversion of capital instruments may affect the Tier 2 Capital Notes*

In addition, the Banking Act requires the relevant UK resolution authority to permanently write-down, or convert into equity, tier 1 capital instruments and tier 2 capital instruments (such as the Tier 2 Capital Notes) at the point of non-viability of the relevant entity and before, or together with, the exercise of any stabilisation option (except where the bail-in tool is to be utilised for other liabilities, in which case such instruments would be written down or converted into equity pursuant to the exercise of the bail-in tool, as described above, rather than the mandatory write-down and conversion power applicable only to capital instruments).

Holders of Tier 2 Capital Notes may be subject to write-down or conversion into equity on application of such powers (without requiring such Noteholders' consent), which may result in such Noteholders losing some or all of their investment. Moreover, in this regard, tier 2 capital instruments (such as the Tier 2

Capital Notes), are third in rank in the sequence of securities subject to write down or conversion, after common equity tier 1 and additional tier 1 instruments. As such, this may increase any risk of the Noteholders' holdings becoming subject to write down or conversion action. The 'no creditor worse off' safeguard would not apply in relation to an application of such powers in circumstances where resolution powers are not also exercised.

The exercise of such mandatory write-down and conversion power under the Banking Act or any suggestion of such exercise could, therefore, materially adversely affect the rights of Holders of Tier 2 Capital Notes, the price or value of their investment in the Tier 2 Capital Notes and/or the ability of the relevant Issuer to satisfy its obligations under the Notes.

*Minimum requirement for own funds and eligible liabilities*

To support the effectiveness of bail-in and other resolution tools, the BRRD requires that all institutions must meet an individual minimum requirement for own funds and eligible liabilities ("**MREL**") requirement, calculated as a percentage of total liabilities and own funds and set by the relevant resolution authorities. Items eligible for inclusion in MREL will include an institution's own funds, along with "eligible liabilities". In December 2015, the Bank of England published a consultation paper entitled "*The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) - Consultation on a proposed Statement of Policy*". The consultation paper sets out the Bank of England's proposed policy for exercising its power to direct institutions to maintain a minimum requirement for MREL under section 3A(4) of the Banking Act. Although the provisions of the BRRD transposed into UK law relating to MREL took effect from the 1 January 2016, the Bank of England has confirmed that it intends to make use of the transition period allowed by the BRRD and the draft EBA regulatory technical standards on the criteria for determining MREL and proposes in most cases to require institutions to comply with MREL requirements from 1 January 2020 (or 2019 for globally systemically important banks ("**G-SIBs**")). Until such time, an institution's MREL requirement will be set equal to the applicable minimum capital requirement. The Bank of England will indicate to institutions during the course of 2016 what their prospective MREL requirement for 2020 (or 2019 for G-SIBS) might be.

Although the EBA has published the final draft regulatory technical standards on the criteria for determining MREL under the BRRD and the Bank of England has published its relevant consultation paper and proposed statement of policy, the precise impact of the MREL requirements on individual firms in the UK will remain a matter of some uncertainty until the final measures are fully adopted and specific requirements imposed on institutions. In addition, while the EBA has stated that it expects such regulatory technical standards to be broadly compatible with the proposals published in November 2014 by the Financial Stability Board (the "**FSB**") for a new international standard on total loss absorbing capacity ("**TLAC**") for G-SIBs (albeit the Bank not being a G-SIB based on the latest FSB list published in November 2015) and the Bank of England has confirmed it intends to set MREL for UK G-SIBs as necessary to implement the TLAC standard and will set similar requirements for all institutions where the preferred resolution strategy is bail-in, the exact way in which the authorities will implement the MREL regime and the final form of MREL requirement is still subject to some uncertainty.

Until these measures are finally applied to the Issuers and the Virgin Money Group, it is not possible to determine the ultimate scope and nature of any resulting obligations for the Issuers or the Virgin Money Group, nor the impact that they will have on the Issuers or the Virgin Money Group once implemented. If the FSB's and EBA's proposals are implemented in their current form however, it is possible that, the Issuers and/or other members of the Virgin Money Group may have to issue MREL eligible liabilities in order to meet the new requirements within the required timeframes and/or alter the quantity and type of internal capital and funding arrangements within the Virgin Money Group. During periods of market dislocation, or when there is significant competition for the type of funding that the Virgin Money Group needs, a requirement to increase the Virgin Money Group's MREL eligible liabilities in order to meet MREL targets may prove more difficult and/or costly. More generally, these proposals could increase the Virgin Money Group's costs and may lead to asset sales and/or other balance sheet reductions. The effects of these proposals could all adversely impact the results of operations, financial condition and prospects of the Virgin Money Group and, in turn, adversely affect the value of the Notes.

***Virgin Money is subject to regulatory capital requirements that are subject to change and may result in additional capital requirements for Virgin Money***

Virgin Money is subject to capital adequacy requirements adopted by the PRA. Virgin Money's ability to do business could be constrained if it fails to maintain sufficient levels of capital. Further, if Virgin Money fails to meet its minimum regulatory capital requirements, this could result in administrative actions or sanctions against it. Effective management of Virgin Money's capital is critical to its ability to operate and grow its business and to pursue its strategy. Any change that limits Virgin Money's ability to manage its balance sheet and capital resources effectively (including, for example, reductions in profits and retained earnings as a result of credit losses, write downs or otherwise, increases in risk weighted assets, delays in the disposal of certain assets or the inability to raise finance through wholesale markets as a result of market conditions or otherwise) could have a material adverse effect on its business, financial condition, results of operations and/or prospects.

Virgin Money faces risks associated with an uncertain and rapidly evolving prudential regulatory environment, pursuant to which it is required, among other things, to maintain adequate capital resources and to satisfy specified capital ratios at all times. Virgin Money's borrowing costs and capital requirements could be affected by these prudential regulatory developments, which include the legislative package, CRD IV, implementing the proposals of the Basel Committee (known as "**Basel III**") in the EU and repealing the existing capital requirements directives and other regulatory developments impacting capital, leverage, liquidity positions (including the imposition of the Liquidity Coverage Ratio and the Net Stable Funding Ratio) and its legal entity structure (including with regard to issuance and deployment of capital and funding for the Virgin Money Group). Any future unfavourable regulatory developments could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

A market perception or actual shortage of capital issued by Virgin Money could result in regulatory and/or governmental interventions, including requiring Virgin Money to issue additional capital instruments or issuing a public censure or the imposition of sanctions.

***Derivative regulation***

The ongoing reforms of derivatives markets are likely to increase the Issuers' costs in respect of its OTC derivative transactions. The requirements under the European Market Infrastructure Regulation ("**EMIR**") (EU Regulation No. 648/2012 on OTC derivatives, central counterparties and trade repositories) in respect of the mandatory clearing of certain types of derivatives transactions and margin requirements for uncleared derivatives transactions are scheduled to come into force during 2016. Further market reforms will be introduced by MiFID2/MiFIR (Directive 2014/65/EU and EU Regulation No. 600/2014 on markets and financial instruments). The full impact of these changes is not yet known but the Issuers' costs in respect of its derivatives transactions are likely to increase.

***Virgin Money is exposed to many forms of legal and regulatory risk***

Virgin Money is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. In particular:

- the high level of scrutiny of the treatment of customers by financial institutions from regulatory bodies, the press and politicians may continue; the FCA in particular continues to focus on retail conduct risk issues, as well as conduct of business activities through its supervision activity;

- certain aspects of its business may be determined by the PRA, the FCA, the CMA, HM Treasury, the Financial Ombudsman Service or the courts as not being conducted in accordance with applicable laws or regulations, or, in the case of the Financial Ombudsman Service, with what is fair and reasonable in the Ombudsman's opinion;

- the FCA introduced new rules into its Handbook as a result of the Mortgage Market Review ("**MMR**"), which launched in 2009. The majority of these rules took effect on 26 April 2014 and include, among other things, a requirement for lenders to undertake a customer loan-affordability assessment in accordance with detailed requirements, transitional arrangements that (in limited circumstances) allow lenders to provide new mortgages or deal to customers with existing loans who may not meet the MMR requirements for the loan, a ban on self-certified loans and new requirements relating to interest-only loans;

- Virgin Money may breach or face allegations of having breached legal and regulatory requirements in respect of business originated by it or which it is has acquired, including Northern Rock plc. These requirements include, but are not limited to, conduct requirements, data protection, money laundering and anti terrorism financing requirements;

- as is common with many other UK credit card issuers, Virgin Money's credit card agreements may not in all circumstances comply in all respects with the Consumer Credit Act 1974 ("**CCA**") or other related or similar legislation (such as the Financial Services (Distance Marketing) Regulations 2004). In such circumstances, as a result, these agreements may only be enforceable at the discretion of the courts (and in relation to pre 6 April 2007 agreements may be entirely unenforceable) or in certain circumstances customers may have the right to cancel their agreement. In addition, it is possible, in certain circumstances that Virgin Money's mortgage contracts may also be subject to the requirements of the CCA and therefore wholly or partly regulated as credit agreements under the CCA. As a result, it is possible that these agreements may also be unenforceable for any period where Virgin Money has failed to comply with the requirements of the CCA;

- the transfer of consumer credit regulation from the Office of Fair Trading to the FCA may result in the FCA carrying out historical reviews of credit agreements (whether originated by Virgin Money or acquired by Virgin Money as part of loan portfolio acquisitions) which now fall under its jurisdiction. This could result in the FCA imposing sanctions in relation to existing agreements and imposing new requirements in respect of future agreements thereby adversely impacting the financial position and performance of Virgin Money's credit card business;

- any alleged mis-selling of financial products, including as a result of having sales practices and/or reward structures in place that are determined to have been inappropriate, may result in disciplinary action (including significant fines) or requirements to amend sales processes, withdraw products or provide restitution to affected customers, all or any of which could result in the incurrence of significant costs, may require provisions to be recorded in Virgin Money's financial statements and may materially adversely affect future revenues from affected products;

- contractual obligations may either not be enforceable as intended or may be enforced against Virgin Money in an adverse way;

- intellectual property may not be protected as intended or Virgin Money may use intellectual property which infringes, or is alleged to infringe, the rights of third parties; and

- Virgin Money may be liable for damages to third parties harmed by the manner in which it has conducted one or more aspects of its business.

Failure to manage these risks adequately, or a failure by Virgin Money to have identified any such risks in the assets it acquired as a result of its acquisition of Northern Rock plc or as a result of any other subsequent asset portfolio acquisitions (including the further mortgage portfolio acquired from NRAM on 20 July 2012 and the acquisition of the Virgin Money branded credit card portfolio held by MBNA), could lead to significant liabilities or reputational damage and have a material adverse effect on Virgin Money's relations with its customers. In addition, Virgin Money may be subject to other penalties and injunctive relief, civil or private litigation arising out of a regulatory investigation, the potential for criminal prosecution in certain circumstances and regulatory restrictions on Virgin Money's business. All of these issues could have a negative effect on Virgin Money's reputation and the confidence of its customers in Virgin Money, as well as taking a significant amount of management time and resources away from the implementation of Virgin Money's strategy.

Virgin Money also faces both financial and reputational risk where legal or regulatory proceedings are brought against it or members of its industry generally in the UK High Court or elsewhere, or where complaints are made against it or members of its industry generally to the Financial Ombudsman Service or another relevant body.

There is currently a significant regulatory focus on the fairness of contract terms, sales practices and reward structures that financial institutions have used when selling financial products. Financial institutions (including Virgin Money) may incur liability for past actions which are determined to have been inappropriate and any such liability incurred could be significant and have a material adverse effect on Virgin Money's reputation, business, financial condition, results of operations and/or prospects.

***Virgin Money is exposed to the risk of changes in tax legislation and its interpretation and to variances in the rate of corporate and other taxes***

Virgin Money's activities are principally conducted in the UK and it is therefore subject to a range of UK taxes at various rates. Future actions by the UK Government to adjust tax rates or to impose additional taxes would reduce Virgin Money's profitability. Revisions to tax legislation or to its interpretation might also affect Virgin Money's financial condition in the future. In addition, Virgin Money is subject to periodic tax audits which could result in additional tax assessments, which may be material, relating to past periods of up to six years being made. Any such assessments could be material which might also affect Virgin Money's financial condition in the future.

Virgin Money is presently not subject to the UK bank levy provided for by the Finance Act 2011 as many of its eligible liabilities are covered by the deposit protection scheme. Growth in eligible liabilities or developments in bank levy legislation may expose Virgin Money to the bank levy in the future.

***Virgin Money has significant shareholders whose interests may differ from those of investors in the Notes***

As at 31 December 2015, Virgin Group Holdings Limited (the "**Controlling Shareholder**") owns 34.96 per cent. of the voting rights of HoldCo. The interests of the Controlling Shareholder could conflict with those of Virgin Money and investors in the Notes. HoldCo is party to a relationship agreement with the Controlling Shareholder (the "**Relationship Agreement**"), to ensure that Virgin Money is capable at all times of carrying on its business independently of its Controlling Shareholder (as defined in the FCA's Listing Rules) and their associates. While it remains a significant shareholder of HoldCo, the Controlling Shareholder will, subject to the terms of the Relationship Agreement, have the power, among other things, to take actions which may favour the shareholders at the expense of the holders of debt securities including Noteholders.

As at the 31 December 2015, WLR IV VM LLC and WLR IV VM II LLC (together, the "**Major Shareholders**") own 3.5 and 8.5 per cent., respectively of the voting rights of Holdco. The interests of the Major Shareholders could conflict with those of Virgin Money and investors in the Notes. HoldCo is also party to a relationship agreement with the Major Shareholders but the independence provisions which apply to the Controlling Shareholder, as referenced above, no longer apply to the Major Shareholders as the Major Shareholders ceased to be a 'controlling shareholder' (for the purposes of the Listing Rules) on 20 April 2015. The Major Shareholders are entitled to certain information concerning HoldCo and the right to appoint a nominee director which, as at 31 December 2015, the Major Shareholder have chosen not to exercise.

***Virgin Money is licensed to use its name and brand but does not own them***

In order for Virgin Money to continue to use the "Virgin" and "Virgin Money" names and brands, Virgin Money is required to comply with certain obligations under the trademark licence agreement entered into between HoldCo and Virgin Enterprises Limited ("**VEL**") on 1 October 2014 ("**Virgin Money Trade Mark Licence Agreement**").

The Virgin Money Trade Mark Licence Agreement has a perpetual term. VEL has the right to terminate the Virgin Money Trade Mark Licence Agreement if Virgin Money challenges VEL's ownership of, entitlement to licence and/or the validity of certain of the licensed trademarks, upon HoldCo's insolvency, upon HoldCo's material, unremedied breach of the Virgin Money Trade Mark Licence Agreement or if HoldCo undergoes a change of control which is not permitted under the Virgin Money Trade Mark Licence Agreement. Loss of Virgin Money's rights to use the Virgin and Virgin Money names and brands under the Virgin Money Trade Mark Licence Agreement could have a material adverse effect on Virgin Money's business, financial condition, results of operations and/or prospects.

VEL may allow other VEL licensees to use the Virgin names and brands for financial products and services in certain defined circumstances. The use by any other VEL licensee of the Virgin name in relation to financial services and products represents a minor dilution of Virgin Money's exclusivity in the financial services field, and could (i) create customer confusion and (ii) create potential reputational damage if the VEL licensee providing the ancillary financial products or services does anything to damage the goodwill of the brand.

**Factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme**

***Certain Notes may be redeemed prior to maturity***

Unless in the case of any particular Tranche of Notes where the relevant Final Terms specify otherwise, in the event that the relevant Issuer would be obliged to increase the amounts payable in respect of any Notes due to any withholding or deduction for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision thereof or any authority therein or thereof having power to tax, the relevant Issuer may redeem all outstanding Notes in accordance with the Conditions (subject, in the case of Tier 2 Capital Notes, to the Supervisory Authority's prior consent and compliance with certain regulatory conditions). Furthermore, the relevant Issuer may be entitled to redeem Tier 2 Capital Notes if the tax treatment for such Issuer in respect of the Tier 2 Capital Notes is negatively altered after their issue date or if a change in certain UK regulatory capital requirements occurs on or after their issue date, in each case in the circumstances described in Condition 10(c) (*Redemption and Purchase – Redemption for tax reasons*) and 10(d) (*Redemption and Purchase -Regulatory Event Redemption of Tier 2 Capital Notes*) (as applicable) and subject to the Supervisory Authority's prior consent and compliance with certain regulatory conditions.

In addition, if in the case of any particular Tranche of Notes the relevant Final Terms specify that the Notes are redeemable at the relevant Issuer's option in certain other circumstances or at any time (subject, in the case of Tier 2 Capital Notes, to the Supervisory Authority's prior consent and compliance with certain regulatory conditions), the relevant Issuer may be expected to choose to redeem the Notes at times when prevailing interest rates may be relatively low. In such circumstances an investor may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as that of the relevant Notes being redeemed and may only be able to do so at a significantly lower rate.

An optional redemption feature is likely to limit the market value of the Notes. During any period when the relevant Issuer may elect to redeem the Notes, the market value of the Notes generally will not rise substantially above the price at which they can be redeemed.

***No limitation on issuing senior or pari passu securities***

There is no restriction on the amount of securities which an Issuer may issue, nor on the amount of any other obligations it may assume, which rank senior to, or *pari passu* with any Tier 2 Capital Notes of an Issuer. The issue of any such securities and/or the assumption of any such other obligations may reduce the amount recoverable by holders of Tier 2 Capital Notes on a winding-up or administration of the relevant Issuer.

***Tier 2 Capital Notes are subordinated to most of the relevant Issuer's liabilities***

Tier 2 Capital Notes will constitute unsecured and subordinated obligations of the relevant Issuer. On a winding-up or administration of the relevant Issuer, all claims in respect of the Notes will rank junior to the claims of all Senior Creditors (as defined in the Conditions) of the relevant Issuer. If, on a winding-up or administration of the relevant Issuer, the assets of the relevant Issuer are insufficient to enable the relevant Issuer to repay the claims of more senior-ranking creditors in full, the holders of the Tier 2 Capital Notes will lose their entire investment in the Tier 2 Capital Notes. If there are sufficient assets to enable the relevant Issuer to pay the claims of senior-ranking creditors in full but insufficient assets to enable it to pay claims in respect of its obligations in respect of the Tier 2 Capital Notes and all other claims that rank *pari passu* with the Tier 2 Capital Notes, holders of the Tier 2 Capital Notes will lose some (which may be substantially all) of their investment in the Tier 2 Capital Notes.

Although Tier 2 Capital Notes may pay a higher rate of interest than Notes which are not subordinated, there is a substantial risk that investors in the Tier 2 Capital Notes will lose all or some of the value of their investment should the relevant Issuer become insolvent.

***Holders of Tier 2 Capital Notes will have limited remedies***

Payment of principal and accrued but unpaid interest on the Tier 2 Capital Notes may only be accelerated in the event of the occurrence of a Winding-up Event (as defined in the Conditions) in respect of the relevant Issuer. There is no right of acceleration in the case of non-payment of principal or interest on the Tier 2 Capital Notes or of the relevant Issuer's failure to perform any of its obligations under or in respect of the Tier 2 Capital Notes.

The sole remedy against the relevant Issuer available for recovery of amounts owing in respect of any non-payment of any amount that has become due and payable under the Tier 2 Capital Notes is, subject to certain conditions and to the provisions set forth in Condition 14 (*Events of Default*), for the Trustee to institute proceedings in England (or such other jurisdiction in which the relevant Issuer may be organised, but not elsewhere) for the winding-up of such Issuer and/or prove in the winding-up of such Issuer and/or claim in such Issuer's liquidation or administration.

Although the Trustee may institute such proceedings against the relevant Issuer as it may think fit to enforce a Performance Obligation (as defined in the Conditions), the Trustee (acting on behalf of the Noteholders but not the Trustee acting in its personal capacity under the Trust Deed) and the Noteholders shall not enforce, and shall not be entitled to enforce or otherwise claim, against the relevant Issuer any judgment or other award given in such proceedings that requires the payment of money by the relevant Issuer, whether by way of damages or otherwise (a "**Monetary Judgment**"), except by proving such Monetary Judgment in a winding-up of the relevant Issuer and/or claiming such Monetary Judgment in an administration of the relevant Issuer.

***HoldCo is a holding company***

The Notes issued by HoldCo are the obligation of HoldCo only. HoldCo is a holding company and conducts substantially all of its operations through its subsidiaries, and accordingly the claims of the Noteholders under the Notes issued by HoldCo will be structurally subordinated to the claims of creditors of HoldCo's subsidiaries. HoldCo's rights to participate in the assets of any subsidiary if such subsidiary is liquidated will be subject to the prior claims of such subsidiary's creditors and any preference shareholders, except in the limited circumstance where HoldCo is a creditor of such subsidiary with claims that are recognised to be ranked ahead of or *pari passu* with such claims. HoldCo's subsidiaries are separate and distinct legal entities, and have no obligation to pay any amounts due or to provide HoldCo with funds to meet any of HoldCo's payment obligations under the Notes.

As well as the risk of losses in the event of a subsidiary’s insolvency, HoldCo may suffer losses if any of its loans to, and investments in, a subsidiary (including the Bank) are subject to statutory write down and conversion powers or if the subsidiary is otherwise subject to bank resolution proceedings. HoldCo may make loans to or investments in the Bank with the proceeds of the Notes issued by it. Such loans or investments are expected to have a legal ranking in the insolvency of the Bank that corresponds to the legal ranking of the Notes issued by HoldCo in the insolvency of HoldCo. However, HoldCo retains its absolute discretion to restructure such loans or investments at any time and for any purpose including, without limitation, in order to provide different amounts or types of capital or funding to the Bank or other HoldCo subsidiaries, or otherwise as part of meeting regulatory requirements, such as the implementation of MREL in respect of the Bank or other HoldCo subsidiaries. A restructuring of such loans or investments could include changes to any or all of their features, including their legal or regulatory form and how they would rank in the insolvency hierarchy as a claim in the liquidation or administration of the Bank. Any restructuring of such loans or investments may be implemented by HoldCo without prior notification to, or consent of, the holders of Notes issued by HoldCo. Such loans or investments may be subject to the statutory write down and conversion powers or the bail-in tool – see "*Regulatory action in the event a bank or investment firm in the Virgin Money Group is failing or is likely to fail could materially adversely affect the value of the Notes*". Any changes in the legal or regulatory form and/or ranking of the loans or investments could also impact their treatment in resolution.

If one of HoldCo's subsidiaries were to be wound up, liquidated or dissolved, (i) the holders of Notes issued by HoldCo would have no right to proceed against the assets of such subsidiary, and (ii) HoldCo would only recover any amounts (directly, or indirectly through its holdings of other subsidiaries) in the winding-up, liquidation or dissolution of that subsidiary in respect of its direct or indirect holding of ordinary shares in such subsidiary, if and to the extent that any surplus assets remain following payment in full of the claims of the creditors (which may include the Bank) and preference shareholders (if any and which may include the Bank) of that subsidiary. Similarly, if the Bank or any other of HoldCo's subsidiaries were subject to resolution proceedings (i) the holders of the Notes issued by HoldCo would have no direct recourse against the Bank or such other subsidiary, and (ii) holders of the Notes themselves may also be exposed to losses pursuant to the exercise by the relevant resolution authority of the stabilisation powers.

***Fixed/Floating Rate Notes***

Fixed/Floating Rate Notes may bear interest at a rate that the relevant Issuer may elect to convert from a fixed rate to a floating rate, or from a floating rate to a fixed rate. The relevant Issuer's ability to convert the interest rate will affect the secondary market and the market value of such Notes since the relevant Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the relevant Issuer converts from a fixed rate to a floating rate, the spread on the Fixed/Floating Rate Notes may be less favourable than the prevailing spreads on comparable Floating Rate Notes tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Notes. If the relevant Issuer converts from a floating rate to a fixed rate, the fixed rate may be lower than then prevailing rates on its Notes.

***The interest rate on Reset Notes will reset on each Reset Date, which can be expected to affect the interest payment on an investment in Reset Notes and could affect the market value of Reset Notes***

Reset Notes will initially bear interest at the Initial Rate of Interest until (but excluding) the First Reset Date. On the First Reset Date and each Subsequent Reset Date (if any) thereafter, the interest rate will be reset to the sum of the applicable Mid-Swap Rate or Benchmark Gilt Rate and the First Margin or Subsequent Margin (as applicable) as determined by the Calculation Agent on the relevant Reset Determination Date (each such interest rate, a "**Subsequent Reset Rate of Interest**"). The Subsequent Reset Rate of Interest for any Reset Period could be less than the Initial Rate of Interest or the Subsequent Reset Rate of Interest for prior Reset Periods and could affect the market value of an investment in the Reset Notes.

***Notes where denominations involve integral multiples***

In relation to any issue of Notes which have a denomination consisting of the minimum Specified Denomination plus a higher integral multiple of another smaller amount, it is possible that the Notes may be traded in amounts in excess of that minimum Specified Denomination that are not integral multiples of that minimum Specified Denomination. In such a case a Noteholder who, as a result of trading such amounts, holds a principal amount of less than the minimum Specified Denomination may not receive a definitive Note in respect of such holding (should definitive Notes be printed) and would need to purchase a principal amount of Notes such that its holding amounts to a Specified Denomination.

If Definitive Notes are issued, holders should be aware that Definitive Notes which have a denomination that is not an integral multiple of the minimum Specified Denomination may be illiquid and difficult to trade.

The market values of securities issued at a substantial discount (such as Zero Coupon Notes) or premium to their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for more conventional interest-bearing securities. Generally, the longer the remaining term of such securities, the greater the price volatility as compared to more conventional interest-bearing securities with comparable maturities.

***Modification, waivers and substitution***

The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

The Conditions also provide that the Trustee may, subject to and in accordance with the Trust Deed without the consent of the Noteholders, agree to (i) any modification of, or waiver or authorisation of any breach or proposed breach of, any of the Conditions (other than in respect of a Reserved Matter (as defined in the Trust Deed)) which, in each case, in the opinion of the Trustee is not materially prejudicial to the interest of the Noteholders and, in the case of a modification, in the opinion of the Trustee is of a formal, minor or technical nature or to correct a manifest error; or (ii) determine without the consent of the Noteholders that any Event of Default or Potential Event of Default (as defined in the Trust Deed) shall not be treated as such if, in the opinion of the Trustee, the interests of the relevant Noteholders would not be materially prejudiced thereby; or (iii) the substitution of any wholly-owned Subsidiary of the relevant Issuer as principal debtor under any Notes in place of the relevant Issuer, in the circumstances described in Condition 18(c) (*Meetings of Noteholders; Modification and Waiver; Substitution*); provided that, in each case, the provisions relating to the Tier 2 Capital Notes shall only be capable of modification or waiver and the relevant Issuer of Tier 2 Capital Notes may only be substituted in accordance with Condition 18(c) (*Substitution*), if the relevant Issuer has notified the Supervisory Authority of such modification, waiver or substitution and/or obtained Regulatory Approval (if such notice and/or consent is then required by the Capital Regulations).

***Investors to rely on the procedures of Euroclear, Clearstream, Luxembourg and/or DTC for transfer, payment and communication with the Issuers***

Notes issued under the Programme may be represented by one or more Global Notes or Global Note Certificates which may be deposited with a common depositary for Euroclear and Clearstream Luxembourg or with DTC (each of Euroclear, Clearstream, Luxembourg and DTC, a "**Clearing System**"). If the Global Notes are NGN or if the Unrestricted Global Note Certificates are to be held under the NSS, they will be deposited with a common safekeeper for Euroclear and Clearstream, Luxembourg and, in the case of Restricted Global Note Certificates will be deposited with a custodian for and registered in the name of a nominee of DTC. Except in the circumstances described in the relevant Global Note or Global Note Certificate, investors will not be entitled to receive definitive Notes. The relevant Clearing System will maintain records of the beneficial interests in the Global Notes or, as the case may be, Global Note Certificates. While the Notes are represented by one or more Global Notes, or as the case may be, Global Note Certificates, investors will be able to trade their beneficial interests only through the relevant Clearing System or, in the case of Restricted Global Note Certificates, DTC.

While the Notes are represented by one or more Global Notes or, as the case may be, Global Note Certificates, the relevant Issuer will discharge its payment obligations under the Notes by making payments to the common depositary or, for Global Notes that are NGN and Global Note Certificates to be held under the NSS, the common safekeeper for Euroclear and Clearstream, Luxembourg or, as appropriate, the custodian for DTC, for distribution to their account holders. A holder of a beneficial interest in a Global Note or Unrestricted Global Note Certificate must rely on the procedures of the relevant Clearing System or, in the case of Restricted Global Note Certificates, DTC, to receive payments under the relevant Notes. The Issuers have no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Notes or Global Note Certificates.

Holders of beneficial interests in the Global Notes or Global Note Certificates will not have a direct right to vote in respect of the relevant Notes. Instead, such holders will be permitted to act only to the extent that they are enabled by the relevant Clearing System or by DTC to appoint appropriate proxies.

The fact that the Notes will not be in physical form may make it difficult for Noteholders to pledge the Notes as security if Notes in physical form are required or necessary for such purposes.

***Change of law***

The Conditions are based on English law in effect as at the date of issue of the relevant Notes. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of issue of the relevant Notes and any such change could materially adversely impact the value of any Notes affected by it.

***Payments on certain Notes may be subject to U.S. withholding tax under FATCA***

The United States has enacted rules, commonly referred to as "FATCA", that generally impose a new reporting and withholding regime with respect to certain payments made to or by, and accounts maintained with, non-U.S. entities that are classified as financial institutions under FATCA (such as the Issuers). Withholding under FATCA will not be applied to non-U.S. source payments by non-U.S. financial institutions prior to 1 January 2019. The United States has entered into an intergovernmental agreement regarding the implementation of FATCA with the United Kingdom (the "**IGA**"). Under the IGA, as currently drafted, the Issuer does not expect payments made on or with respect to the Notes to be subject to withholding under FATCA. However, significant aspects of when and how FATCA will apply remain unclear, and no assurance can be given that withholding under FATCA will not become relevant with respect to payments made on or with respect to the Notes in the future. Prospective investors should consult their own tax advisors regarding the potential impact of FATCA.

***Absence of secondary market***

No assurance is provided that there is an active and liquid secondary market for the Notes, and no assurance is provided that a secondary market for the Notes will develop or, if it does develop, that it will provide Noteholders with liquidity of investment for the life of the Notes. Any investor in the Notes must be prepared to hold their Notes for an indefinite period of time or until their Maturity Date or alternatively such investor may only be able to sell the Notes at a discount to the original purchase price of those Notes. Although application has been made for Notes issued under the Programme to be admitted to trading on the PSM, if so specified in the relevant Final Terms, the relevant Issuer cannot guarantee that the Notes will be accepted for listing or admitted to trading or that an active trading market will develop.

***Exchange rate risks and exchange controls***

The relevant Issuer will pay principal and interest on the Notes in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

***The value of Fixed Rate Notes may be adversely affected by movements in market interest rates***

Investment in Fixed Rate Notes involves the risk that if market interest rates subsequently increase above the rate paid on the Fixed Rate Notes, this will adversely affect the value of the Fixed Rate Notes.

***The credit ratings may not be reliable, and changes to the credit ratings could affect the value of the Notes***

A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. One or more independent credit rating agencies may assign credit ratings to the relevant Issuer or the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. Any downgrade in the rating of a relevant Issuer by a rating agency may have a negative impact on the ratings of the Notes.

***UK's potential exit from the European Union***

A referendum on the UK's membership of the EU will be held on 23 June 2016. The outcome of such a referendum is not known and raises the possibility of a prolonged, potentially disruptive exit from the EU which may increase market volatility and affect investment confidence. There is also considerable uncertainty as to the impact of an exit vote on the fiscal, monetary and regulatory environment to which Virgin Money is subject. No assurance can be given that Virgin Money's operating results, financial condition and prospects would not be adversely impacted as a result of the vote.

***Financial Transactions Tax***

On 14 February 2013, the European Commission issued proposals, including a draft Directive (the "**Commission's proposal**") for a financial transaction tax ("**FTT**") to be adopted in certain participating

EU member states (including Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia). However, Estonia has since stated that it will not participate. If the Commission's proposal was adopted, the FTT would be a tax primarily on "financial institutions" (which would include the Issuers) in relation to "financial transactions" (which would include the conclusion or modification of derivative contracts and the purchase and sale of financial instruments).

Under the Commission's proposal, the FTT would apply to persons both within and outside of the participating member states. Generally, it would apply to certain dealings in Notes where at least one party is a financial institution, and at least one party is established in a participating member state. A financial institution may be, or be deemed to be, "established" in a participating member state in a broad range of circumstances, including (i) by transacting with a person established in a participating member state or (ii) where the financial instrument which is subject to the financial transaction is issued in a participating member state.

The FTT may give rise to tax liabilities for the Issuers with respect to certain transactions if it is adopted based on the Commission's Proposal. Examples of such transactions are the conclusion of a derivative contract in the context of the Issuers' hedging arrangements or the purchase or sale of Notes. Any such tax liabilities may reduce amounts available to the Issuer to meet its obligations under the Notes, which may result in Noteholders receiving less than expected in respect of the Notes. It should also be noted that the FTT could be payable in relation to relevant transactions by investors in respect of the Notes (including secondary market transactions) if conditions for a charge to arise are satisfied and the FTT is adopted based on the Commission's Proposal. Primary market transactions referred to in Article 5(c) of Regulation EC No 1287/2006 are expected to be exempt. There is however some uncertainty in relation to the intended scope of this exemption for certain money market instruments and structured issues.

However, the FTT proposal remains subject to negotiation between the participating member states. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU member states may decide to participate.

Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT.

***Market Disruption***

In certain situations, interest is determined by reference to market information sources. Such market information sources might become unavailable for various reasons, including suspensions or limitations on trading, events which affect or impair the ability of market participants in general, or early closure of market institutions. These could be caused by, amongst other things, physical threats to the publishers of the market information sources, market institutions or market participants in general, or unusual trading, or matters such as currency changes.

In respect of a Floating Rate Note (where the Rate of Interest is to be determined by reference to a screen rate, such as LIBOR and/or EURIBOR), if LIBOR and/or EURIBOR (each as defined in the Conditions) (the "**Reference Rate**") does not appear on the relevant screen page or if the relevant screen page is not available for any reason, the Calculation Agent (as defined in the Conditions) will request each of the Reference Banks (as defined in the Conditions), appointed by the Issuer, to provide the Calculation Agent with its offered quotation to leading banks for the Reference Rate for the purposes of determining the applicable Rate of Interest. However, there can be no assurance that the Issuer will be able to appoint one or more Reference Banks to provide offered quotations and no Reference Banks have been appointed at the date of this Offering Circular. If fewer than two such quotations are provided, the Calculation Agent will determine the arithmetic mean of the rates quoted by major banks in the principal financial centre of the specified currency of the Notes, selected by the Calculation Agent, for loans in the specified currency to leading European banks for a period equal to the relevant Interest Period and in an amount that is representative for a single transaction in that market at that time.

If a Reference Rate is not available and the Issuer is unable to appoint one or more Reference Banks or source quotations from the major banks (as described above), the applicable Rate of Interest for the relevant Interest Period will be the Rate of Interest in effect for the last preceding Interest Period, in accordance with the Conditions, and Noteholders may be adversely affected.

## INFORMATION INCORPORATED BY REFERENCE

The following information shall be deemed to be incorporated in, and to form part of, this Offering Circular:

(a) the audited consolidated financial statements (including the auditors' report thereon and notes thereto) of HoldCo in respect of the years ended 31 December 2015 and 31 December 2014 (set out on pages 209 to 282 and 213 to 301, respectively, of the 2015 Annual Report and Accounts of the Virgin Money Group and the 2014 Annual Report and Accounts of the Virgin Money Group (together, the "**HoldCo Financial Statements**");

(b) the risk management report set out on pages 139 to 208 of the 2015 Annual Report and Accounts of the Virgin Money Group (the "**Risk Management Report**"); and

(c) the terms and conditions set out on pages 47-78 of the offering circular relating to the Programme dated 27 March 2015 (the "**2015 Conditions**").

Copies of the documents specified above as containing information incorporated by reference in this Offering Circular (i) may be inspected, free of charge during normal business hours on weekdays at the registered office of the Issuers at Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL, United Kingdom and at the specified office of the Principal Paying Agent at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, United Kingdom. Any information contained in any of the documents specified above which is not incorporated by reference in this Offering Circular is either not relevant to investors or is covered elsewhere in this Offering Circular.

## FINAL TERMS AND DRAWDOWN OFFERING CIRCULARS

In this section the expression "necessary information" means, in relation to any Tranche of Notes, the information necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of each Issuer and of the rights attaching to the Notes. In relation to the different types of Notes which may be issued under the Programme, the Issuers have included in this Offering Circular all of the necessary information except for information relating to the Notes which is not known at the date of this Offering Circular and which can only be determined at the time of an individual issue of a Tranche of Notes.

Any information relating to the Notes which is not included in this Offering Circular and which is required in order to complete the necessary information in relation to a Tranche of Notes will be contained either in the relevant Final Terms or in a Drawdown Offering Circular.

For a Tranche of Notes which is the subject of Final Terms, those Final Terms will, for the purposes of that Tranche only, complete this Offering Circular and must be read in conjunction with this Offering Circular. The terms and conditions applicable to any particular Tranche of Notes which is the subject of Final Terms are the Conditions described in this Offering Circular as completed to the extent described in the relevant Final Terms.

The terms and conditions applicable to any particular Tranche of Notes which is the subject of a Drawdown Offering Circular will be the Conditions as supplemented, amended and/or replaced to the extent described in the relevant Drawdown Offering Circular.

In the case of a Tranche of Notes which is the subject of a Drawdown Offering Circular, each reference in this Offering Circular to information being specified or identified in the relevant Final Terms shall be read and construed as a reference to such information being specified or identified in the relevant Drawdown Offering Circular, unless the context requires otherwise.

# FORMS OF THE NOTES

## Bearer Notes

Each Tranche of Notes in bearer form ("**Bearer Notes**") will initially be in the form of either a temporary global note in bearer form (the "**Temporary Global Note**"), without interest coupons, or a permanent global note in bearer form (the "**Permanent Global Note**"), without interest coupons, in each case as specified in the relevant Final Terms. Each Temporary Global Note or, as the case may be, Permanent Global Note (each a "**Global Note**") which is not intended to be issued in new global note form, as specified in the relevant Final Terms, will be deposited on or around the issue date of the relevant Tranche of the Notes with a depositary or a common depositary for Euroclear Bank SA/NV as operator of the Euroclear System ("**Euroclear**") and/or Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**") and/or any other relevant clearing system. Each Global Note which is intended to be issued in new global note form ("**NGN**"), as specified in the relevant Final Terms, will be deposited on or around the issue date of the relevant Tranche of the Notes with a common safekeeper for Euroclear and/or Clearstream, Luxembourg.

On 13 June 2006 the European Central Bank (the "**ECB**") announced that Notes in NGN form are in compliance with the "Standards for the use of EU securities settlement systems in ESCB credit operations" of the central banking system for the euro (the "**Eurosystem**"), **provided that** certain other criteria are fulfilled. At the same time the ECB also announced that arrangements for Notes in NGN form will be offered by Euroclear and Clearstream, Luxembourg as of 30 June 2006 and that debt securities in global bearer form issued through Euroclear and Clearstream, Luxembourg after 31 December 2006 will only be eligible as collateral for Eurosystem operations if the NGN form is used.

In the case of each Tranche of Bearer Notes, the relevant Final Terms will also specify whether United States Treasury Regulation §1.163-5(c)(2)(i)(C) (or any successor rules in substantially the same form) (the "**TEFRA C Rules**") or United States Treasury Regulation §1.163-5(c)(2)(i)(D) (or any successor rules in substantially the same form) (the "**TEFRA D Rules**") are applicable in relation to the Notes or, if the Notes do not have a maturity of more than 365 days, that neither the TEFRA C Rules nor the TEFRA D Rules are applicable.

### *Temporary Global Note exchangeable for Permanent Global Note*

If the relevant Final Terms specifies the form of Notes as being "Temporary Global Note exchangeable for a Permanent Global Note", then the Notes will initially be in the form of a Temporary Global Note which will be exchangeable, in whole or in part, for interests in a Permanent Global Note, without interest coupons, not earlier than 40 days after the issue date of the relevant Tranche of the Notes upon certification as to non-U.S. beneficial ownership. No payments will be made under the Temporary Global Note unless exchange for interests in the Permanent Global Note is improperly withheld or refused. In addition, interest payments in respect of the Notes cannot be collected without such certification of non-U.S. beneficial ownership.

Whenever any interest in the Temporary Global Note is to be exchanged for an interest in a Permanent Global Note, the relevant Issuer shall procure (in the case of first exchange) the delivery of a Permanent Global Note, duly authenticated and, in the case of a NGN, effectuated, to the bearer of the Temporary Global Note or (in the case of any subsequent exchange) an increase in the principal amount of the Permanent Global Note in accordance with its terms against:

(a) presentation and (in the case of final exchange) presentation and surrender of the Temporary Global Note to or to the order of the Principal Paying Agent; and

(b) receipt by the Principal Paying Agent of a certificate or certificates of non-U.S. beneficial ownership,

(c) within 7 days of the bearer requesting such exchange. The Permanent Global Note will then be exchangeable for definitive Notes ("**Definitive Notes**") in the manner set out in "Permanent *Global Note exchangeable for Definitive Notes*" below.

***Temporary Global Note exchangeable for Definitive Notes***

If the relevant Final Terms specifies the form of Notes as being "Temporary Global Note exchangeable for Definitive Notes" and also specifies that the TEFRA C Rules are applicable or that neither the TEFRA C Rules nor the TEFRA D Rules are applicable, then the Notes will initially be in the form of a Temporary Global Note which will be exchangeable, in whole but not in part, for Definitive Notes not earlier than 40 days after the issue date of the relevant Tranche of the Notes.

If the relevant Final Terms specifies the form of Notes as being "Temporary Global Note exchangeable for Definitive Notes" and also specifies that the TEFRA D Rules are applicable, then the Notes will initially be in the form of a Temporary Global Note which will be exchangeable, in whole or in part, for Definitive Notes not earlier than 40 days after the issue date of the relevant Tranche of the Notes upon certification as to non-U.S. beneficial ownership. Interest payments in respect of the Notes cannot be collected without such certification of non-U.S. beneficial ownership.

Whenever the Temporary Global Note is to be exchanged for Definitive Notes, the relevant Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Notes, duly authenticated and with Coupons and Talons attached (if so specified in the relevant Final Terms), in an aggregate principal amount equal to the principal amount of the Temporary Global Note to the bearer of the Temporary Global Note against the surrender of the Temporary Global Note to or to the order of the Principal Paying Agent within 30 days of the bearer requesting such exchange.

In relation to any issue of Notes which have a denomination consisting of the minimum Specified Denomination plus a higher integral multiple of another smaller amount, the Temporary Global Note shall only be exchangeable for Definitive Notes in the limited circumstances specified in the Permanent Global Note.

***Permanent Global Note exchangeable for Definitive Notes***

If the relevant Final Terms specifies the form of Notes as being "Permanent Global Note exchangeable for Definitive Notes", then the Notes will initially be in the form of a Permanent Global Note which will be exchangeable in whole, but not in part, for Definitive Notes:

(a) on the expiry of such period of notice as may be specified in the relevant Final Terms; or

(b) at any time, if so specified in the relevant Final Terms; or

(c) if the relevant Final Terms specifies "in the limited circumstances described in the Permanent Global Note", then if either of the following events occurs:

  (i) Euroclear or Clearstream, Luxembourg or any other relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or

  (ii) any of the circumstances described in Condition 14 (*Events of Default*) occurs.

Whenever the Permanent Global Note is to be exchanged for Definitive Notes, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Notes, duly authenticated and with Coupons and Talons attached (if so specified in the relevant Final Terms), in an aggregate principal amount equal to the principal amount of Notes represented by the Permanent Global Note to the bearer of the Permanent Global Note against the surrender of the Permanent Global Note to or to the order of the Principal Paying Agent within 30 days of the bearer requesting such exchange.

In relation to any issue of Notes which have a denomination consisting of the minimum Specified Denomination plus a higher integral multiple of another smaller amount, the Permanent Global Note shall only be exchangeable for Definitive Notes in the limited circumstances specified in the Permanent Global Note.

***Terms and Conditions applicable to the Notes***

The terms and conditions applicable to any Definitive Note will be endorsed on that Note and will consist of the terms and conditions set out under "*Terms and Conditions of the Notes*" below, and the provisions of the relevant Final Terms which complete those terms and conditions or the provisions of the relevant Drawdown Offering Circular which supplement, amend and/or replace those terms and conditions.

The terms and conditions applicable to any Note in global form will differ from those terms and conditions which would apply to the Note were it in definitive form to the extent described under "*Summary of Provisions Relating to the Notes while in Global Form*" below.

***Legend concerning United States persons***

In the case of any Tranche of Bearer Notes having a maturity of more than 365 days, the Notes in global form, the Notes in definitive form and any Coupons and Talons appertaining thereto will bear a legend to the following effect:

"*Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code.*"

**Registered Notes**

Each Tranche of Notes in registered form ("**Registered Notes**") will be represented by either:

(a) individual note certificates in registered form ("**Individual Note Certificates**"); or

(b) one or more unrestricted global note certificates ("**Unrestricted Global Note Certificate(s)**") in the case of Registered Notes sold outside the United States to non-U.S. persons in reliance on Regulation S ("**Unrestricted Registered Notes**") and/or one or more restricted global note certificates ("**Restricted Global Note Certificate(s)**") in the case of Registered Notes sold to QIBs in reliance on Rule 144A ("**Restricted Registered Notes**"),

in each case as specified in the relevant Final Terms, and references in this Offering Circular to "**Global Note Certificates**" shall be construed as a reference to Unrestricted Global Note Certificates and/or Restricted Global Note Certificates.

In a press release dated 22 October 2008, "*Evolution of the custody arrangement for international debt securities and their eligibility in Eurosystem credit operations*", the ECB announced that it has assessed the new holding structure and custody arrangements for registered notes which the ICSDs had designed in cooperation with market participants and that Notes to be held under the new structure (the "**New Safekeeping Structure**" or "**NSS**") would be in compliance with the "*Standards for the use of EU securities settlement systems in ESCB credit operations*" of the Eurosystem, subject to the conclusion of the necessary legal and contractual arrangements. The press release also stated that the new arrangements for Notes to be held in NSS form will be offered by Euroclear and Clearstream, Luxembourg as of 30 June 2010 and that registered debt securities in global registered form issued through Euroclear and Clearstream, Luxembourg after 30 September 2010 will only be eligible as collateral in Eurosystem operations if the New Safekeeping Structure is used.

Each Note represented by an Unrestricted Global Note Certificate will either be: (a) in the case of an Unrestricted Global Note Certificate which is not to be held under the New Safekeeping Structure, registered in the name of a common depositary (or its nominee) for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system and the relevant Unrestricted Global Note Certificate will be deposited on or about the issue date with the common depositary; or (b) in the case of an Unrestricted Global Note Certificate to be held under the New Safekeeping Structure, be registered in the name of a common safekeeper (or its nominee) for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system and the relevant Unrestricted Global Note Certificate will be deposited on or about the issue date with the common safekeeper for Euroclear and/or Clearstream, Luxembourg.

Each Note represented by a Restricted Global Note Certificate will be registered in the name of Cede & Co. as nominee for The Depository Trust Company ("**DTC**") and the relevant Restricted Global Note Certificate will be deposited on or about the issue date with the custodian for DTC (the "**DTC Custodian**"). Beneficial interests in Notes represented by a Restricted Global Note Certificate may only be held through DTC at any time.

If the relevant Final Terms specifies the form of Notes as being "Individual Note Certificates", then the Notes will at all times be represented by Individual Note Certificates issued to each Noteholder in respect of their respective holdings.

***Global Note Certificate exchangeable for Individual Note Certificates***

If the relevant Final Terms specifies the form of Notes as being "Global Note Certificate exchangeable for Individual Note Certificates", then the Notes will initially be represented by one or more Global Note Certificates each of which will be exchangeable in whole, but not in part, for Individual Note Certificates:

(a) on the expiry of such period of notice as may be specified in the relevant Final Terms; or

(b) at any time, if so specified in the relevant Final Terms; or

(c) if the relevant Final Terms specifies "in the limited circumstances described in the Global Note Certificate", then:

    (i) in the case of any Restricted Global Note Certificate held by or on behalf of DTC, if DTC notifies the relevant Issuer that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Global Note Certificate or DTC ceases to be a "clearing agency" registered under the Exchange Act or if at any time DTC is no longer eligible to act as such, and the relevant Issuer is unable to locate a qualified successor within 90 days of receiving notice or becoming aware of such ineligibility on the part of DTC;

    (ii) in the case of any Unrestricted Global Note Certificate, if Euroclear, Clearstream, Luxembourg or any other relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business; and

    (iii) in any case, if any of the circumstances described in Condition 14 (Events of Default) occurs.

Whenever a Global Note Certificate is to be exchanged for Individual Note Certificates, each person having an interest in a Global Note Certificate must provide the Registrar (through the relevant clearing system) with such information as the relevant Issuer and the Registrar may require to complete and deliver Individual Note Certificates (including the name and address of each person in which the Notes represented by the Individual Note Certificates are to be registered and the principal amount of each such person's holding). In addition, whenever a Restricted Global Note Certificate is to be exchanged for Individual Note Certificates, each person having an interest in the Restricted Global Note Certificate must provide the Registrar (through the relevant clearing system) with a certificate given by or on behalf of the holder of each beneficial interest in the Restricted Global Note Certificate stating either (i) that such holder is not transferring its interest at the time of such exchange or (ii) that the transfer or exchange of such interest has been made in compliance with the transfer restrictions applicable to the Notes and that the person transferring such interest reasonably believes that the person acquiring such interest is a QIB and is obtaining such beneficial interest in a transaction meeting the requirements of Rule 144A. Individual Note Certificates issued in exchange for interests in the Restricted Global Note Certificate will bear the legends and be subject to the transfer restrictions set out under "*Transfer Restrictions*".

Whenever a Global Note Certificate is to be exchanged for Individual Note Certificates, the relevant Issuer shall procure that Individual Note Certificates will be issued in an aggregate principal amount equal to the principal amount of the Global Note Certificate within five business days of the delivery, by or on behalf of the registered holder of the Global Note Certificate to the Registrar of such information as is required to complete and deliver such Individual Note Certificates against the surrender of the Global Note Certificate at the specified office of the Registrar.

In relation to any issue of Notes which have a denomination consisting of the minimum Specified Denomination plus a higher integral multiple of another smaller amount, the Global Note Certificate shall only be exchangeable for Individual Note Certificates in the limited circumstances specified in the Global Note Certificate.

Such exchange will be effected in accordance with the provisions of the Trust Deed and the Agency Agreement and the regulations concerning the transfer and registration of Notes scheduled to the Agency Agreement and, in particular, shall be effected without charge to any holder, but against such indemnity as the Registrar may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such exchange.

***Terms and Conditions applicable to the Notes***

The terms and conditions applicable to any Individual Note Certificate will be endorsed on that Individual Note Certificate and will consist of the terms and conditions set out under "*Terms and Conditions of the Notes*" below, and the provisions of the relevant Final Terms which complete those terms and conditions or the provisions of the relevant Drawdown Offering Circular which supplement, amend and/or replace those terms and conditions.

The terms and conditions applicable to any Global Note Certificate will differ from those terms and conditions which would apply to the Note were it in definitive form to the extent described under "*Summary of Provisions Relating to the Notes while in Global Form*" below.

**Summary of Provisions relating to the Notes while in Global Form**

***Clearing System Accountholders***

In relation to any Tranche of Notes represented by a Global Note, references in the Terms and Conditions of the Notes to "Noteholder" are references to the bearer of the relevant Global Note which, for so long as the Global Note is held by a depositary or a common depositary, in the case of a CGN, or a common safekeeper, in the case of an NGN for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system, will be that depositary or common depositary or, as the case may be, common safekeeper.

In relation to any Tranche of Notes represented by one or more Global Note Certificates, references in the Terms and Conditions of the Notes to "Noteholder" are references to the person in whose name the relevant Global Note Certificate is for the time being registered in the Register which (a) in the case of a Restricted Global Note Certificate held by or on behalf of DTC, will be Cede & Co. as nominee for DTC; and (b) in the case of any Unrestricted Global Note Certificate which is held by or on behalf of a depositary or a common depositary or a common safekeeper for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system, will be that depositary or common depositary or common safekeeper or a nominee for that depositary or common depositary or common safekeeper.

Each of the persons shown in the records of DTC, Euroclear, Clearstream, Luxembourg and/or any other relevant clearing system as being entitled to an interest in a Global Note or a Global Note Certificate (each an "**Accountholder**") must look solely to DTC, Euroclear, Clearstream, Luxembourg and/or such other relevant clearing system (as the case may be) for such Accountholder's share of each payment made by the relevant Issuer to the holder of such Global Note or Global Note Certificate and in relation to all other rights arising under such Global Note or Global Note Certificate. The extent to which, and the manner in which, Accountholders may exercise any rights arising under a Global Note or Global Note Certificate will be determined by the respective rules and procedures of DTC, Euroclear and Clearstream, Luxembourg and any other relevant clearing system from time to time. For so long as the relevant Notes are represented by a Global Note or Global Note Certificate, Accountholders shall have no claim directly against the relevant Issuer in respect of payments due under the Notes and such obligations of the relevant Issuer will be discharged by payment to the holder of such Global Note or Global Note Certificate.

***Transfers of Interests in Global Notes and Global Note Certificates***

Transfers of interests in Global Notes and Global Note Certificates within DTC, Euroclear and Clearstream, Luxembourg or any other relevant clearing system will be in accordance with their respective rules and operating procedures. None of the Issuers, the Trustee, the Registrar, the Dealers or the Agents will have any responsibility or liability for any aspect of the records of DTC, Euroclear and Clearstream, Luxembourg or any other relevant clearing system or any of their respective participants relating to payments made on account of beneficial ownership interests in a Global Note or Global Note Certificate or for maintaining, supervising or reviewing any of the records of DTC, Euroclear and

Clearstream, Luxembourg or any other relevant clearing system or the records of their respective participants relating to such beneficial ownership interests.

The laws of some states of the United States require that certain persons receive individual certificates in respect of their holdings of Notes. Consequently, the ability to transfer interests in a Global Note Certificate to such persons will be limited. Because clearing systems only act on behalf of participants, who in turn act on behalf of indirect participants, the ability of a person having an interest in a Global Note Certificate to pledge such interest to persons or entities which do not participate in the relevant clearing systems, or otherwise take actions in respect of such interest, may be affected by the lack of an Individual Note Certificate representing such interest.

Subject to compliance with the transfer restrictions applicable to the Registered Notes described under "*Transfer Restrictions*", transfers between DTC participants, on the one hand, and Euroclear or Clearstream, Luxembourg accountholders, on the other, will be effected by the relevant clearing systems in accordance with their respective rules and through action taken by the DTC Custodian, the Registrar and the Principal Paying Agent.

On or after the issue date for any Series, transfers of Notes of such Series between accountholders in Euroclear and/or Clearstream, Luxembourg and transfers of Notes of such Series between participants in DTC will generally have a settlement date three business days after the trade date (T+3). The customary arrangements for delivery versus payment will apply to such transfers.

Transfers between DTC participants, on the one hand, and Euroclear or Clearstream, Luxembourg accountholders, on the other, will need to have an agreed settlement date between the parties to such transfer. Because there is no direct link between DTC, on the one hand, and Euroclear and Clearstream, Luxembourg, on the other, transfers of interests in the relevant Global Note Certificates will be effected through the Principal Paying Agent, the DTC Custodian, the relevant Registrar and any applicable Transfer Agent receiving instructions (and where appropriate certification) from the transferor and arranging for delivery of the interests being transferred to the credit of the designated account for the transferee. Transfers will be effected on the later of (i) three business days after the trade date for the disposal of the interest in the relevant Global Note Certificate resulting in such transfer and (ii) two business days after receipt by the Principal Paying Agent or the Registrar, as the case may be, of the necessary certification or information to effect such transfer. In the case of cross-market transfers, settlement between Euroclear or Clearstream, Luxembourg accountholders and DTC participants cannot be made on a delivery versus payment basis. The securities will be delivered on a free delivery basis and arrangements for payment must be made separately. The customary arrangements for delivery versus payment between Euroclear and Clearstream, Luxembourg accountholders or between DTC participants are not affected.

For a further description of restrictions on the transfer of Notes, see "*Subscription and Sale*" and "*Transfer Restrictions*".

Upon the issue of a Restricted Global Note Certificate to be held by or on behalf of DTC, DTC or the DTC Custodian will credit the respective nominal amounts of the individual beneficial interests represented by such Restricted Global Note Certificate to the account of DTC participants. Ownership of beneficial interests in such Restricted Global Note Certificate will be held through participants of DTC, including the respective depositaries of Euroclear and Clearstream, Luxembourg. Ownership of beneficial interests in such Global Note Certificate will be shown on, and the transfer of such ownership will be effected only through, records maintained by DTC or its nominee. DTC has advised the Issuers that it will take any action permitted to be taken by a holder of Registered Notes represented by a Restricted Global Note Certificate held by or on behalf of DTC (including, without limitation, the presentation of such Restricted Global Note Certificates for exchange as described above) only at the direction of one or more participants in whose account with DTC interests in such Restricted Global Note Certificate are credited, and only in respect of such portion of the aggregate nominal amount of such Restricted Global Note Certificate as to which such participant or participants has or have given such direction. However, in certain circumstances, DTC will exchange the relevant Restricted Global Note Certificate for Individual Note Certificates (which will bear the relevant legends set out in "*Transfer Restrictions*").

Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the foregoing procedures in order to facilitate transfers of interests in the Global Note Certificates among participants and accountholders of DTC, Euroclear and Clearstream, Luxembourg, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuers, the Trustee, the Registrar, the Dealers or the Agents will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their respective operations.

While a Global Note Certificate is lodged with DTC, Euroclear, Clearstream, Luxembourg or any relevant clearing system, Individual Note Certificates for the relevant Series of Notes will not be eligible for clearing and settlement through such clearing systems.

***Conditions applicable to Global Notes and Global Note Certificates***

Each Global Note and Global Note Certificate will contain provisions which modify the Terms and Conditions of the Notes as they apply to the Global Note or Global Note Certificate. The following is a summary of certain of those provisions:

*Payments:* All payments in respect of the Global Note or Global Note Certificate which, according to the Terms and Conditions of the Notes, require presentation and/or surrender of a Note, Note Certificate or Coupon will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Global Note or Global Note Certificate to or to the order of any Paying Agent and will be effective to satisfy and discharge the corresponding liabilities of the relevant Issuer in respect of the Notes. On each occasion on which a payment of principal or interest is made in respect of the Global Note, the relevant Issuer shall procure that in respect of a CGN the payment is noted in a schedule thereto and in respect of an NGN the payment is entered pro rata in the records of Euroclear and Clearstream, Luxembourg.

*Payment Business Day*: in the case of a Global Note or a Global Note Certificate, shall be: if the currency of payment is euro, any day which is a TARGET Settlement Day and a day on which dealings in foreign currencies may be carried on in each (if any) Additional Financial Centre; or, if the currency of payment is not euro, any day which is a day on which dealings in foreign currencies may be carried on in the Principal Financial Centre of the currency of payment and in each (if any) Additional Financial Centre.

*Payment Record Date:* Each payment in respect of a Global Note Certificate will be made to the person shown as the Holder in the Register at the close of business (in the relevant clearing system) on the Clearing System Business Day before the due date for such payment (the "**Record Date**") where "**Clearing System Business Day**" means a day on which each clearing system for which the Global Note Certificate is being held is open for business.

*Exercise of put option:* In order to exercise the option contained in Condition 10(e) (*Redemption and Purchase – Redemption at the option of Noteholders*), the bearer of a Permanent Global Note or the holder of a Global Note Certificate must, within the period specified in the Conditions for the deposit of the relevant Note and put notice, give written notice of such exercise to the Principal Paying Agent specifying the principal amount of Notes in respect of which such option is being exercised. Any such notice will be irrevocable and may not be withdrawn.

*Partial exercise of call option:* In connection with an exercise of the option contained in Condition 10(b) (*Redemption and Purchase – Redemption at the option of the Issuer*) in relation to some only of the Notes, the Permanent Global Note or Global Note Certificate may be redeemed in part in the principal amount specified by the relevant Issuer in accordance with the Conditions and the Notes to be redeemed will not be selected as provided in the Conditions but in accordance with the rules and procedures of DTC, Euroclear and/or Clearstream, Luxembourg (to be reflected in the records of DTC, Euroclear and/or Clearstream, Luxembourg as either a pool factor or a reduction in principal amount, at their discretion).

*Notices:* Notwithstanding Condition 20 (*Notices*), while all the Notes are represented by a Permanent Global Note (or by a Permanent Global Note and/or a Temporary Global Note) or a Global Note Certificate and the Permanent Global Note is (or the Permanent Global Note and/or the Temporary Global Note are), or the Global Note Certificate is, registered in the name of DTC's nominee or deposited with a depositary or a common depositary for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system or a common safekeeper, notices to Noteholders may be given by delivery of the relevant notice to DTC and/or Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system and, in any case, such notices shall be deemed to have been given to the Noteholders in accordance with Condition 20 (*Notices*) on the date of delivery to DTC and/or Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system.

## TERMS AND CONDITIONS OF THE NOTES

*The following is the text of the terms and conditions which, as completed by the relevant Final Terms or as supplemented, amended and/or replaced by the relevant Drawdown Offering Circular, will be endorsed on each Note in definitive form issued under the Programme. The terms and conditions applicable to any Note in global form will differ from those terms and conditions which would apply to the Note were it in definitive form to the extent described under "Forms of the Notes - Summary of Provisions Relating to the Notes while in Global Form" above.*

1. **Introduction**

(a) *Programme*: Virgin Money Holdings (UK) plc ("**HoldCo**") and Virgin Money plc (the "**Bank**" and, together with HoldCo, the "**Issuers**", and each an "**Issuer**") have established a Global Medium Term Note Programme (the "**Programme**") for the issuance of up to £3,000,000,000 in aggregate principal amount of notes (the "**Notes**"). In these conditions, references to the "**Issuer**" are to HoldCo or the Bank, as the case may be, as the Issuer of the Notes under the Programme and references to the "**relevant Issuer**" shall be construed accordingly.

(b) *Final Terms or Drawdown Offering Circular*: Notes issued under the Programme are issued in series (each a "**Series**") and each Series may comprise one or more tranches (each a "**Tranche**") of Notes. Each Tranche is the subject of either (i) a final terms (the "**Final Terms**") which completes these terms and conditions (the "**Conditions**") or (ii) a separate drawdown offering circular (the "**Drawdown Offering Circular**") which supplements, amends and/or replaces the Conditions. The terms and conditions applicable to any particular Tranche of Notes are these Conditions as completed by the relevant Final Terms or as supplemented, amended and/or replaced by the relevant Drawdown Offering Circular. In the event of any inconsistency between these Conditions and the relevant Final Terms or Drawdown Offering Circular, the relevant Final Terms or Drawdown Offering Circular (as applicable) shall prevail. In the case of a Tranche of Notes which is the subject of a Drawdown Offering Circular, each reference in these Conditions to information being specified or identified in the relevant Final Terms shall be read and construed as a reference to such information being specified or identified in the relevant Drawdown Offering Circular.

(c) *Trust Deed:* The Notes are constituted by, are subject to, and have the benefit of, a trust deed dated 14 April 2016 (as amended or supplemented from time to time, the "**Trust Deed**") between the Issuers and Citicorp Trustee Company Limited as trustee (the "**Trustee**", which expression includes all persons for the time being trustee or trustees appointed under the Trust Deed).

(d) *Agency Agreement*: The Notes are the subject of an issue and paying agency agreement dated 27 March 2015 (the "**Agency Agreement**") between the Issuers, Citibank, N.A., London Branch as principal paying agent (the "**Principal Paying Agent**", which expression includes any successor principal paying agent appointed from time to time in connection with the Notes), Citibank, N.A., London Branch as registrar (the "**Registrar**", which expression includes any successor registrar appointed from time to time in connection with the Notes), the paying agents named therein (together with the Principal Paying Agent, the "**Paying Agents**", which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes), the transfer agents named therein (together with the Registrar, the "**Transfer Agents**", which expression includes any successor or additional transfer agents appointed from time to time in connection with the Notes), the other agents named therein and the Trustee. In these Conditions references to the "**Agents**" are to the Paying Agents and the Transfer Agents and any reference to an "**Agent**" is to any one of them.

(e) *The Notes*: The Notes may be issued in bearer form ("**Bearer Notes**"), or in registered form ("**Registered Notes**"). All subsequent references in these Conditions to "Notes" are to the Notes which are the subject of the relevant Final Terms or Drawdown Offering Circular (as the case may be). Copies of the relevant Final Terms or Drawdown Offering Circular are available for viewing at the registered office of the Issuers at Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL, United Kingdom.

(f) *Summaries*: Certain provisions of these Conditions are summaries of the Trust Deed and the Agency Agreement and are subject to their detailed provisions. Noteholders (as defined below) and the holders of the related interest coupons, if any, (the "**Couponholders**" and the "**Coupons**", respectively) are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them. Copies of the Trust Deed and the Agency Agreement are available for inspection by Noteholders during normal business hours at the Specified Offices of each of the Agents, the initial Specified Offices of which are set out below.

2. **Definitions and Interpretation**

(a) *Definitions*: In these **Conditions** the following expressions have the following meanings:

"**Accrual Yield**" has the meaning given in the relevant Final Terms;

"**Additional Business Centre(s)**" means the city or cities specified as such in the relevant Final Terms;

"**Additional Financial Centre(s)**" means the city or cities specified as such in the relevant Final Terms;

"**Bank Group**" means the Bank and its subsidiaries;

"**Benchmark Gilt**" means, in respect of a Reset Period, such United Kingdom government security having a maturity date on or about the last day of such Reset Period as the Calculation Agent, following consultation with the Issuer and with the advice of the Reference Banks, may determine to be appropriate;

"**Benchmark Gilt Rate**" means, in respect of a Reset Period and subject to Condition 6(e) (*Reset Note Provisions – Fallbacks – Benchmark Gilt Rate*), the gross redemption yield (as calculated by the Calculation Agent in accordance with generally accepted market practice at such time) on a semi-annual compounding basis (converted to an annualised yield and rounded up (if necessary) to four decimal places) of the Benchmark Gilt in respect of that Reset Period, with the price of the Benchmark Gilt for this purpose being the arithmetic average (rounded up (if necessary) to the nearest 0.001 per cent. (0.0005 per cent. being rounded upwards)) of the bid and offered prices of such Benchmark Gilt quoted by the Reference Banks at 3.00 p.m. (London time) on the relevant Reset Determination Date on a dealing basis for settlement on the next following dealing day in London. If at least four quotations are provided, the Benchmark Gilt Rate will be the rounded arithmetic mean of the quotations provided, eliminating the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest). If only two or three quotations are provided, the Benchmark Gilt Rate will be the rounded arithmetic mean of the quotations provided. If only one quotation is provided, the Benchmark Gilt Rate will be the rounded quotation provided;

"**Broken Amount**" means, in respect of any Notes, the amount (if any) that is specified in the relevant Final Terms;

"**Business Day**" means:

(a) in relation to any sum payable in euro, a TARGET Settlement Day and a day on which commercial banks and foreign exchange markets settle payments generally in each (if any) Additional Business Centre; and

(b) in relation to any sum payable in a currency other than euro, a day on which commercial banks and foreign exchange markets settle payments generally in London, in the Principal Financial Centre of the relevant currency and in each (if any) Additional Business Centre;

"**Business Day Convention**", in relation to any particular date, has the meaning given in the relevant Final Terms and, if so specified in the relevant Final Terms, may have different meanings in relation to different dates and, in this context, the following expressions shall have the following meanings:

(a) "**Following Business Day Convention**" means that the relevant date shall be postponed to the first following day that is a Business Day;

(b) "**Modified Following Business Day Convention**" or "**Modified Business Day Convention**" means that the relevant date shall be postponed to the first following day that is a Business Day unless that day falls in the next calendar month in which case that date will be the first preceding day that is a Business Day;

(c) "**Preceding Business Day Convention**" means that the relevant date shall be brought forward to the first preceding day that is a Business Day;

(d) "**FRN Convention**", "**Floating Rate Convention**" or "**Eurodollar Convention**" means that each relevant date shall be the date which numerically corresponds to the preceding such date in the calendar month which is the number of months specified in the relevant Final Terms as the Specified Period after the calendar month in which the preceding such date occurred **provided, however, that**:

(i) if there is no such numerically corresponding day in the calendar month in which any such date should occur, then such date will be the last day which is a Business Day in that calendar month;

(ii) if any such date would otherwise fall on a day which is not a Business Day, then such date will be the first following day which is a Business Day unless that day falls in the next calendar month, in which case it will be the first preceding day which is a Business Day; and

(iii) if the preceding such date occurred on the last day in a calendar month which was a Business Day, then all subsequent such dates will be the last day which is a Business Day in the calendar month which is the specified number of months after the calendar month in which the preceding such date occurred; and

(e) "**No Adjustment**" means that the relevant date shall not be adjusted in accordance with any Business Day Convention;

"**Calculation Agent**" means the Principal Paying Agent or such other Person specified in the relevant Final Terms as the party responsible for calculating the Rate(s) of Interest and Interest Amount(s) and/or such other amount(s) as may be specified in the relevant Final Terms;

"**Calculation Amount**" has the meaning given in the relevant Final Terms;

"**Capital Regulations**" means, at any time, the laws, regulations, requirements, standards, guidelines and policies relating to capital adequacy for credit institutions of either (i) the Supervisory Authority and/or (ii) any other national or European authority, in each case then in effect in the United Kingdom (or in such other jurisdiction in which the relevant Issuer may be organised or domiciled) and applicable to the relevant Issuer and/or (where the Issuer is HoldCo) the HoldCo Group and/or (where the Issuer is the Bank) the Bank Group, including, as at the date of this Offering Circular, CRD IV and related technical standards;

"**Coupon Sheet**" means, in respect of a Note, a coupon sheet relating to the Note;

"**CRD IV**" means the legislative package consisting of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms of the European Parliament and of the Council of 26 June 2013, as the same may be amended or replaced from time to time, and the CRD IV Regulation;

"**CRD IV Regulation**" means Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms of the European Parliament and of the Council of 26 June 2013, as the same may be amended or replaced from time to time;

"**Day Count Fraction**" means, in respect of the calculation of an amount for any period of time (the "**Calculation Period**"), such day count fraction as may be specified in these Conditions or the relevant Final Terms and:

(a) if "**Actual/Actual (ICMA)**" is so specified, means:

(i) where the Calculation Period is equal to or shorter than the Regular Period during which it falls, the actual number of days in the Calculation Period divided by the product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year; and

(ii) where the Calculation Period is longer than one Regular Period, the sum of:

(A) the actual number of days in such Calculation Period falling in the Regular Period in which it begins divided by the product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year; and

(B) the actual number of days in such Calculation Period falling in the next Regular Period divided by the product of (a) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year;

(b) if "**Actual/Actual (ISDA)**" is so specified, means the actual number of days in the Calculation Period divided by 365 (or, if any portion of the Calculation Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Calculation Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Calculation Period falling in a non-leap year divided by 365);

(c) if "**Actual/365 (Fixed)**" is so specified, means the actual number of days in the Calculation Period divided by 365;

(d) if "**Actual/360**" is so specified, means the actual number of days in the Calculation Period divided by 360;

(e) if "**30/360**" is so specified, means the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 x (Y_2 - Y_1)] + [30 x (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"$\mathbf{Y_1}$" is the year, expressed as a number, in which the first day of the Calculation Period falls;

"$\mathbf{Y_2}$" is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"$\mathbf{M_1}$" is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

"$\mathbf{M_2}$" is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"$\mathbf{D_1}$" is the first calendar day, expressed as a number, of the Calculation Period, unless such number would be 31, in which case $D_1$ will be 30; and

"$\mathbf{D_2}$" is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless such number would be 31 and $D_1$ is greater than 29, in which case $D_2$ will be 30";

(f) if "**30E/360**" or "**Eurobond Basis**" is so specified, means the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360x(Y_2 - Y_1)] + [30x(M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"$\mathbf{Y_1}$" is the year, expressed as a number, in which the first day of the Calculation Period falls;

"$\mathbf{Y_2}$" is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"$\mathbf{M_1}$" is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

"$\mathbf{M_2}$" is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"$\mathbf{D_1}$" is the first calendar day, expressed as a number, of the Calculation Period, unless such number would be 31, in which case $D_1$ will be 30; and

"$\mathbf{D_2}$" is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless such number would be 31, in which case $D_2$ will be 30; and

(g) if "**30E/360 (ISDA)**" is so specified, means the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360x(Y_2 - Y_1)] + [30x(M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"$\mathbf{Y_1}$" is the year, expressed as a number, in which the first day of the Calculation Period falls;

"$\mathbf{Y_2}$" is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"$\mathbf{M_1}$" is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

"$\mathbf{M_2}$" is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"$\mathbf{D_1}$" is the first calendar day, expressed as a number, of the Calculation Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case $D_1$ will be 30; and

"$\mathbf{D_2}$" is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case $D_2$ will be 30,

**provided, however, that** in each such case the number of days in the Calculation Period is calculated from and including the first day of the Calculation Period to but excluding the last day of the Calculation Period;

"**dealing day**" means a day, other than a Saturday or Sunday, on which the London Stock Exchange (or such other stock exchange on which the Benchmark Gilt is at the relevant time listed) is ordinarily open for the trading of securities;

"**Early Redemption Amount (Tax)**" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Final Terms;

"**Early Termination Amount**" means, in respect of any Note, its principal amount or such other amount as may be specified in these Conditions or the relevant Final Terms;

"**EURIBOR**" means, in respect of any specified currency and any specified period, the interest rate benchmark known as the Euro zone interbank offered rate which is calculated and published by a designated distributor (currently Thomson Reuters) in accordance with the requirements from time to time of the European Banking Federation (or any other person which takes over the administration of that rate) based on estimated interbank borrowing rates for a number of designated currencies and maturities which are provided, in respect of each such currency, by a panel of contributor banks (details of historic EURIBOR rates can be obtained from the designated distributor);

"**Extraordinary Resolution**" has the meaning given in the Trust Deed;

"**Final Redemption Amount**" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Final Terms;

"**First Interest Payment Date**" means the date specified in the relevant Final Terms;

"**First Margin**" means the margin specified as such in the relevant Final Terms;

"**First Reset Date**" means the date specified in the relevant Final Terms;

"**First Reset Period**" means the period from (and including) the First Reset Date until (but excluding) the first Subsequent Reset Date or, if a Subsequent Reset Date is not specified in the relevant Final Terms, the Maturity Date;

"**First Reset Rate of Interest**" means, in respect of the First Reset Period and subject to Conditions 6(d) (*Reset Note Provisions - Fallbacks – Mid-Swap Rate*) and 6(e) (*Reset Note Provisions – Fallback – Benchmark Gilt Rate*) (as applicable) the rate of interest determined by the Calculation Agent on the relevant Reset Determination Date as the sum of the relevant Reset Rate and the First Margin;

"**Fixed Coupon Amount**" has the meaning given in the relevant Final Terms;

"**Fixed Rate Note**" means a Note on which interest is calculated at a fixed rate payable in arrear on a fixed date or dates in each year and on redemption or on such other dates as may be agreed between the relevant Issuer and the relevant dealer(s) (as indicated in the relevant Final Terms);

"**Floating Rate Note**" means a Note on which interest is calculated at a floating rate payable at intervals of one, two, three, six or 12 months or at such other intervals as may be agreed between the relevant Issuer and the relevant dealer(s) (as indicated in the relevant Final Terms);

"**Foreign Exchange Agent**" has the meaning given in the Agency Agreement;

"**Group**" means (i) in respect of HoldCo, the HoldCo Group and (ii) in respect of the Bank, the Bank Group;

"**HoldCo Group**" means the HoldCo and each entity which is part of the UK prudential consolidation group (as that term, or its successor, is used in the Capital Regulations) of which the HoldCo is part from time to time;

"**Holder**", in the case of Bearer Notes, has the meaning given in Condition 3(b) (*Form, Denomination, Title and Transfer - Title to Bearer Notes*) and, in the case of Registered Notes, has the meaning given in Condition 3(d) (*Form, Denomination, Title and Transfer - Title to Registered Notes*);

"**Initial Rate of Interest**" has the meaning specified in the relevant Final Terms;

"**Interest Amount**" means, in relation to a Note and an Interest Period, the amount of interest payable in respect of that Note for that Interest Period;

"**Interest Commencement Date**" means the Issue Date of the Notes or such other date as may be specified as the Interest Commencement Date in the relevant Final Terms;

"**Interest Determination Date**" shall mean the date specified as such in the relevant Final Terms or, if none is so specified:

(a) if the Reference Rate is EURIBOR, the second TARGET Settlement Day prior to the start of each Interest Period; and

(b) if the Reference Rate is LIBOR, the second London Business Day prior to the start of each Interest Period;

"**Interest Payment Date**" means the First Interest Payment Date and any other date or dates specified as such in the relevant Final Terms and, if a Business Day Convention is specified in the relevant Final Terms:

(a) as the same may be adjusted in accordance with the relevant Business Day Convention; or

(b) if the Business Day Convention is the FRN Convention, Floating Rate Convention or Eurodollar Convention and an interval of a number of calendar months is specified in the relevant Final Terms as being the Specified Period, each of such dates as may occur in accordance with the FRN Convention, Floating Rate Convention or Eurodollar Convention at such Specified Period of calendar months following the Interest Commencement Date (in the case of the First Interest Payment Date) or the previous Interest Payment Date (in any other case);

"**Interest Period**" means each period beginning on (and including) the Interest Commencement Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date;

"**ISDA Definitions**" means the 2006 ISDA Definitions (as amended and updated as at the date of issue of the first Tranche of the Notes of the relevant Series (as specified in the relevant Final Terms) as published by the International Swaps and Derivatives Association, Inc.);

"**Issue Date**" has the meaning given in the relevant Final Terms;

"**LIBOR**" means, in respect of any specified currency and any specified period, the interest rate benchmark known as the London interbank offered rate which is calculated and published by a designated distributor (currently Thomson Reuters) in accordance with the requirements from time to time of ICE Benchmark Administration Limited (or any other person which takes over the administration of that rate) based on estimated interbank borrowing rates for a number of designated currencies and maturities which are provided, in respect of each such currency, by a panel of contributor banks (details of historic LIBOR rates can be obtained from the designated distributor);

"**Margin**" has the meaning given in the relevant Final Terms;

"**Maturity Date**" has the meaning given in the relevant Final Terms;

"**Maximum Redemption Amount**" has the meaning given in the relevant Final Terms;

"**Mid-Swap Maturity**" has the meaning given in the relevant Final Terms;

"**Mid-Market Swap Rate**" means for any Reset Period the mean of the bid and offered rates for the fixed leg payable with a frequency equivalent to the frequency with which scheduled interest payments are payable on the Notes during the relevant Reset Period (calculated on the day count basis customary for fixed rate payments in the Specified Currency, such day count basis as determined by the Calculation Agent) of a fixed-for-floating interest rate swap transaction in the Specified Currency which transaction (i) has a term equal to the relevant Reset Period and commencing on the relevant Reset Date, (ii) is in an amount that is representative for a single transaction in the relevant market at the relevant time with an acknowledged dealer of good credit in the swap market and (iii) has a floating leg based on the Mid-Swap Floating Leg Benchmark Rate for the Mid-Swap Maturity (as specified in the relevant Final Terms) (calculated on the day count basis customary for floating rate payments in the Specified Currency, such day count basis as determined by the Calculation Agent);

"**Mid-Market Swap Rate Quotation**" means a quotation (expressed as a percentage rate per annum) for the relevant Mid-Market Swap Rate;

"**Mid-Swap Floating Leg Benchmark Rate**" means EURIBOR if the Specified Currency is euro or LIBOR for the Specified Currency if the Specified Currency is not euro or the Reference Rate as specified in the relevant Final Terms;

"**Mid-Swap Rate**" means, in relation to a Reset Determination Date and subject to Condition 6(d) (*Reset Note Provisions - Fallbacks – Mid-Swap Rate*), either:

(a) if Single Mid-Swap Rate is specified in the relevant Final Terms, the rate for swaps in the Specified Currency:

(i) with a term equal to the relevant Reset Period; and

(ii) commencing on the relevant Reset Date,

which appears on the Relevant Screen Page; or

(b) if Mean Mid-Swap Rate is specified in the relevant Final Terms, the arithmetic mean (expressed as a percentage rate per annum and rounded, if necessary, to the nearest 0.001 per cent. (0.0005 per cent. being rounded upwards) of the bid and offered swap rate quotations for swaps in the Specified Currency:

(i) with a term equal to the relevant Reset Period; and

(ii) commencing on the relevant Reset Date,

which appear on the Relevant Screen Page,

in either case, as at approximately 11.00 a.m. in the Principal Financial Centre of the Specified Currency on such Reset Determination Date, all as determined by the Calculation Agent;

"**Minimum Redemption Amount**" has the meaning given in the relevant Final Terms;

"**Noteholder**", in the case of Bearer Notes, has the meaning given in Condition 3(b) (*Form, Denomination, Title and Transfer - Title to Bearer Notes*) and, in the case of Registered Notes, has the meaning given in Condition 3(d) (*Form, Denomination*, *Title and Transfer - Title to Registered Notes*);

"**Optional Redemption Amount (Call)**" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Final Terms;

"**Optional Redemption Amount (Put)**" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Final Terms;

"**Optional Redemption Amount (Regulatory Event)**" means, in respect of any Tier 2 Capital Note, its principal amount or such other amount as may be specified in the relevant Final Terms;

"**Optional Redemption Date (Call)**" has the meaning given in the relevant Final Terms;

"**Optional Redemption Date (Put)**" has the meaning given in the relevant Final Terms;

"**Payment Business Day**" means:

(a) if the currency of payment is euro, any day which is:

(i) a day on which banks in the relevant place of presentation are open for presentation and payment of bearer debt securities and for dealings in foreign currencies; and

(ii) in the case of payment by transfer to an account, a TARGET Settlement Day and a day on which dealings in foreign currencies may be carried on in each (if any) Additional Financial Centre; or

(b) if the currency of payment is not euro, any day which is:

(i) a day on which banks in the relevant place of presentation are open for presentation and payment of bearer debt securities and for dealings in foreign currencies; and

(ii) in the case of payment by transfer to an account, a day on which dealings in foreign currencies may be carried on in the Principal Financial Centre of the currency of payment and in each (if any) Additional Financial Centre;

"**Person**" means any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality;

"**Principal Financial Centre**" means, in relation to any currency, the principal financial centre for that currency **provided, however, that**:

(a) in relation to euro, it means the principal financial centre of such Member State of the European Union as is selected (in the case of a payment) by the payee or (in the case of a calculation) by the Calculation Agent; and

(b) in relation to New Zealand dollars, it means either Wellington or Auckland as is selected (in the case of a payment) by the payee or (in the case of a calculation) by the Calculation Agent;

"**Put Option Notice**" means a notice which must be delivered to a Paying Agent by any Noteholder wanting to exercise a right to redeem a Note at the option of the Noteholder;

"**Put Option Receipt**" means a receipt issued by a Paying Agent to a depositing Noteholder upon deposit of a Note with such Paying Agent by any Noteholder wanting to exercise a right to redeem a Note at the option of the Noteholder;

"**Rate of Interest**" means (i) in the case of Notes other than Reset Notes, the rate or rates (expressed as a percentage per annum) of interest payable in respect of the Notes specified in the relevant Final Terms or calculated or determined in accordance with the provisions of these Conditions and/or the relevant Final Terms, and (ii) in the case of Reset Notes, the Initial Rate of Interest, the First Reset Rate of Interest or the Subsequent Reset Rate of Interest, as applicable;

"**Redemption Amount**" means, as appropriate, the Final Redemption Amount, the Early Redemption Amount (Tax), the Optional Redemption Amount (Call), the Optional Redemption Amount (Put), the Optional Redemption Amount (Regulatory Event) or such other amount in the nature of a redemption amount as may be specified in the relevant Final Terms;

"**Reference Banks**" (i) in the case of Notes other than Reset Notes, has the meaning given in the relevant Final Terms or, if none, four major banks selected by the Calculation Agent in the market that is most closely connected with the Reference Rate; and (ii) in the case of Reset Notes, has the meaning given in the relevant Final Terms or, if none (a) in the case of the calculation of a Mid-Market Swap Rate, four major banks in the swap, money, securities or other market most closely connected with the relevant Mid-Swap Rate as selected by the relevant Issuer on the advice of an investment bank of international repute or (b) in the case of the calculation of a

Benchmark Gilt Rate, five brokers of gilts and/or gilt-edged market makers as selected by the relevant Issuer on the advice of an investment bank of international repute;

"**Reference Price**" has the meaning given in the relevant Final Terms;

"**Reference Rate**" means EURIBOR or LIBOR in each case for the relevant currency and for the relevant period as specified in the relevant Final Terms;

"**Regular Period**" means:

(a) in the case of Notes where interest is scheduled to be paid only by means of regular payments, each period from and including the Interest Commencement Date to but excluding the First Interest Payment Date and each successive period from and including one Interest Payment Date to but excluding the next Interest Payment Date;

(b) in the case of Notes where, apart from the first Interest Period, interest is scheduled to be paid only by means of regular payments, each period from and including a Regular Date falling in any year to but excluding the next Regular Date, where "**Regular Date**" means the day and month (but not the year) on which any Interest Payment Date falls; and

(c) in the case of Notes where, apart from one Interest Period other than the first Interest Period, interest is scheduled to be paid only by means of regular payments, each period from and including a Regular Date falling in any year to but excluding the next Regular Date, where "**Regular Date**" means the day and month (but not the year) on which any Interest Payment Date falls other than the Interest Payment Date falling at the end of the irregular Interest Period;

"**Regulatory Approval**" means such prior permission of the Supervisory Authority as is required under the then prevailing Capital Regulations;

"**Regulatory Preconditions**" means, in relation to any redemption of Tier 2 Capital Notes, to the extent required by prevailing Capital Regulations:

(a) on or before the relevant redemption date, the relevant Issuer and/or the relevant Group having replaced such Tier 2 Capital Notes with own funds instruments of equal or higher quality at terms that are sustainable for the income capacity of the relevant Issuer and/or the relevant Group; or

(b) the relevant Issuer having demonstrated to the satisfaction of the Supervisory Authority that the own funds of the relevant Issuer and/or the relevant Group would, following such redemption, exceed its minimum capital requirements (including any capital buffer requirements) by a margin that the Supervisory Authority considers necessary at such time.

Notwithstanding the above conditions, if, at the time of such redemption, the prevailing Capital Regulations permit the redemption after compliance with one or more alternative pre-conditions to either of those set out in paragraphs (a) and (b) of this definition, or require compliance with one or more additional pre-conditions, the relevant Issuer shall comply with such other pre-conditions;

"**Relevant Date**" means, in relation to any payment, whichever is the later of (a) the date on which the payment in question first becomes due and (b) if the full amount payable has not been received in the Principal Financial Centre of the currency of payment by the Principal Paying Agent or the Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders;

"**Relevant Financial Centre**" has the meaning given in the relevant Final Terms;

"**Relevant Screen Page**" means the page, section or other part of a particular information service (or any successor or replacement page, section or other part of a particular information service, including, without limitation, Reuters) specified as the Relevant Screen Page in the relevant Final Terms, or such other page, section or other part as may replace it on that information service or such other information service, in each case, as may be nominated by the Person providing or sponsoring the information appearing there for the purpose of displaying rates or prices comparable to the Reference Rate;

"**Relevant Time**" has the meaning given in the relevant Final Terms;

"**Reserved Matter**" has the meaning given in the Trust Deed and includes any proposal: to change any date fixed for or to reduce the amount of payment of principal or interest in respect of the Notes or to alter the method of calculating the amount of any payment in respect of the Notes on redemption or maturity or the date for any such payment; to change the currency in which amounts due in respect of the Notes are payable; or to change the quorum required at any meeting or the majority required to pass an Extraordinary Resolution;

"**Reset Date**" means the First Reset Date and each Subsequent Reset Date (as applicable);

"**Reset Determination Date**" means, unless otherwise specified in the relevant Final Terms, the second Business Day prior to each relevant Reset Date;

"**Reset Note**" means a Note which bears interest at a rate of interest which is recalculated at specified intervals;

"**Reset Period**" means the First Reset Period or a Subsequent Reset Period, as the case may be;

"**Reset Rate**" means (a) if "Mid-Swap Rate" is specified in the relevant Final Terms, the relevant Mid-Swap Rate or (b) if "Benchmark Gilt Rate" is specified in the relevant Final Terms, the relevant Benchmark Gilt Rate;

"**Senior Creditors**" means creditors of the relevant Issuer (i) who are depositors and/or other unsubordinated creditors of such relevant Issuer; or (ii) who are subordinated creditors of such Issuer (whether in the event of winding-up or administration of such Issuer or otherwise) other than those whose claims by law rank, or by their terms are expressed to rank, *pari passu* with or junior to the claims of the Holders of Tier 2 Capital Notes and relevant Couponholders;

"**Specified Currency**" has the meaning given in the relevant Final Terms;

"**Specified Denomination(s)**" has the meaning given in the relevant Final Terms;

"**Specified Office**" has the meaning given in the Agency Agreement;

"**Specified Period**" has the meaning given in the relevant Final Terms;

"**Subsequent Margin**" means the margin specified as such in the relevant Final Terms;

"**Subsequent Reset Date**" means the date or dates specified in the relevant Final Terms;

"**Subsequent Reset Period**" means the period from (and including) the first Subsequent Reset Date to (but excluding) the next Subsequent Reset Date, and each successive period from (and including) a Subsequent Reset Date to (but excluding) the next succeeding Subsequent Reset Date;

"**Subsequent Reset Rate of Interest**" means, in respect of any Subsequent Reset Period and subject to Conditions 6(d) (*Reset Note Provisions - Fallbacks - Mid-Swap Rate*) and 6(e) (*Reset Note Provisions - Fallbacks - Benchmark Gilt Rate*) (as applicable), the rate of interest determined by the Calculation Agent on the relevant Reset Determination Date as the sum of the relevant Reset Rate and the relevant Subsequent Margin;

"**Subsidiary**" means each subsidiary undertaking (as defined under section 1159 of the Companies Act) for the time being of the relevant Issuer;

"**Supervisory Authority**" means the United Kingdom Prudential Regulation Authority and/or any successor or replacement thereto or such other authority having primary responsibility for the prudential oversight and supervision of the relevant Issuer and/or the HoldCo Group;

"**Talon**" means a talon for further Coupons;

"**TARGET2**" means the Trans-European Automated Real-Time Gross Settlement Express Transfer payment system which utilises a single shared platform and which was launched on 19 November 2007;

"**TARGET Settlement Day**" means any day on which TARGET2 is open for the settlement of payments in euro;

"**Tier 2 Capital**" means Tier 2 Capital for the purposes of the Capital Regulations;

"**Winding-up Event**" means with respect to the Notes if (i) a court of competent jurisdiction in England (or such other jurisdiction in which the relevant Issuer may be organised) makes an order for its winding-up which is not successfully appealed within 30 days of the making of such order, (ii) the relevant Issuer's shareholders adopt an effective resolution for its winding-up (other than, in the case of either (i) or (ii) above, under or in connection with a scheme of reconstruction, merger or amalgamation not involving a bankruptcy or insolvency) or (iii) following the appointment of an administrator of the relevant Issuer, the administrator gives notice that it intends to declare and distribute a dividend; and

"**Zero Coupon Note**" means a Note specified as such in the relevant Final Terms.

(b) *Interpretation*

In these Conditions:

(i) if the Notes are Zero Coupon Notes, references to Coupons and Couponholders are not applicable;

(ii) if Talons are specified in the relevant Final Terms as being attached to the Notes at the time of issue, references to Coupons shall be deemed to include references to Talons;

(iii) if Talons are not specified in the relevant Final Terms as being attached to the Notes at the time of issue, references to Talons are not applicable;

(iv) any reference to principal shall be deemed to include the Redemption Amount, any additional amounts in respect of principal which may be payable under Condition 13 (*Taxation*), any premium payable in respect of a Note and any other amount in the nature of principal payable pursuant to these Conditions;

(v) any reference to interest shall be deemed to include any additional amounts in respect of interest which may be payable under Condition 13 (*Taxation*) and any other amount in the nature of interest payable pursuant to these Conditions;

(vi) references to Notes being "outstanding" shall be construed in accordance with the Trust Deed;

(vii) if an expression is stated in Condition 2(a) (*Definitions and Interpretation - Definitions*) to have the meaning given in the relevant Final Terms, but the relevant Final Terms gives no such meaning or specifies that such expression is "not applicable" then such expression is not applicable to the Notes; and

(viii) any reference to the Trust Deed or the Agency Agreement shall be construed as a reference to the Trust Deed or the Agency Agreement, as the case may be, as amended and/or supplemented up to and including the Issue Date of the Notes.

## 3. Form, Denomination, Title and Transfer

(a) *Bearer Notes*: Bearer Notes are in the Specified Denomination(s) with Coupons and, if specified in the relevant Final Terms, Talons attached at the time of issue. In the case of a Series of Bearer Notes with more than one Specified Denomination, Bearer Notes of one Specified Denomination will not be exchangeable for Bearer Notes of another Specified Denomination.

(b) *Title to Bearer Notes*: Title to Bearer Notes and the Coupons will pass by delivery. In the case of Bearer Notes, "**Holder**" means the holder of such Bearer Note and "**Noteholder**" and "**Couponholder**" shall be construed accordingly.

(c) *Registered Notes*: Registered Notes are in the Specified Denomination(s), which may include a minimum denomination specified in the relevant Final Terms and higher integral multiples of a smaller amount specified in the relevant Final Terms.

(d) *Title to Registered Notes*: The Registrar will maintain the register (the "**Register**") in accordance with the provisions of the Agency Agreement. A certificate (each, a "**Note Certificate**") will be issued to each Holder of Registered Notes in respect of its registered holding. Each Note Certificate will be numbered serially with an identifying number which will be recorded in the Register. In the case of Registered Notes, "**Holder**" means the person in whose name such Registered Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and "**Noteholder**" shall be construed accordingly.

(e) *Ownership*: The Holder of any Note or Coupon shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or, in the case of Registered Notes, on the Note Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft thereof) and no Person shall be liable for so treating such Holder. No person shall have any right to enforce any term or condition of any Note under the Contracts (Rights of Third Parties) Act 1999.

(f) *Transfers of Registered Notes*: Subject to Conditions 3(i) (*Closed periods*) and 3(j) (*Regulations concerning transfers and registration*) below, a Registered Note may be transferred upon surrender of the relevant Note Certificate, with the endorsed form of transfer duly completed, at the Specified Office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or (as the case may be) such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals who have executed the form of transfer; provided, however, that a Registered Note may not be transferred unless the principal amount of Registered Notes transferred and (where not all of the Registered Notes held by a Holder are being transferred) the principal amount of the balance of Registered Notes not transferred are Specified Denominations. Where not all the Registered Notes represented by the surrendered Note Certificate are the subject of the transfer, a new Note Certificate in respect of the balance of the Registered Notes will be issued to the transferor.

(g) *Registration and delivery of Note Certificates*: Within five business days of the surrender of a Note Certificate in accordance with Condition 3(f) (*Transfers of Registered Notes*) above, the Registrar will register the transfer in question and deliver a new Note Certificate of a like principal amount to the Registered Notes transferred to each relevant Holder at its Specified Office or (as the case may be) the Specified Office of any Transfer Agent or (at the request and risk of any such relevant Holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant Holder. In this paragraph, "business day" means a day on which commercial banks are open for general business (including dealings in foreign currencies) in the city where the Registrar or (as the case may be) the relevant Transfer Agent has its Specified Office.

(h) *No charge*: The transfer of a Registered Note will be effected without charge by or on behalf of the relevant Issuer or the Registrar or any Transfer Agent but against such indemnity as the Registrar or (as the case may be) such Transfer Agent may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such transfer.

(i) *Closed periods*: Noteholders may not require transfers to be registered during the period of 15 days ending on the due date for any payment of principal or interest in respect of the Registered Notes or once notice of redemption of the Notes has been given in accordance with Condition 10 (*Redemption and Purchase*).

(j) *Regulations concerning transfers and registration*: All transfers of Registered Notes and entries on the Register are subject to the detailed regulations concerning the transfer of Registered Notes scheduled to the Agency Agreement. The regulations may be changed by the relevant Issuer with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests in writing a copy of such regulations.

(k) *No exchange*: Registered Notes may not be exchanged for Bearer Notes and Bearer Notes may not be exchanged for Registered Notes.

4. **Status**

The Notes are either Senior Notes ("**Senior Notes**") or Tier 2 Capital Notes ("**Tier 2 Capital Notes**"), as specified in the relevant Final Terms.

(a) *Senior Notes*

The Senior Notes (and the Coupons relating thereto, if any) constitute direct, unconditional, unsecured and unsubordinated obligations of the relevant Issuer which will at all times rank *pari passu* among themselves and *pari passu* with all other present and future unsecured and unsubordinated obligations of the relevant Issuer, save for such obligations as may be preferred by provisions of law.

(b) *Tier 2 Capital Notes*

The Tier 2 Capital Notes (and the Coupons relating thereto, if any) constitute direct, unsecured and subordinated obligations of the relevant Issuer ranking *pari passu* without any preference among themselves. In the event of the winding up or administration of the relevant Issuer, the claims of the Trustee (on behalf of the Noteholders but not the rights and claims of the Trustee in its personal capacity under the Trust Deed) and the Holders of Tier 2 Capital Notes and any related Coupons against the relevant Issuer in respect of such Notes and Coupons (including any damages or other amounts (if payable)) shall (i) be subordinated to the claims of all Senior Creditors; (ii) rank at least *pari passu* with the claims of all other subordinated creditors of the relevant Issuer which in each case by law rank, or by their terms are expressed to rank, *pari passu* with the Tier 2 Capital Notes (including holders of instruments of the relevant Issuer that qualify as Tier 2 instruments in accordance with the Capital Regulations); and (iii) rank senior to the relevant Issuer's ordinary shares, preference shares and any junior subordinated obligations or other securities of the relevant Issuer which by law rank, or by their terms are expressed to rank, junior to the Tier 2 Capital Notes.

Nothing in this Condition 4 shall affect or prejudice the payment of the costs, charges, expenses, liabilities or remuneration of the Trustee or the rights and remedies of the Trustee in respect thereof.

(c) *No set-off*

Subject to applicable law, claims in respect of any Tier 2 Capital Notes or related Coupons may not be set off, or be the subject of a counterclaim, by the Holder against or in respect of any of its obligations to the relevant Issuer, the Trustee or any other person and every Holder waives, and shall be treated for all purposes as if it had waived, any right that it might otherwise have to set-off, or to raise by way of counterclaim any of its claims in respect of any Tier 2 Capital Notes or related Coupons, against or in respect of any of its obligations to the relevant Issuer, the Trustee or any other person. If, notwithstanding the preceding sentence, any Holder receives or recovers any sum or the benefit of any sum in respect of any Tier 2 Capital Note or related Coupon by virtue of any such set-off or counterclaim, it shall hold the same on trust for the relevant Issuer and shall pay the amount thereof to the relevant Issuer or, in the event of the winding up of the relevant Issuer, to the liquidator of the relevant Issuer.

5. **Fixed Rate Note Provisions**

(a) *Application:* This Condition 5 is applicable to the Notes only if the Fixed Rate Note Provisions are specified in the relevant Final Terms as being applicable.

(b) *Accrual of interest:* The Notes bear interest from (and including) the Interest Commencement Date at the Rate of Interest payable in arrear on each Interest Payment Date, subject as provided in Condition 11 (*Payments - Bearer Notes*) and Condition 12 (*Payments - Registered Notes*). Each Note will cease to bear interest from (and including) the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition 5 (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

(c) *Fixed Coupon Amount:* The amount of interest payable in respect of each Note for any Interest Period shall be the relevant Fixed Coupon Amount and, if the Notes are in more than one Specified Denomination, shall be the relevant Fixed Coupon Amount in respect of the relevant Specified Denomination. Payments of interest on any Interest Payment Date will, if so specified in the relevant Final Terms, amount to the Broken Amount so specified.

(d) *Calculation of interest amount:* The amount of interest payable in respect of each Note for any period for which a Fixed Coupon Amount is not specified shall be calculated by applying the Rate of Interest to the Calculation Amount, multiplying the product by the relevant Day Count Fraction, rounding the resulting figure to the nearest sub-unit of the Specified Currency (half a sub-unit being rounded upwards) and multiplying such rounded figure by a fraction equal to the Specified Denomination of such Note divided by the Calculation Amount. For this purpose a "**sub-unit**" means, in the case of any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, in the case of euro, means one cent.

## 6. Reset Note Provisions

(a) *Application:* This Condition 6 is applicable to the Notes only if the Reset Note Provisions are specified in the relevant Final Terms as being applicable.

(b) *Accrual of interest:* The Notes bear interest:

(i) from (and including) the Interest Commencement Date until (but excluding) the First Reset Date at the rate per annum equal to the Initial Rate of Interest;

(ii) from (and including) the First Reset Date until (but excluding) the first Subsequent Reset Date or, if a Subsequent Reset Date is not specified in the relevant Final Terms, the Maturity Date at the rate per annum equal to the First Reset Rate of Interest; and

(iii) for each Subsequent Reset Period thereafter (if any), at the rate per annum equal to the relevant Subsequent Reset Rate of Interest,

payable, in each case, in arrear on each Interest Payment Date subject as provided in Condition 11 (*Payments - Bearer Notes*) and Condition 12 (*Payments - Registered Notes*). Each Note will cease to bear interest from (and including) the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition 6 (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

(c) *Rate of Interest and Interest Amount:* The Rate of Interest applicable for each Reset Period shall be determined by the Calculation Agent at or as soon as practicable after each time at which the Rate of Interest is to be determined on each Reset Determination Date. The Interest Amount payable on the Notes shall be calculated in accordance with the provisions for calculating amounts of interest in Condition 5 (*Fixed Rate Note Provisions*) and, for such purposes, references in Condition 5 (*Fixed Rate Note Provisions*) to "Fixed Rate Notes" shall be deemed to be to "Reset Notes" and Condition 5 (*Fixed Rate Note Provisions*) shall be construed accordingly.

(d) *Fallbacks – Mid-Swap Rate:* Where "Mid-Swap Rate" is specified as applicable in the relevant Final Terms and if on any Reset Determination Date the Relevant Screen Page is not available or the Mid-Swap Rate does not appear on the Relevant Screen Page, the Calculation Agent shall request each of the Reference Banks to provide the Calculation Agent with its Mid-Market Swap Rate Quotation as at approximately 11.00 a.m. in the Principal Financial Centre of the Specified Currency on the Reset Determination Date in question.

If two or more of the Reference Banks provide the Calculation Agent with Mid-Market Swap Rate Quotations, the First Reset Rate of Interest or the Subsequent Reset Rate of Interest (as applicable) for the relevant Reset Period shall be the sum of the arithmetic mean (rounded, if necessary, to the nearest 0.001 per cent. (0.0005 per cent. being rounded upwards)) of the relevant Mid-Market Swap Rate Quotations and the First Margin or Subsequent Margin (as applicable), all as determined by the Calculation Agent.

If only one of the Reference Banks provides the Calculation Agent with a Mid-Market Swap Rate Quotation, the First Reset Rate of Interest or the Subsequent Reset Rate of Interest (as applicable) for the Reset Period shall be the sum of such Mid-Market Swap Rate Quotation and the First Margin or Subsequent Margin (as applicable), all as determined by the Calculation Agent. If on any Reset Determination Date none of the Reference Banks provides the Calculation Agent with a Mid-Market Swap Rate Quotation as provided in the foregoing provisions of this paragraph (d), the First Reset Rate of Interest or the Subsequent Reset Rate of Interest (as applicable) shall be determined to be the Rate of Interest as at the last preceding Reset Date or, in the case of the first Reset Determination Date, the First Reset Rate of Interest shall be the Initial Rate of Interest.

(e) *Fallback – Benchmark Gilt Rate:* Where "Benchmark Gilt Rate" is specified as applicable in the relevant Final Terms and where no quotations with respect to the Benchmark Gilt are provided by the relevant Reference Banks, the First Reset Rate of Interest or the Subsequent Reset Rate of Interest (as applicable) shall be determined to be the Rate of Interest as at the last preceding Reset Date or, in the case of the first Reset Determination Date, the First Reset Rate of Interest shall be the Initial Rate of Interest.

(f) *Publication:* The Calculation Agent will cause each Rate of Interest determined by it, together with the relevant Interest Payment Date, and any other amount(s) required to be determined by it together with any relevant payment date(s) to be notified to the relevant Issuer, the Paying Agents, the Trustee and each competent authority, stock exchange and/or quotation system (if any) by which the Notes have then been admitted to listing, trading and/or quotation as soon as practicable after such determination but (in the case of each Rate of Interest and Interest Payment Date) in any event not later than the relevant Reset Date. Notice thereof shall also be given to the Noteholders in accordance with Condition 20 (*Notices*) as soon as practicable after the determination or calculation thereof.

(g) *Notifications etc:* All notifications, opinions, communications, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 6 by the Calculation Agent will (in the absence of manifest error) be final and binding on the relevant Issuer, the Trustee, the Paying Agents, the Noteholders and the Couponholders. No Noteholder or Couponholder shall be entitled to proceed against the Calculation Agent, the Trustee, the Paying Agents or any of them in connection with the exercise or non-exercise by them of their powers, duties and discretions hereunder, including without limitation in respect of any notification, opinion, communication, determination, certificate, calculation, quotation or decision given, expressed or made for the purposes of this Condition 6.

(h) *Determination or calculation by the Trustee*: If the Calculation Agent does not at any time for any reason determine the Rate of Interest or any other item required to be determined or calculated by it under the relevant Final Terms, the Trustee, or an agent on its behalf and at the expense of the Issuer, shall do so and such determination or calculation shall be deemed to have been made by the Calculation Agent. In doing so, the Trustee or its agent shall apply the foregoing provisions of this Condition 6 and, where applicable, the relevant Final Terms, with any necessary consequential amendments, to the extent that, in its opinion, it can do so, and in all other respects it shall do so in such manner as it shall deem fair and reasonable in all the circumstances (subject always to this Condition 6).

## 7. Floating Rate Note Provisions

(a) *Application:* This Condition 7 is applicable to the Notes only if the Floating Rate Note Provisions are specified in the relevant Final Terms as being applicable.

(b) *Accrual of interest:* The Notes bear interest from (and including) the Interest Commencement Date at the Rate of Interest payable in arrear on each Interest Payment Date, subject as provided in Condition 11 (*Payments - Bearer Notes*) and Condition 12 (*Payments - Registered Notes*). Each Note will cease to bear interest from (and including) the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

(c) *Screen Rate Determination:* If Screen Rate Determination is specified in the relevant Final Terms as the manner in which the Rate(s) of Interest is/are to be determined, the Rate of Interest applicable to the Notes for each Interest Period will be determined by the Calculation Agent on the following basis:

(i) if the Reference Rate is a composite quotation or customarily supplied by one entity, the Calculation Agent will determine the Reference Rate which appears on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date;

(ii) if Linear Interpolation is specified as applicable in respect of an Interest Period in the applicable Final Terms, the Rate of Interest for such Interest Period shall be calculated by the Calculation Agent by straight-line linear interpolation by reference to two rates which appear on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date, where:

(A) one rate shall be determined as if the relevant Interest Period were the period of time for which rates are available next shorter than the length of the relevant Interest Period; and

(B) the other rate shall be determined as if the relevant Interest Period were the period of time for which rates are available next longer than the length of the relevant Interest Period;

***provided, however, that*** if no rate is available for a period of time next shorter or, as the case may be, next longer than the length of the relevant Interest Period, then the Calculation Agent shall determine such rate at such time and by reference to such sources as it determines appropriate;

(iii) in any other case, the Calculation Agent will determine the arithmetic mean of the Reference Rates which appear on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date;

(iv) if, in the case of (i) above, such rate does not appear on that page or, in the case of (iii) above, fewer than two such rates appear on that page or if, in either case, the Relevant Screen Page is unavailable, the Calculation Agent will:

(A) request the principal Relevant Financial Centre office of each of the Reference Banks to provide a quotation of the Reference Rate at approximately the Relevant Time on the Interest Determination Date to prime banks in the Relevant Financial Centre interbank market in an amount that is representative for a single transaction in that market at that time; and

(B) determine the arithmetic mean of such quotations; and

(v) if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean of the rates quoted by major banks in the Principal Financial Centre of the Specified Currency, selected by the Calculation Agent, at approximately 11.00 a.m. (local time in the Principal Financial Centre of the Specified Currency) on the first day of the relevant Interest Period for loans in the Specified Currency to leading European banks for a period equal to the relevant Interest Period and in an amount that is representative for a single transaction in that market at that time,

and the Rate of Interest for such Interest Period shall be the sum of the Margin and the rate or (as the case may be) the arithmetic mean so determined; **provided, however, that** if the Calculation Agent is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Interest Period, the Rate of Interest applicable to the Notes during such Interest Period will be the sum of the Margin and the rate or (as the case may be) the arithmetic mean last determined in relation to the Notes in respect of a preceding Interest Period.

(d) *ISDA Determination:* If ISDA Determination is specified in the relevant Final Terms as the manner in which the Rate(s) of Interest is/are to be determined, the Rate of Interest applicable to the Notes for each Interest Period will be the sum of the Margin and the relevant ISDA Rate where "ISDA Rate" in relation to any Interest Period means a rate equal to the Floating Rate (as defined in the ISDA Definitions) that would be determined by the Calculation Agent under an interest rate swap transaction if the Calculation Agent were acting as Calculation Agent for that interest rate swap transaction under the terms of an agreement incorporating the ISDA Definitions and under which:

(i) the Floating Rate Option (as defined in the ISDA Definitions) is as specified in the relevant Final Terms;

(ii) the Designated Maturity (as defined in the ISDA Definitions) is a period specified in the relevant Final Terms;

(iii) the relevant Reset Date (as defined in the ISDA Definitions) is either (A) if the relevant Floating Rate Option is based on LIBOR for a currency, the first day of that Interest Period or (B) in any other case, as specified in the relevant Final Terms; and

(iv) if Linear Interpolation is specified as applicable in respect of an Interest Period in the applicable Final Terms, the Rate of Interest for such Interest Period shall be calculated by the Calculation Agent by straight-line linear interpolation by reference to two rates based on the relevant Floating Rate Option, where:

(A) one rate shall be determined as if the Designated Maturity were the period of time for which rates are available next shorter than the length of the relevant Interest Period; and

(B) the other rate shall be determined as if the Designated Maturity were the period of time for which rates are available next longer than the length of the relevant Interest Period

***provided, however, that*** if there is no rate available for a period of time next shorter than the length of the relevant Interest Period or, as the case may be, next longer than the length of the relevant Interest Period, then the Calculation Agent shall determine such rate at such time and by reference to such sources as it determines appropriate.

(e) *Maximum or Minimum Rate of Interest:* If any Maximum Rate of Interest or Minimum Rate of Interest is specified in the relevant Final Terms, then the Rate of Interest shall in no event be greater than the maximum or be less than the minimum so specified.

(f) *Calculation of Interest Amount:* The Calculation Agent will, as soon as practicable after the time at which the Rate of Interest is to be determined in relation to each Interest Period, calculate the Interest Amount payable in respect of each Note for such Interest Period. The Interest Amount will be calculated by applying the Rate of Interest for such Interest Period to the Calculation Amount, multiplying the product by the relevant Day Count Fraction, rounding the resulting figure to the nearest sub-unit of the Specified Currency (half a sub-unit being rounded upwards) and multiplying such rounded figure by a fraction equal to the Specified Denomination of the relevant Note divided by the Calculation Amount. For this purpose a "**sub-unit**" means, in the case of any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, in the case of euro, means one cent.

(g) *Publication:* The Calculation Agent will cause each Rate of Interest and Interest Amount determined by it, together with the relevant Interest Payment Date, and any other amount(s) required to be determined by it together with any relevant payment date(s) to be notified to the relevant Issuer, the Paying Agents, the Trustee and each competent authority, stock exchange and/or quotation system (if any) by which the Notes have then been admitted to listing, trading and/or quotation as soon as practicable after such determination but (in the case of each Rate of Interest, Interest Amount and Interest Payment Date) in any event not later than the first day of the relevant Interest Period. Notice thereof shall also be given to the Noteholders in accordance with Condition 20 (*Notices*) as soon as practicable after the determination or calculation thereof. The Calculation Agent will be entitled to recalculate any Interest Amount (on the basis of the foregoing provisions) without notice in the event of an extension or shortening of the relevant Interest Period. If the Calculation Amount is less than the minimum Specified Denomination the Calculation Agent shall not be obliged to publish each Interest Amount but instead may publish only the Calculation Amount and the Interest Amount in respect of a Note having the minimum Specified Denomination.

(h) *Notifications etc:* All notifications, opinions, communications, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 7 by the Calculation Agent will (in the absence of manifest error) be final and binding on the relevant Issuer, the Trustee, the Paying Agents, the Noteholders and the Couponholders. No Noteholder or Couponholder shall be entitled to proceed against the Calculation Agent, the Trustee, the Paying Agents or any of them in connection with the exercise or non-exercise by them of their powers, duties and discretions hereunder, including without limitation in respect of any notification, opinion, communication, determination, certificate, calculation, quotation or decision given, expressed or made for the purposes of this Condition 7.

(i) *Determination or calculation by the Trustee*: If the Calculation Agent does not at any time for any reason determine the Rate of Interest or calculate the Interest Amount or any other item required to be determined or calculated by it under the relevant Final Terms, the Trustee, or an agent on its behalf and at the expense of the Issuer, shall do so and such determination or calculation shall be deemed to have been made by the Calculation Agent. In doing so, the Trustee or its agent shall apply the foregoing provisions of this Condition 7 and, where applicable, the relevant Final Terms, with any necessary consequential amendments, to the extent that, in its opinion, it can do so, and in all other respects it shall do so in such manner as it shall deem fair and reasonable in all the circumstances (subject always to this Condition 7).

## 8. Zero Coupon Note Provisions

(a) *Application:* This Condition 8 is applicable to the Notes only if the Zero Coupon Note Provisions are specified in the relevant Final Terms as being applicable.

(b) *Late payment on Zero Coupon Notes:* If the Redemption Amount payable in respect of any Zero Coupon Note is improperly withheld or refused, the Redemption Amount shall thereafter be an amount equal to the sum of:

(i) the Reference Price; and

(ii) the product of the Accrual Yield (compounded annually) being applied to the Reference Price on the basis of the relevant Day Count Fraction from (and including) the Issue Date to (but excluding) whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

9. **Fixed/Floating Rate Notes**

(a) *Application*: This Condition 9 is applicable to the Notes only if the Fixed Rate Note Provisions and the Floating Rate Note Provisions are specified in the relevant Final Terms as being applicable.

(b) *Fixed/Floating Rate*: The relevant Issuer may issue Notes (i) that the relevant Issuer may elect to convert on the date set out in the relevant Final Terms from a Fixed Rate Note to a Floating Rate Note, or from a Floating Rate Note to a Fixed Rate Note or (ii) that will automatically change from a Fixed Rate Note to a Floating Rate Note, or from a Floating Rate Note to a Fixed Rate Note on the date set out in the relevant Final Terms.

10. **Redemption and Purchase**

(a) *Scheduled redemption*: Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their Final Redemption Amount on the Maturity Date, subject as provided in Condition 11 (*Payments - Bearer Notes*) and Condition 12 (*Payments - Registered Notes*).

(b) *Redemption at the option of the Issuer:* Subject to Condition 10(k) (*Restriction on Early Redemption of Tier 2 Capital Notes*) below, if the Call Option is specified in the relevant Final Terms as being applicable, the Notes may be redeemed at the option of the relevant Issuer in whole or, if so specified in the relevant Final Terms, in part on any Optional Redemption Date (Call) at the relevant Optional Redemption Amount (Call) on the relevant Issuer giving not less than 30 nor more than 60 days' notice to the Noteholders, or such other period(s) as may be specified in the relevant Final Terms (which notice shall be irrevocable and shall oblige the relevant Issuer to redeem the Notes or, as the case may be, the Notes specified in such notice on the relevant Optional Redemption Date (Call) at the Optional Redemption Amount (Call) plus accrued interest (if any) to such date).

(c) *Redemption for tax reasons:* Subject to Condition 10(k) (*Restriction on Early Redemption of Tier 2 Capital Notes*) below, the Notes may be redeemed at the option of the relevant Issuer in whole, but not in part (x) at any time (if the Floating Rate Note Provisions are specified in the relevant Final Terms as being not applicable); or (y) on any Interest Payment Date (if the Floating Rate Note Provisions are specified in the relevant Final Terms as being applicable), at their Early Redemption Amount (Tax), together with any accrued but unpaid interest to the date fixed for redemption, *provided that*:

(i) the relevant Issuer provides not less than 30 days' nor more than 60 days' prior notice to the Trustee and the Holders of the Notes (such notice being irrevocable) specifying the date fixed for such redemption; and

(ii) if, immediately before giving such notice, the relevant Issuer satisfies the Trustee that, as a result of any change or proposed change in or amendment or proposed amendment to the laws or regulations of the United Kingdom or any authority or political subdivision therein or thereof having power to tax, including any treaty to which such jurisdiction is a party, or any change in the official application of those laws or regulations (including a holding by a court or tribunal of competent jurisdiction), which change or amendment becomes effective on or after the Issue Date of the first Tranche of the Notes and, in the case of Tier 2 Capital Notes only where such redemption occurs prior to the fifth anniversary of the Issue Date of the first Tranche of the Tier 2 Capital Notes, which the relevant Issuer demonstrates to the satisfaction of the Supervisory Authority is material and was not reasonably foreseeable as at the Issue Date of the first Tranche of the Tier 2 Capital Notes:

(A) the relevant Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 13 (*Taxation*); or

(B) in the case of Tier 2 Capital Notes only:

(1) the relevant Issuer is or would not be entitled to claim a deduction in computing its taxable profits and losses in respect of interest payable on the Notes, or such a deduction is or would be reduced or deferred; or

(2) the relevant Issuer is not or would not be able to treat the Notes as loan relationships for the purposes of Part 5 of the Corporation Tax Act 2009;

(3) the relevant Issuer treats or would be required to treat any part of the Notes as an embedded derivative for tax purposes, or the relevant Issuer otherwise is or would be required to take changes in or re-estimates of the value of the Notes or any part of the Notes, or of the present value of the cashflows arising in respect of the Notes or any part of the Notes, into account in computing its taxable profits and losses; or

(4) the Notes are not or would not be treated as "normal commercial loans" for the purposes of Chapter 6 of Part 5 of the Corporation Tax Act 2010, or the Notes otherwise are or would be required to be taken into account for the purposes of determining any group for tax purposes, such that there is or would be a change in the membership of any group for tax purposes,

(each such change or amendment, a "**Tax Event**"); and

in the case of each of (A) and (B), such consequences cannot be avoided by the relevant Issuer taking reasonable measures available to it,

provided, further, that no such notice of redemption shall be given earlier than (1) where the Notes may be redeemed at any time, 90 days prior to the earliest date on which the relevant Issuer would be obliged to pay such additional amounts or is unable to make such deduction if a payment in respect of the Notes were then due; or (2) where the Notes may be redeemed only on an Interest Payment Date, 60 days prior to the Interest Payment Date occurring immediately before the earliest date on which the relevant Issuer would be obliged to pay such additional amounts or is unable to make such deduction if a payment in respect of the Notes were then due.

Before the publication of any notice of redemption pursuant to this Condition 10(c) (*Redemption for tax reasons*) the relevant Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories (as defined in the Trust Deed) of the relevant Issuer stating that the conditions precedent for redeeming the Notes pursuant to this Condition 10(c) (*Redemption for tax reasons*) have been met and the Trustee shall be entitled to accept without liability for so doing the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders and Couponholders.

Upon the expiry of any such notice as is referred to in this Condition 10(c) (*Redemption for tax reasons*), the relevant Issuer shall be bound to redeem the Notes in accordance with this Condition 10(c) (*Redemption for tax reasons*).

(d) *Regulatory Event Redemption of Tier 2 Capital Notes*: Subject to Condition 10(k) (*Restriction on Early Redemption of Tier 2 Capital Notes*) below, if there is a change (or a pending change which the Supervisory Authority considers to be sufficiently certain) in the regulatory classification of the Tier 2 Capital Notes under the Capital Regulations that occurs on or after the Issue Date of the first Tranche of such Tier 2 Capital Notes (and which, where such redemption occurs prior to the fifth anniversary of the Issue Date of the first Tranche of the Tier 2 Capital Notes, the relevant Issuer demonstrates to the satisfaction of the Supervisory Authority was not reasonably foreseeable as at the Issue Date of the first Tranche of such Tier 2 Capital Notes) and that does, or would be likely to, result in the whole or any part of the outstanding aggregate principal amount of such Tier 2 Capital Notes being excluded from the Tier 2 Capital of the relevant Issuer and/or the relevant Group (a "**Regulatory Event**"), the relevant Issuer may, at its option, redeem the Tier 2 Capital Notes, in whole but not in part, at the relevant Optional Redemption Amount (Regulatory Event), together with any accrued but unpaid interest to the date fixed for redemption, *provided that* the relevant Issuer provides not less than 30 days' nor more than 60 days' prior notice to the Trustee, the Principal Paying Agent and the Holders of the Tier 2 Capital Notes (such notice being irrevocable) specifying the date fixed for such redemption.

Prior to the publication of any notice of redemption pursuant to this Condition 10(d), the relevant Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories (as defined in the Trust Deed) of the relevant Issuer stating that the conditions precedent for redeeming the Tier 2 Capital Notes pursuant to this Condition 10(d) have been met and the Trustee shall be entitled to accept without liability for so doing the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders and Couponholders.

Upon the expiry of such notice period, the relevant Issuer shall be bound to redeem the Tier 2 Capital Notes accordingly.

(e) *Redemption at the option of Noteholders:* In the case of any Series of Senior Notes only, if the Put Option is specified in the relevant Final Terms as being applicable, the relevant Issuer shall, at the option of the Holder of any Note redeem such Note on the Optional Redemption Date (Put) specified in the relevant Put Option Notice (which notice shall be irrevocable) at the relevant Optional Redemption Amount (Put) together with interest (if any) accrued to such date. No Series of Tier 2 Capital Notes shall contain a Put Option. In order to exercise the option contained in this Condition 10(e), the Holder of a Note must, not less than 30 nor more than 60 days before the relevant Optional Redemption Date (Put) (or such other period(s) as may be specified in the relevant Final Terms), deposit with any Paying Agent (in the case of Bearer Notes) or the Registrar (in the case of Registered Notes) such Note together with all unmatured Coupons relating thereto and a duly completed Put Option Notice in the form obtainable from any Paying Agent. The Paying Agent or the Registrar (as the case may be) with which a Note is so deposited shall deliver a duly completed Put Option Receipt to the depositing Noteholder. No Note, once deposited with a duly completed Put Option Notice in accordance with this Condition 10(e), may be withdrawn; **provided, however, that** if, prior to the relevant Optional Redemption Date (Put), any such Note becomes immediately due and payable or, upon due presentation of any such Note on the relevant Optional Redemption Date (Put), payment of the redemption moneys is improperly withheld or refused, the relevant Paying Agent shall mail notification thereof to the depositing Noteholder at such address as may have been given by such Noteholder in the relevant Put Option Notice and shall hold such Note at its Specified Office for collection by the depositing Noteholder against surrender of the relevant Put Option Receipt. For so long as any outstanding Note is held by a Paying Agent or the Registrar (as the case may be) in accordance with this Condition 10(e), the depositor of such Note and not such Paying Agent or the Registrar (as the case may be) shall be deemed to be the Holder of such Note for all purposes. The Holder of a Note may not exercise such option in respect of any Note which is the subject of an exercise by the Issuer of its option to redeem such Note under Conditions 10(b) (*Redemption at the option of the Issuer*), 10(c) (*Redemption for tax reasons*), or 10(f) (*Partial redemption*) and any exercise of the first-mentioned option in such circumstances shall have no effect.

(f) *Partial redemption:* If the Notes are to be redeemed in part only on any date in accordance with Condition 10(b) (*Redemption at the option of the Issuer*), in the case of Bearer Notes, the Notes to be redeemed shall be selected by the drawing of lots in such place as the Principal Paying Agent approves and in such manner as the Principal Paying Agent considers appropriate, subject to compliance with applicable law, the rules of each competent authority, stock exchange and/or quotation system (if any) by which the Notes have then been admitted to listing, trading and/or quotation and the notice to Noteholders referred to in Condition 10(b) (*Redemption at the option of the Issuer*) shall specify the serial numbers of the Notes so to be redeemed, and, in the case of Registered Notes, each Note shall be redeemed in part in the proportion which the aggregate principal amount of the outstanding Notes to be redeemed on the relevant Optional Redemption Date (Call) bears to the aggregate principal amount of outstanding Notes on such date. If any Maximum Redemption Amount or Minimum Redemption Amount is specified in the relevant Final Terms, then the Optional Redemption Amount (Call) shall in no event be greater than the maximum or be less than the minimum so specified.

(g) *No other redemption:* The relevant Issuer shall not be entitled to redeem the Notes otherwise than as provided in Condition 10(a) (*Scheduled redemption*) to Condition 10(f) (*Partial redemption*) above.

(h) *Early redemption of Zero Coupon Notes:* Unless otherwise specified in the relevant Final Terms, the Redemption Amount payable on redemption of a Zero Coupon Note at any time before the Maturity Date shall be an amount equal to the sum of:

(i) the Reference Price; and

(ii) the product of the Accrual Yield (compounded annually) being applied to the Reference Price from (and including) the Issue Date to (but excluding) the date fixed for redemption or (as the case may be) the date upon which the Note becomes due and payable.

Where such calculation is to be made for a period which is not a whole number of years, the calculation in respect of the period of less than a full year shall be made on the basis of such Day Count Fraction as may be specified in the Final Terms for the purposes of this Condition 10(h) or, if none is so specified, a Day Count Fraction of 30E/360.

(i) *Purchase:* The relevant Issuer or any of its Subsidiaries may at any time purchase or otherwise acquire any of the outstanding Notes at any price in the open market or otherwise, **provided that** all unmatured Coupons (if any) are purchased therewith. In the case of Tier 2 Capital Notes, any such purchases shall be in accordance with the Capital Regulations in force at the relevant time, and subject to Regulatory Approval.

(j) *Cancellation:* All Notes which are redeemed by the relevant Issuer pursuant to this Condition 10 will be cancelled. All Notes purchased by or on behalf of the relevant Issuer or any of its Subsidiaries may be held, reissued, resold or, at the option of the relevant Issuer or any such Subsidiary, cancelled.

(k) *Restriction on Early Redemption of Tier 2 Capital Notes*: Notwithstanding any other provision in this Condition 10, the relevant Issuer may redeem the Tier 2 Capital Notes (and give notice thereof to the Holders) only if it has (x) obtained Regulatory Approval and (y) complied with the Regulatory Preconditions.

## 11. Payments - Bearer Notes

This Condition 11 (*Payments - Bearer Notes*) is only applicable to Bearer Notes.

(a) *Principal:* Payments of principal shall be made only against presentation and (**provided that** payment is made in full) surrender of Bearer Notes at the Specified Office of any Paying Agent outside the United States by cheque drawn in the currency in which the payment is due on, or by transfer to an account denominated in that currency (or, if that currency is euro, any other account to which euro may be credited or transferred) and maintained by the payee with, a bank in the Principal Financial Centre of that currency.

(b) *Interest:* Payments of interest shall, subject to Condition 11(h) (*Payments other than in respect of matured Coupons*) below, be made only against presentation and (**provided that** payment is made in full) surrender of the appropriate Coupons at the Specified Office of any Paying Agent outside the United States in the manner described in Condition 11(a) (*Principal*) above.

(c) *Payments in New York City:* Payments of principal or interest may be made at the Specified Office of a Paying Agent in New York City if (i) the relevant Issuer has appointed Paying Agents outside the United States with the reasonable expectation that such Paying Agents will be able to make payment of the full amount of the interest on the Notes in the currency in which the payment is due when due, (ii) payment of the full amount of such interest at the offices of all such Paying Agents is illegal or effectively precluded by exchange controls or other similar restrictions and (iii) payment is permitted by applicable United States law.

(d) *Payments subject to fiscal laws:* All payments in respect of the Bearer Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 13 (*Taxation*). No commissions or expenses shall be charged to the Noteholders or Couponholders in respect of such payments.

(e) *Deductions for unmatured Coupons:* If the relevant Final Terms specifies that the Fixed Rate Note Provisions are applicable and a Bearer Note is presented without all unmatured Coupons relating thereto:

(i) if the aggregate amount of the missing Coupons is less than or equal to the amount of principal due for payment, a sum equal to the aggregate amount of the missing Coupons will be deducted from the amount of principal due for payment; **provided, however, that** if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of such missing Coupons which the gross amount actually available for payment bears to the amount of principal due for payment;

(ii) if the aggregate amount of the missing Coupons is greater than the amount of principal due for payment:

(A) so many of such missing Coupons shall become void (in inverse order of maturity) as will result in the aggregate amount of the remainder of such missing Coupons (the "**Relevant Coupons**") being equal to the amount of principal due for payment; **provided, however, that** where this sub-paragraph would otherwise require a fraction of a missing Coupon to become void, such missing Coupon shall become void in its entirety; and

(B) a sum equal to the aggregate amount of the Relevant Coupons (or, if less, the amount of principal due for payment) will be deducted from the amount of principal due for payment; **provided, however, that**, if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of the Relevant Coupons (or, as the case may be, the amount of principal due for payment) which the gross amount actually available for payment bears to the amount of principal due for payment.

Each sum of principal so deducted shall be paid in the manner provided in Condition 11(a) (*Principal*) above against presentation and (**provided that** payment is made in full) surrender of the relevant missing Coupons.

(f) *Unmatured Coupons void*: If the relevant Final Terms specifies that this Condition 11(f) is applicable, that the Reset Note Provisions are applicable or that the Floating Rate Note Provisions are applicable, on the due date for final redemption of any Note or early redemption in whole of such Note pursuant to Condition 10(b) (*Redemption at the option of the Issuer*), Condition 10(c) (*Redemption for tax reasons*), Condition 10(d) (*Regulatory Event Redemption of Tier 2 Capital Notes*), Condition 10(e) (*Redemption at the option of Noteholders*) or Condition 14 (*Events of Default*), all unmatured Coupons relating thereto (whether or not still attached) shall become void and no payment will be made in respect thereof.

(g) *Payments on business days:* If the due date for payment of any amount in respect of any Bearer Note or Coupon is not a Payment Business Day in the place of presentation, the Holder shall not be entitled to payment in such place of the amount due until the next succeeding Payment Business Day in such place and shall not be entitled to any further interest or other payment in respect of any such delay.

(h) *Payments other than in respect of matured Coupons:* Payments of interest other than in respect of matured Coupons shall be made only against presentation of the relevant Bearer Notes at the Specified Office of any Paying Agent outside the United States (or in New York City if permitted by Condition 11(c) (*Payments in New York City*) above).

(i) *Partial payments:* If a Paying Agent makes a partial payment in respect of any Bearer Note or Coupon presented to it for payment, such Paying Agent will endorse thereon a statement indicating the amount and date of such payment.

(j) *Exchange of Talons:* On or after the maturity date of the final Coupon which is (or was at the time of issue) part of a Coupon Sheet relating to the Bearer Notes, the Talon forming part of such

Coupon Sheet may be exchanged at the Specified Office of the Principal Paying Agent for a further Coupon Sheet (including, if appropriate, a further Talon but excluding any Coupons in respect of which claims have already become void pursuant to Condition 15 (*Prescription*). Upon the due date for redemption of any Bearer Note, any unexchanged Talon relating to such Note shall become void and no Coupon will be delivered in respect of such Talon.

12. **Payments - Registered Notes**

This Condition 12 is only applicable to Registered Notes.

(a) *Principal:* Payments of principal shall be made by cheque drawn in the currency in which the payment is due drawn on, or, upon application by a Holder of a Registered Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to an account denominated in that currency (or, if that currency is euro, any other account to which euro may be credited or transferred) and maintained by the payee with, a bank in the Principal Financial Centre of that currency and (in the case of redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of any Paying Agent.

(b) *Interest:* Payments of interest shall be made by cheque drawn in the currency in which the payment is due drawn on, or, upon application by a Holder of a Registered Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to an account denominated in that currency (or, if that currency is euro, any other account to which euro may be credited or transferred) and maintained by the payee with, a bank in the Principal Financial Centre of that currency (in the case of a sterling cheque, a town clearing branch of a bank in the City of London) and (in the case of interest payable on redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of any Paying Agent.

(c) *Payments subject to fiscal laws:* All payments in respect of the Registered Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 13 (*Taxation*). No commissions or expenses shall be charged to the Noteholders in respect of such payments.

(d) *Payments on business days:* Where payment is to be made by transfer to an account, payment instructions (for value the due date, or, if the due date is not Payment Business Day, for value the next succeeding Payment Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed (i) (in the case of payments of principal and interest payable on redemption) on the later of the due date for payment and the day on which the relevant Note Certificate is surrendered (or, in the case of part payment only, endorsed) at the Specified Office of a Paying Agent and (ii) (in the case of payments of interest payable other than on redemption) on the due date for payment. A Holder of a Registered Note shall not be entitled to any interest or other payment in respect of any delay in payment resulting from (A) the due date for a payment not being a Payment Business Day or (B) a cheque mailed in accordance with this Condition 12 arriving after the due date for payment or being lost in the mail.

(e) *Partial payments:* If a Paying Agent makes a partial payment in respect of any Registered Note, the relevant Issuer shall procure that the amount and date of such payment are noted on the Register and, in the case of partial payment upon presentation of a Note Certificate, that a statement indicating the amount and the date of such payment is endorsed on the relevant Note Certificate.

(f) *Record date:* Each payment in respect of a Registered Note will be made to the person shown as the Holder in the Register at the opening of business in the place of the Registrar's Specified Office on the fifteenth day before the due date for such payment (the "**Record Date**"). Where payment in respect of a Registered Note is to be made by cheque, the cheque will be mailed to the address shown as the address of the Holder in the Register at the opening of business on the relevant Record Date.

## 13. Taxation

(a) *Gross up:* All payments of principal and interest in respect of the Notes and the Coupons by or on behalf of the relevant Issuer shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision therein or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments, or governmental charges is required by law. In that event, the relevant Issuer shall pay such additional amounts as will result in receipt by the Noteholders and the Couponholders after such withholding or deduction of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Note or Coupon:

(i) held by or on behalf of a Holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Note or Coupon by reason of its having some connection with the United Kingdom other than the mere holding of the Note or Coupon; or

(ii) where the relevant Note or Coupon or Note Certificate is presented or surrendered for payment more than 30 days after the Relevant Date except to the extent that the Holder of such Note or Coupon would have been entitled to such additional amounts on presenting or surrendering such Note or Coupon or Note Certificate for payment on the last day of such period of 30 days; or

(iii) where the Holder is able to avoid such withholding or deduction by complying, or procuring that a third party complies with, any applicable statutory requirements or by making, or procuring that any third party makes, a declaration of non-residence or other similar claim for exemption to any tax authority.

(b) *FATCA*: For the avoidance of doubt, any amounts to be paid by the relevant Issuer on the Notes will be paid net of any deduction or withholding imposed or required pursuant to Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986, as amended (the "**Code**"), any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, any intergovernmental agreement, or any fiscal or regulatory legislation, rules or practices adopted pursuant to any intergovernmental agreement entered into in connection with the implementation of such Sections of the Code (or any law implementing such an intergovernmental agreement) (a "**FATCA Withholding Tax**"). Neither the relevant Issuer nor any other person will be required to pay any additional amounts on account of any FATCA Withholding Tax.

(c) *Taxing jurisdiction:* If the relevant Issuer becomes subject at any time to any taxing jurisdiction other than the United Kingdom, references in these Conditions to the United Kingdom shall be construed as references to such other jurisdiction.

## 14. Events of Default

(a) *Senior Notes*: The provisions of this Condition 14(a) shall have effect in relation to any Series of Senior Notes.

If any of the following events occurs and is continuing, then the Trustee at its discretion may and, if so requested in writing by Holders of at least one quarter of the aggregate principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject, in all cases, to the Trustee having been indemnified and/or secured and/or pre-funded to its satisfaction) give written notice to the relevant Issuer declaring the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their Early Termination Amount together with any accrued but unpaid interest without further action or formality:

(i) *Non-payment:* any principal or interest on such Notes has not been paid within 7 days (in the case of principal) and within 14 days (in the case of interest) from the due date for payment *provided that the* relevant Issuer shall not, however, be in default if it satisfies the Trustee during the 14 or 7 day period (as applicable) that such sums were not paid in order to comply with any law, regulation or order of any court of competent jurisdiction. Where there is doubt as to the validity or applicability of any such law, regulation or order, the relevant Issuer will not be in default if it acts on the advice given to it during such period by independent legal advisers approved by the Trustee; or

(ii) *Breach of other obligations:* the relevant Issuer defaults in the performance or observance of any of its other obligations under or in respect of the Notes or the Trust Deed and that breach has not been remedied within 30 days of receipt of a written notice from the Trustee certifying that in its *opinion* the breach is materially prejudicial to the interests of the holders of such Notes and requiring the same to be remedied; or

(iii) *Winding-up etc.*: a Winding-up Event occurs.

At any time after any Series of Senior Notes shall have become due and repayable in accordance with this Condition 14(a) (*Senior Notes*), the Trustee may at its discretion and, if so requested in writing by Holders of at least one quarter of the aggregate principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or secured and/or pre-funded to its satisfaction), without further notice, institute such proceedings or take such steps or actions as it may think fit against the relevant Issuer to enforce payment.

(b) *Tier 2 Capital Notes*: The provisions of this Condition 14(b) shall have effect in relation to any Series of Tier 2 Capital Notes.

(i) If any of the following events occurs and is continuing, then the Trustee at its discretion may and, if so requested in writing by Holders of at least one quarter of the aggregate principal amount of the outstanding Tier 2 Capital Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or secured and/or pre-funded to its satisfaction), without further notice:

(A) *Non-payment*: in the event that any principal or interest on such Tier 2 Capital Notes has not been paid within 7 days (in the case of principal) and within 14 days (in the case of interest) from the due date for payment, institute proceedings in a court of competent jurisdiction in England (or such other jurisdiction in which the relevant Issuer is organised) (but not elsewhere) for the winding up of the relevant Issuer and/or prove in its winding-up and/or claim in its liquidation or administration, *provided that* the relevant Issuer shall not be in default if it satisfies the Trustee during the 14 or 7 day period (as applicable) that such sums were not paid in order to comply with any law, regulation or order of any court of competent jurisdiction. Where there is doubt as to the validity or applicability of any such law, regulation or order, the relevant Issuer will not be in default if it acts on the advice given to it during such period by independent legal advisers approved by the Trustee; or

(B) *Limited remedies for breach of other obligations (other than non-payment)*: institute such proceedings or take such steps or actions against the relevant Issuer as it may think fit to enforce any term, obligation or condition binding on the relevant Issuer under such Tier 2 Capital Notes or Coupons or the terms of the Trust Deed relating thereto (other than any payment obligation of the relevant Issuer under or arising from the Tier 2 Capital Notes or Coupons or the Trust Deed, including, without limitation, payment of any principal or interest) (a "**Performance Obligation**"); provided always that the Trustee (acting on behalf of the Holders but not the Trustee acting in its personal capacity under the Trust Deed) and the Holders shall not enforce, and shall not be entitled to enforce or otherwise claim against the relevant Issuer, any judgment or other award given in such proceedings, steps or actions that requires the payment of money by the relevant Issuer, whether by way of damages or otherwise (a "**Monetary Judgment**"), except by proving such Monetary Judgment in a winding-up of the relevant Issuer and/or claiming such Monetary Judgment in an administration of the relevant Issuer.

Nothing in this Condition 14(b)(i) shall affect or prejudice the payment of the costs, charges, expenses, liabilities or remuneration of the Trustee or the rights and remedies of the Trustee in respect thereof.

(ii) If a Winding-up Event occurs, the Trustee at its discretion may and, if so requested in writing by the Holders of at least one quarter of the aggregate principal amount of the outstanding Tier 2 Capital Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or secured and/or prefunded to its satisfaction) declare such Tier 2 Capital Notes to be due and repayable immediately (and such Tier 2 Capital Notes shall thereby become so due and repayable) at their outstanding principal amount (or at such other repayment amount as may be specified in or determined in accordance with the relevant Final Terms) together with any accrued but unpaid interest as provided in the Trust Deed and payments are subject to the subordination provisions set out in Condition 4(b) (*Status - Tier 2 Capital Notes*).

(c) *All Notes*: The provisions of this Condition 14(c) shall have effect in relation to any Series of Notes. No Holder of any Notes and no holder of the Coupons (if any) appertaining thereto shall be entitled to institute any of the proceedings or to take any of the steps or actions referred to in Conditions 14(a) (*Senior Notes*) or 14(b) (*Tier 2 Capital Notes*) above or to prove in the winding up of the relevant Issuer except that if the Trustee, having become bound to proceed against the relevant Issuer as aforesaid, fails to do so or, having become bound to prove in such winding up, fails to do so, or having become bound to take any such steps or actions, fails to do so, in each case within a reasonable period, and in each such case such failure shall be continuing, then any such holder may itself institute such proceedings and/or prove in such winding up and/or take such steps or actions to the same extent (but not further or otherwise) that the Trustee would have been entitled so to do in respect of its Notes and/or Coupons. In the case of Tier 2 Capital Notes, no remedy against the relevant Issuer other than as referred to in Condition 14(b) (*Tier 2 Capital Notes*), shall be available to the Trustee or the Holders of such Notes or the Coupons (if any) appertaining thereto whether for the recovery of amounts owing in respect of such Notes or Coupons or under the Trust Deed in relation thereto or in respect of any breach by the relevant Issuer of any of its other obligations under or in respect of such Notes or Coupons or under the Trust Deed in relation thereto.

## 15. Prescription

Claims for principal in respect of Bearer Notes shall become void unless the relevant Bearer Notes are presented for payment within ten years of the appropriate Relevant Date. Claims for interest in respect of Bearer Notes shall become void unless the relevant Coupons are presented for payment within five years of the appropriate Relevant Date. Claims for principal and interest on redemption in respect of Registered Notes shall become void unless the relevant Note Certificates are surrendered for payment within ten years of the appropriate Relevant Date.

## 16. Replacement of Notes, Note Certificates, Coupons and Talons

If any Note, Note Certificate, Coupon or Talon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Principal Paying Agent, in the case of Bearer Notes, or the Registrar, in the case of Registered Notes (and, if the Notes are then admitted to listing, trading and/or quotation by any competent authority, stock exchange and/or quotation system which requires the appointment of a Paying Agent or Transfer Agent in any particular place, the Paying Agent or Transfer Agent having its Specified Office in the place required by such competent authority, stock exchange and/or quotation system), subject to all applicable laws and competent authority, stock exchange and/or quotation system requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the relevant Issuer may reasonably require. Mutilated or defaced Notes, Note Certificates, Coupons or Talons must be surrendered before replacements will be issued.

## 17. Trustee and Agents

Under the Trust Deed, the Trustee is entitled to be indemnified and/or secured and/or prefunded before taking any steps or actions or initiating any proceedings and relieved from responsibility in certain circumstances and to be paid its costs, fees and expenses in priority to the claims of the Noteholders. In addition, the Trustee is entitled to enter into business transactions with the relevant Issuer and any entity relating to the relevant Issuer without accounting for any profit.

In the exercise of its powers and discretions under these Conditions and the Trust Deed, the Trustee will have regard to the interests of the Noteholders as a class and will not be responsible for any consequence for individual Holders of Notes as a result of such Holders being connected in any way with a particular territory or taxing jurisdiction.

In acting under the Agency Agreement and in connection with the Notes and the Coupons, the Agents, the Foreign Exchange Agent, and any Calculation Agent act solely as agents of the relevant Issuer and (to the extent provided therein) the Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders or Couponholders.

The initial Agents and their initial Specified Offices are listed below. The initial Calculation Agent (if any) is specified in the relevant Final Terms. The relevant Issuer reserves the right (with the prior approval of the Trustee) at any time to vary or terminate the appointment of any Agent, the Foreign Exchange Agent, or any Calculation Agent and to appoint a successor fiscal agent or registrar or Calculation Agent and additional or successor paying agents; **provided, however, that***:*

(i) the relevant Issuer shall at all times maintain a Principal Paying Agent and a Registrar; and

(ii) if a Calculation Agent is specified in the relevant Final Terms, the relevant Issuer shall at all times maintain a Calculation Agent; and

(iii) if and for so long as the Notes are admitted to listing, trading and/or quotation by any competent authority, stock exchange and/or quotation system which requires the appointment of a Paying Agent and/or a Transfer Agent in any particular place, the relevant Issuer shall maintain a Paying Agent and/or a Transfer Agent having its Specified Office in the place required by such competent authority, stock exchange and/or quotation system.

Notice of any change in any of the Agents, the Foreign Exchange Agent, or any Calculation Agent or in their Specified Offices shall promptly be given to the Noteholders.

18. **Meetings of Noteholders; Modification and Waiver; Substitution**

(a) *Meetings of Noteholders*: The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions by Extraordinary Resolution, except that the provisions relating to the Tier 2 Capital Notes shall only be capable of modification in accordance with Condition 18(d) (*Supervisory Authority notice or consent*) below.

Such a meeting may be convened by the relevant Issuer or by the Trustee and, subject to the Trustee being indemnified and/or secured and/or prefunded to its satisfaction, shall be convened by the Trustee upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be one or more Persons holding or representing more than half of the aggregate principal amount of the outstanding Notes or, at any adjourned meeting, one or more Persons being or representing Noteholders whatever the principal amount of the Notes held or represented; **provided, however, that** Reserved Matters may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which one or more Persons holding or representing not less than two-thirds or, at any adjourned meeting not less than one-third of the aggregate principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders and Couponholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of the holders of at least 75 per cent. in aggregate principal amount of the outstanding Notes who for the time being are entitled to receive notice of a meeting of Noteholders under the Trust Deed will take effect as if it were an

Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

(b) *Modification and waiver:* Subject to certain exceptions and Condition 18(d) (*Supervisory Authority notice or consent*) below, the Trustee may, without the consent of the Noteholders, agree to any modification of these Conditions or the Trust Deed (other than in respect of a Reserved Matter) which is, in the opinion of the Trustee, not materially prejudicial to the interests of Noteholders and to any modification of the Notes or the Trust Deed which is, in the opinion of the Trustee, of a formal, minor or technical nature or is to correct a manifest error.

In addition, the Trustee may, subject to and in accordance with the Trust Deed, without the consent of the Noteholders, authorise or waive any proposed breach or breach of the Notes or the Trust Deed (other than a proposed breach or breach relating to the subject of a Reserved Matter) if, in the opinion of the Trustee, the interests of the Noteholders will not be materially prejudiced thereby.

In addition, the Trustee may, subject to and in accordance with the Trust Deed, determine, without the consent of the Noteholders, that any Event of Default or Potential Event of Default (both as defined in the Trust Deed) by the relevant Issuer shall not be treated as such for the purpose of the Trust Deed and such Notes if, in the opinion of the Trustee, the interests of the relevant Noteholders would not be materially prejudiced thereby.

Unless the Trustee agrees otherwise, any such authorisation, determination, waiver or modification shall be notified to the Noteholders by the relevant Issuer or the Issuers (as applicable) as soon as practicable thereafter in accordance with Condition 20 (*Notices*).

(c) *Substitution*: Subject to Condition 18(d) (*Supervisory Authority notice or consent*) below, the Trustee may, without the consent of the Noteholders, agree with the relevant Issuer to the substitution in place of the relevant Issuer (or of any previous substitute under this Condition 18(c)) as the principal debtor under the Notes and the Trust Deed of any of its wholly-owned Subsidiaries, subject to:

(i) the Trustee being satisfied that such substitution is not materially prejudicial to the interests of the Noteholders; and

(ii) certain other conditions set out in the Trust Deed being complied with.

(d) *Supervisory Authority notice or consent:* The provisions relating to the Tier 2 Capital Notes shall only be capable of modification or waiver and the relevant Issuer of Tier 2 Capital Notes may only be substituted in accordance with Condition 18(c) (*Substitution*) above, if the relevant Issuer has notified the Supervisory Authority of such modification, waiver or substitution and/or obtained Regulatory Approval (if such notice and/or consent is then required by the Capital Regulations). Wherever such modification or waiver of the Tier 2 Capital Notes is proposed or a substitution of the relevant Issuer of the Tier 2 Capital Notes is proposed in accordance with Condition 18(c) (*Substitution*) above, the relevant Issuer shall provide to the Trustee a certificate signed by two Authorised Signatories, certifying either that (i) it has notified the Supervisory Authority of, and/or received the Supervisory Authority's consent to such modification, waiver or substitution, as the case may be; or (ii) the relevant Issuer is not required to notify the Supervisory Authority of, and/or obtain the Supervisory Authority's consent to, such modification, waiver or substitution. The Trustee shall be entitled to rely absolutely on such certificate without further enquiry and without liability for so doing.

(e) *Effect for the Holders:* Any such substitution shall be binding on all the Noteholders and Couponholders of the relevant Series and shall be notified to the holders of Notes of that Series not less than 30 nor more than 60 days' prior to such substitution taking effect in accordance with Condition 20 (*Notices*).

In connection with the exercise of its powers, trusts, authorities or discretions (including, but not limited to, those in relation to any such modification, waiver, authorisation or substitution as aforesaid) the Trustee shall have regard to the interests of the holders of the Notes of the relevant Series as a class and in particular, but without limitation, shall not have regard to the consequences of such exercise for individual Noteholders or Couponholders resulting from the individual Noteholders or Couponholders being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory and the Trustee shall not be entitled to require, nor shall any Noteholder or Couponholder be entitled to claim, from the relevant Issuer any indemnification or payment in respect of any tax consequences of any such exercise upon individual Noteholders or Couponholders.

19. **Further Issues**

The relevant Issuer may from time to time, without the consent of the Noteholders and in accordance with the Trust Deed, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the date for, and the amount of, the first payment of interest) so as to form a single series with the Notes. The relevant Issuer may from time to time, with the consent of the Trustee, create and issue other series of notes having the benefit of the Trust Deed.

20. **Notices**

(a) *Bearer Notes:* Notices to the Holders of Bearer Notes shall be valid if published in a leading English language daily newspaper published in London (which is expected to be the *Financial Times*) or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. Any such notice shall be deemed to have been given on the date of first publication (or if required to be published in more than one newspaper, on the first date on which publication shall have been made in all the required newspapers). Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Holders of Bearer Notes.

(b) *Registered Notes:* Notices to the Holders of Registered Notes shall be sent to them by first class mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective addresses on the Register. Any such notice shall be deemed to have been given on the fourth day after the date of mailing.

21. **Rounding**

For the purposes of any calculations referred to in these Conditions (unless otherwise specified in these Conditions or the relevant Final Terms), (a) all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point (with 0.000005 per cent. being rounded up to 0.00001 per cent.), (b) all United States dollar amounts used in or resulting from such calculations will be rounded to the nearest cent (with one half cent being rounded up), (c) all Japanese Yen amounts used in or resulting from such calculations will be rounded downwards to the next lower whole Japanese Yen amount, and (d) all amounts denominated in any other currency used in or resulting from such calculations will be rounded to the nearest two decimal places in such currency, with 0.005 being rounded upwards.

22. **Governing Law and Jurisdiction**

(a) *Governing law:* The Notes and the Trust Deed and all non-contractual obligations arising out of or in connection with the Notes and the Trust Deed are governed by English law.

(b) *Jurisdiction:* The parties to the Trust Deed have (i) agreed that the courts of England shall have exclusive jurisdiction to settle any dispute (a "**Dispute**") arising out of or in connection with the Notes (including a dispute relating to the Notes or any non-contractual obligation arising out of or in connection with them); and (ii) agreed that those courts are the most appropriate and convenient courts to settle any Dispute and, accordingly, that they will not argue that any other courts are more appropriate or convenient.

## FORM OF FINAL TERMS

**Final Terms dated [•]**

**[VIRGIN MONEY HOLDINGS (UK) PLC] /**

**[VIRGIN MONEY PLC]**

Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes]

under the **£3,000,000,000 Global Medium Term Note Programme**

**PART A – CONTRACTUAL TERMS**

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions of the Notes (the "**Conditions**") set forth in the offering circular dated 14 April 2016 [and the supplemental offering circular dated [•]] (together, the "**Offering Circular**") which [together] constitute[s] listing particulars for the purposes of Chapter 4 of the listing rules of the United Kingdom Financial Conduct Authority. This document constitutes the Final Terms of the Notes described herein and must be read in conjunction with the Offering Circular.

[*The following alternative language applies if the first tranche of an issue which is being increased was issued under an offering circular with an earlier date and the relevant terms and conditions from that offering circular with an earlier date were incorporated by reference in this Offering Circular.*

Terms used herein shall be deemed to be defined as such for the purposes of the 2015 Conditions (the "**Conditions**") incorporated by reference in the Offering Circular dated 27 March 2015. These Final Terms contain the final terms of the Notes and must be read in conjunction with the Offering Circular dated 14 April 2016 [and the supplemental Offering Circular dated [*date*]] (together, the "**Offering Circular**") which [together] constitute[s] listing particulars for the purposes of Chapter 4 of the listing rules of the United Kingdom Financial Conduct Authority, save in respect of the Conditions which are set forth in the offering circular dated 27 March 2015 and are incorporated by reference in the Offering Circular. This document constitutes the Final Terms of the Notes described herein and must be read in conjunction with the Offering Circular.]

Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Offering Circular. The Offering Circular is available for viewing [at [*www.londonstockexchange.com/exchange/news/market-news/market-news-home.html*] [and] [during normal business hours at the registered office of the Issuer at Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL, United Kingdom].

No prospectus is required under Directive 2003/71/EC (as amended) for this issue of the Notes described herein.

| | | | |
|---|---|---|---|
| 1. | Issuer: | | [Virgin Money Holdings (UK) plc]<br>[Virgin Money plc] |
| 2. | (i) | Series Number: | [•] |
| | (ii) | Tranche Number: | [•] |
| | (iii) | Date on which the Notes become fungible: | [Not Applicable/The Notes shall be consolidated, form a single series and be interchangeable for trading purposes with the [•] on [[•]/the Issue Date/exchange of the Temporary Global Note for interests in the Permanent Global Note, as referred to in paragraph [24] below [which is expected to occur on or about [•]].] |
| 3. | Specified Currency or Currencies: | | [•] |

| | | | |
|---|---|---|---|
| 4. | Aggregate Nominal Amount: | | [•] |
| | [(i)] | [Series]: | [•] |
| | [(ii) | Tranche: | [•]] |
| 5. | Issue Price: | | [•] per cent. of the Aggregate Nominal Amount [plus accrued interest from [•]] |
| 6. | (i) | Specified Denominations: | [•] |
| | (ii) | Calculation Amount: | [•] |
| 7. | (i) | Issue Date: | [•] |
| | (ii) | Interest Commencement Date: | [[•]/Issue Date/Not Applicable] |
| 8. | Maturity Date: | | [•] |
| 9. | Interest Basis: | | [[•] per cent. Fixed Rate]<br><br>[Reset Notes]<br><br>[EURIBOR/LIBOR] +/- [•] per cent. Floating Rate]<br><br>[Zero Coupon]<br><br>(see paragraph [14/15/16/17] below) |
| 10. | Redemption/Payment Basis: | | Subject to any purchase and cancellation or early redemption, the Notes will be redeemed on the Maturity Date at [[•]/[100]] per cent. of their nominal amount. |
| 11. | Change of Interest or Redemption/ Payment Basis: | | [[•]/Not Applicable] |
| 12. | Put/Call Options: | | [Investor Put]<br><br>[Issuer Call]<br><br>[(see paragraph [18/19] below)]<br><br>[Not Applicable] |
| 13. | [(i)] | Status of the Notes: | [Senior/Tier 2 Capital Notes] |
| | [(ii)] | [Date [Board] approval for issuance of Notes obtained]: | [•] |

**PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE**

| | | | |
|---|---|---|---|
| 14. | **Fixed Rate Note Provisions** | | [Applicable/Not Applicable/Applicable from [•] to [•] [if so elected by the Issuer on or before [•]]] |
| | (i) | Rate[(s)] of Interest: | [•] per cent. per annum payable in arrear on each Interest Payment Date |
| | (ii) | Interest Payment Date(s): | [•] [and [•]] in each year |
| | (iii) | Fixed Coupon Amount[(s)]: | [•] per Calculation Amount |

| | | |
|---|---|---|
| (iv) | Broken Amount(s): | [•] per Calculation Amount, payable on the Interest Payment Date falling [in/on] [•] |
| (v) | Day Count Fraction: | [30/360 / Actual/Actual (ICMA) Actual/Actual (ISDA) / Actual/365 (Fixed) / Actual/360 / 30E/360 / Eurobond Basis / 30E/360 (ISDA)] |

15. **Reset Note Provisions** [Applicable/Not Applicable]

| | | |
|---|---|---|
| (i) | Initial Rate of Interest: | [•] per cent. per annum payable in arrear [on each Interest Payment Date] |
| (ii) | Reset Rate: | [Mid-Swap Rate]/[Benchmark Gilt Rate] |
| (iii) | First Margin: | [+/-][•] per cent. per annum |
| (iv) | Subsequent Margin: | [[+/-][•] per cent. per annum]/[Not Applicable][1] |
| (v) | Interest Payment Date(s): | [•] [and [•]] in each year up to and including the Maturity Date |
| (vi) | Fixed Coupon Amount up to (but excluding) the First Reset Date: | [[•] per Calculation Amount]/[Not Applicable] |
| (vii) | Broken Amount(s): | [[•] per Calculation Amount payable on the Interest Payment Date falling [in/on] [•]]/[Not Applicable] |
| (viii) | First Reset Date: | [•] |
| (ix) | Subsequent Reset Date(s): | [•] [and [•]] |
| (x) | Relevant Screen Page: | [•] |
| (xi) | Mid-Swap Rate: | [Single Mid-Swap Rate/Mean Mid-Swap Rate] |
| (xii) | Mid-Swap Maturity: | [•] |
| (xiii) | Reference Rate: | [EURIBOR/LIBOR] |
| (xiv) | Reference Banks: | [•] |
| (xv) | Day Count Fraction: | [30/360 / Actual/Actual (ICMA) / Actual/Actual (ISDA) / Actual/365 (Fixed) / Actual/360 / 30E/360 / Eurobond Basis / 30E/360(ISDA)] |
| (xvi) | Reset Determination Dates: | [[•] in each year]/[The provisions in the Conditions apply] |
| (xvii) | Party responsible for calculating the Rate(s) of Interest and/or Interest Amount(s) (if not the [Principal Paying Agent]): | [[•] shall be the Calculation Agent] |
| (xviii) | Mid-Swap Floating Leg | [EURIBOR/ LIBOR/[•]] |

[1] For Tier 2 Capital Notes, the Subsequent Margin shall be equal to the First Margin.

Benchmark Rate

| | | | |
|---|---|---|---|
| 16. | **Floating Rate Note Provisions** | | [Applicable/Not Applicable/Applicable from [•] to [•] [if so elected by the Issuer on or before [•]]] |
| | (i) | Specified Period: | [•] |
| | (ii) | Interest Payment Dates: | [•] in each year |
| | (iii) | First Interest Payment Date: | [•] |
| | (iv) | Business Day Convention: | [Following Business Day Convention/Modified Following Business Day Convention/Modified Business Day Convention/Preceding Business Day Convention/FRN Convention/Floating Rate Convention/Eurodollar Convention/No Adjustment]/[Not Applicable] |
| | (v) | Additional Business Centre(s): | [Not Applicable/[•]] |
| | (vi) | Manner in which the Rate(s) of Interest is/are to be determined: | [Screen Rate Determination/ISDA Determination] |
| | (vii) | Party responsible for calculating the Rate(s) of Interest and/or Interest Amount(s) (if not the [Principal Paying Agent]): | [[•] shall be the Calculation Agent] |
| | (viii) | Screen Rate Determination: | |
| | | • Reference Rate: | [EURIBOR/LIBOR] |
| | | • Reference Banks: | [•] |
| | | • Interest Determination Date(s): | [•] |
| | | • Relevant Screen Page: | [•] |
| | | • Relevant Time: | [•] |
| | | • Relevant Financial Centre: | [•] |
| | (ix) | ISDA Determination: | |
| | | • Floating Rate Option: | [•] |
| | | • Designated Maturity: | [•] |
| | | • Reset Date: | [•] |
| | | • ISDA Definitions: | 2006 |
| | (x) | Linear Interpolation: | [Not Applicable/Applicable – the Rate of Interest for the [long/short] [first/last] Interest Period shall be calculated using Linear Interpolation] |
| | (xi) | Margin(s): | [+/-][•] per cent. per annum |

| | | | |
|---|---|---|---|
| | (xii) | Minimum Rate of Interest: | [•] per cent. per annum |
| | (xiii) | Maximum Rate of Interest: | [•] per cent. per annum |
| | (xiv) | Day Count Fraction: | [30/360 / Actual/Actual (ICMA) / Actual/Actual (ISDA) / Actual/365 (Fixed) / Actual/360 / 30E/360 / Eurobond Basis / 30E/360(ISDA)] |
| 17. | **Zero Coupon Note Provisions** | | [Applicable/Not Applicable] |
| | (i) | Accrual Yield: | [•] per cent. per annum |
| | (ii) | Reference Price: | [•] |
| | (iii) | Day Count Fraction in relation to Early Redemption Amount: | [30/360 / Actual/Actual (ICMA) / Actual/Actual (ISDA) / Actual/365 (Fixed) / Actual/360 / 30E/360 / Eurobond Basis / 30E/360(ISDA)] |

**PROVISIONS RELATING TO REDEMPTION**

| | | | |
|---|---|---|---|
| 18. | **Call Option** | | [Applicable/Not Applicable] |
| | (i) | Optional Redemption Date(s) (Call): | [•] |
| | (ii) | Optional Redemption Amount (Call) of each Note: | [•] per Calculation Amount |
| | (iii) | Series redeemable in part: | [[Yes; [•] per cent. of the Aggregate Nominal Amount of the Notes may be redeemed on [each][the] Optional Redemption Date (Call)] / [No]] |
| | (iv) | If redeemable in part: | |
| | | Minimum Redemption Amount: | [•] per Calculation Amount |
| | | Maximum Redemption Amount | [•] per Calculation Amount |
| | (v) | Notice period: | [•] / As per the Conditions |
| 19. | **Put Option** | | [Applicable/Not Applicable] |
| | (i) | Optional Redemption Date(s) (Put): | [•] |
| | (ii) | Optional Redemption Amount (Put) of each Note: | [•] per Calculation Amount |
| | (iii) | Notice period: | [•] / As per the Conditions |
| 20. | **Final Redemption Amount of each Note** | | [•] per Calculation Amount |
| 21. | **Optional Redemption Amount (Regulatory Event)** | | [[•] per Calculation Amount/Not Applicable] |
| 22. | **Early Redemption Amount (Tax)** | | [[•] per Calculation Amount/Not Applicable] |
| 23. | **Early Termination Amount** | | [[•] per Calculation Amount/Not Applicable] |

**GENERAL PROVISIONS APPLICABLE TO THE NOTES**

| | | |
|---|---|---|
| 24. | **Form of Notes:** | **Bearer Notes:**<br><br>[Temporary Global Note exchangeable for a Permanent Global Note which is exchangeable for Definitive Notes on [•] days' notice/at any time/in the limited circumstances specified in the Permanent Global Note]<br><br>[Temporary Global Note exchangeable for Definitive Notes on [•] days' notice]<br><br>[Permanent Global Note exchangeable for Definitive Notes on [•] days' notice/at any time/in the limited circumstances specified in the Permanent Global Note]<br><br>**Registered Notes**:<br><br>[Unrestricted Global Note Certificate exchangeable for Unrestricted Individual Note Certificates on [•] days' notice/at any time/in the limited circumstances specified in the Unrestricted Global Note Certificate]<br><br>[and]<br><br>[Restricted Global Note Certificate exchangeable for Restricted Individual Note Certificates on [•] days' notice/at any time/in the limited circumstances specified in the Restricted Global Note Certificate]<br><br>[and]<br><br>[Restricted Global Note Certificate [(U.S.$ [•]/Euro [•] nominal amount)] registered in the name of a nominee for [DTC].]<br><br>[Unrestricted Global Note Certificate [(U.S.$/Euro [•] nominal amount)] registered in the name of a nominee for [a common depositary for Euroclear and Clearstream, Luxembourg/a common safekeeper for Euroclear and Clearstream, Luxembourg (that is, held under the New Safekeeping Structure (NSS))].]<br><br>[Individual Note Certificates] |
| 25. | New Global Note: | [Yes]/[No]/[Not Applicable] |
| 26. | New Safekeeping Structure: | [Yes]/[No]/[Not Applicable] |
| 27. | Additional Financial Centre(s) or other special provisions relating to payment dates: | [Not Applicable/[•]] |
| 28. | Talons for future Coupons to be attached to Definitive Notes (and dates on which such | [Yes/No. As the Notes have more than 27 coupon payments, talons may be required if, |

| | |
|---|---|
| Talons mature): | on exchange into definitive form, more than 27 coupon payments are left.] |

Signed on behalf of [Virgin Money Holdings (UK) plc]/[Virgin Money plc]:

By: ............................................
Duly authorised

## PART B – OTHER INFORMATION

1. **LISTING AND ADMISSION TO TRADING**

| | |
|---|---|
| (i) Admission to Trading: | [Application has been made by the Issuer (or on its behalf) for the Notes to be admitted to trading on the Professional Securities Market of the London Stock Exchange with effect from [•].] [Application is expected to be made by the Issuer (or on its behalf) for the Notes to be admitted to trading on the Professional Securities Market of the London Stock Exchange with effect from [•].] [Not Applicable.] |
| (ii) Estimate of total expenses related to admission to trading: | [•] |

2. **RATINGS**

The Notes to be issued [have [not] been/are expected to be] rated[:

[Fitch Ratings Limited ("**Fitch**"): [•]]

[[Other]: [•]]

[Each of] [Fitch] [and [•]] is established in the EEA and registered under Regulation (EU) No.1060/2009, as amended (the "**CRA Regulation**")]].

3. **[INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUE/OFFER]**

[Save for any fees payable to the [Managers/Dealers], so far as the Issuer is aware, no person involved in the offer of the Notes has an interest material to the offer. The [Managers/Dealers] and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform other services for, the Issuer and its affiliates in the ordinary course of business.]

4. **USE OF PROCEEDS**

[It is the Issuer's intention to use the proceeds of the issue of the Notes issued by it, to initially make an investment in the Bank in the form of [senior debt] / [subordinated debt intended to qualify as tier 2 capital of the Bank]. The Issuer retains the discretion to restructure any investment made with the proceeds at any time.]/[•]

5. **[*Fixed Rate Notes only* – YIELD**

| | |
|---|---|
| Indication of yield: | [•] |
| | [The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.] |

6. **OPERATIONAL INFORMATION**

| | |
|---|---|
| ISIN: | [•] |
| CUSIP: | [•] [Not Applicable] |
| Common Code: | [•] |

| | |
|---|---|
| Any clearing system(s) other than Euroclear and/or Clearstream, Luxembourg and the relevant identification number(s): | [•] [Not Applicable] |
| Delivery: | Delivery [against/free of] payment |
| Names and addresses of additional Paying Agent(s) (if any): | [•] |
| [Intended to be held in a manner which would allow Eurosystem eligibility: | [Yes. Note that the designation "yes" simply means that the Notes are intended upon issue to be deposited with one of the ICSDs as common safekeeper [, and registered in the name of a nominee of one of the ICSDs acting as common safekeeper,] and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon the ECB being satisfied that Eurosystem eligibility criteria have been met.] /<br><br>[No. Whilst the designation is specified as "no" at the date of these Final Terms, should the Eurosystem eligibility criteria be amended in the future such that the Notes are capable of meeting them the Notes may then be deposited with one of the ICSDs as common safekeeper [, and registered in the name of a nominee of one of the ICSDs acting as common safekeeper]. Note that this does not necessarily mean that the Notes will then be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem at any time during their life. Such recognition will depend upon the ECB being satisfied that Eurosystem eligibility criteria have been met.] |

7. **DISTRIBUTION**

| | | |
|---|---|---|
| (i) | Method of Distribution: | [Syndicated/Non-syndicated] |
| (ii) | If syndicated: | |
| | (a) Names of Dealers: | [•] |
| | (b) Stabilising Manager(s) (if any): | [Not Applicable/[•]] |
| (iii) | If non-syndicated, name of Dealer: | [Not Applicable/[•]] |
| (iv) | U.S. Selling Restrictions | Reg. S Compliance Category 2; - [TEFRA C/TEFRA D/TEFRA not applicable] – [Not] Rule 144A Eligible |

## USE OF PROCEEDS

The net proceeds from the issue of each Tranche of Senior Notes will be used for the general corporate purposes of the Virgin Money Group, as may be more specifically set out in the Final Terms.

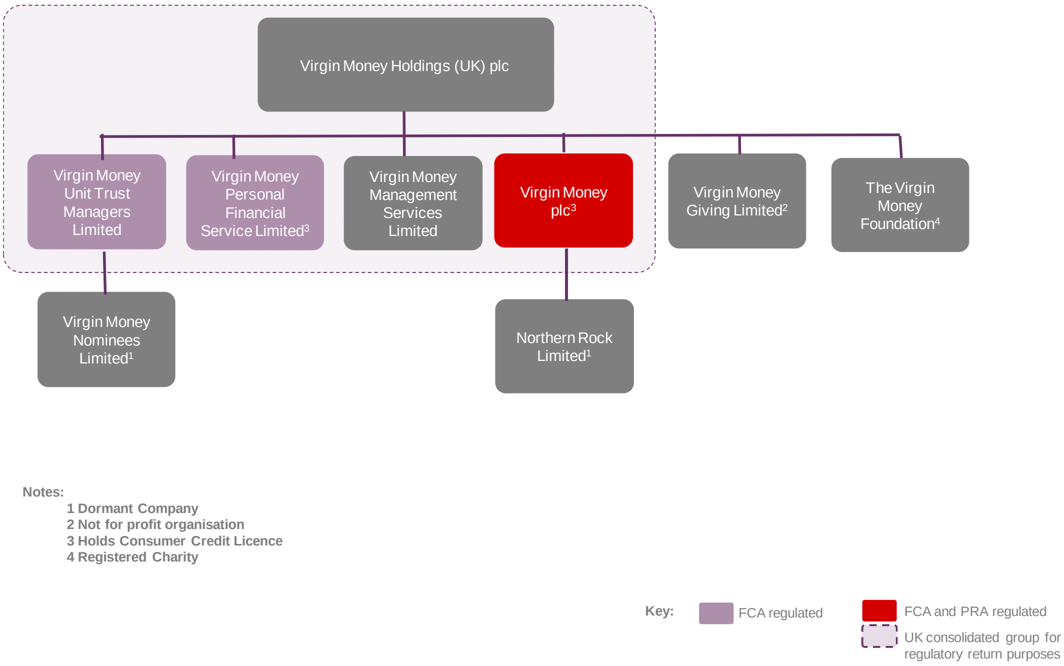
The net proceeds from the issue of each Tranche of Tier 2 Capital Notes will be used for general corporate purposes of the Virgin Money Group and to further strengthen the regulatory capital base of the relevant Issuer and/or the Virgin Money Group, as may be more specifically set out in the Final Terms.

## DESCRIPTION OF VIRGIN MONEY

### THE ISSUERS AND THE VIRGIN MONEY GROUP

Virgin Money Holdings (UK) plc ("**HoldCo**") and Virgin Money plc (the "**Bank**") are public limited companies registered in England and Wales, under numbers 03087587 and 06952311, respectively. HoldCo is the ultimate holding company of the Virgin Money Group and the whole of the issued ordinary share capital of the Bank is beneficially owned by HoldCo.

The chart below sets out the current structure of the Virgin Money Group.




The Virgin Money Group is primarily focused on providing residential mortgages, savings and credit cards, along with a range of financial products including investments and insurance. With over 3 million customers the Virgin Money Group provides access to its products and services to customers through a range of channels, including digital (online and mobile), intermediaries, call centres and a national network of 75 stores and six customer lounges. Access to certain banking services is also available through the Post Office's 11,500 branches. The Virgin Money Group's operations are centred in Gosforth, with additional offices in London, Edinburgh, Norwich, Chester and Milton Keynes. The monthly average number of persons (including directors) employed by the Virgin Money Group was 3,058 in 2015 (2014: 2,904).

The Virgin Money Group's approach to banking reflects its corporate ambition of making "everyone better off". The Virgin Money Group aspires to offer good value to customers, treat its employees well, make a positive contribution to society, build positive relationships with its corporate partners and deliver sustainable profits to shareholders.

The registered office of both Issuers is at Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL, United Kingdom. Virgin Money's internet address is www.virginmoney.com (it should be noted that the content of the www.virginmoney.com website does not form part of this Offering Circular) and its telephone number is +44 845 600 8401.

As at the date of this Offering Circular, HoldCo is unrated and the Bank has been assigned a Short-term Issuer Default Rating of F2 and a Long-term Issuer Default Rating of BBB+ by Fitch. The Bank's ratings were upgraded in January 2014, from F3 and BBB, respectively, and the outlook is positive.

### HISTORY

Virgin Money commenced operations as Virgin Direct in 1995, initially offering personal equity plans (known as PEPs) and later personal pensions, ISAs and various forms of insurance. In 1997, Virgin One

Ltd, a joint venture between Virgin Direct and The Royal Bank of Scotland plc ("**RBS**") developed an innovative current account mortgage (the "**Virgin One Account**") and this business was sold to RBS in 2001. In 2002, Virgin Direct was rebranded as Virgin Money and launched the Virgin Money credit card in partnership with MBNA. In 2010, Virgin Money obtained its first deposit taking licence following the acquisition of Church House Trust, a small privately owned, regional bank.

Northern Rock Building Society was formed in 1965 following the merger of the Northern Counties Permanent Building Society and the Rock Building Society. It converted to a public limited company in 1997 when it was also listed on the London Stock Exchange. In 2008, it entered temporary public ownership and, on 1 January 2010, its business was separated into two entities: the original entity renamed Northern Rock (Asset Management) plc and, subsequently, NRAM plc ("**NRAM**"), which retained all stressed and securitised assets and continues to be owned by HM Treasury through UK Asset Resolution, and a new entity, Northern Rock plc, which held all of the customer retail savings and current accounts and a core portfolio of high quality performing mortgage assets. In addition, all branches, mortgage origination capabilities and information technology were transferred to the new Northern Rock plc.

Following the separation, Northern Rock plc carried on business as a mortgage and savings bank, primarily funded by retail deposits.

On 1 January 2012, HoldCo acquired the entire issued share capital of Northern Rock plc from HM Treasury. As a result, Northern Rock plc became part of Virgin Money and it was renamed Virgin Money plc on 12 October 2012. As part of the acquisition, a new board of directors of Northern Rock plc was appointed on 1 January 2012.

On 2 January 2012, the Bank (then still known as Northern Rock plc) acquired Virgin Money Cards Limited (formerly Virgin Money Limited) from HoldCo. The principal business of Virgin Money Cards Limited was the marketing of personal credit cards and pre-paid cards which were distributed pursuant to partnership agreements with MBNA.

On 20 July 2012, the Bank entered into a transaction to acquire a mortgage portfolio of NRAM originated loans from NRAM for a purchase consideration of £466.4 million, paid in cash.

On 18 January 2013, the Bank completed the sale of Virgin Money Cards Limited to MBNA and the acquisition from MBNA of £1.0 billion of assets from the Virgin Money credit card portfolio. Since then, the Bank has provided on-going funding and liquidity for these credit card assets and has taken the full economic risk and reward for these assets onto the Bank's balance sheet. Under a transitional arrangement agreed as part of the MBNA transaction, up until 30 November 2014, MBNA originated new credit card accounts on Virgin Money's behalf. On 30 November 2014, the Bank completed an agreement to purchase the assets originated during this period which had a fair value of £354.5 million. The Bank now originates its own credit cards.

On 13 November 2014, HoldCo successfully listed on the London Stock Exchange, via an initial public offering.

**BOARD OF DIRECTORS**

The below table lists the directors of HoldCo and the Bank.

| Directors of HoldCo | Directors of the Bank |
|---|---|
| Glen Moreno | Glen Moreno |
| Jayne-Anne Gadhia | Jayne-Anne Gadhia |
| Norman McLuskie | Marian Martin |
| Colin Keogh | Norman McLuskie |
| Marilyn Spearing | Colin Keogh |
| Patrick McCall | Marilyn Spearing |
| Gordon McCallum | Geeta Gopalan |
| Geeta Gopalan | |

The directors' months and years of birth, dates of appointment, functions within the Virgin Money Group and principal directorships are as set out below.

| **Name (and date of birth)** | **Date of appointment (HoldCo)** | **Date of appointment (Bank)** | **Business functions within the Virgin Money Group** | **Principal directorships** |
|---|---|---|---|---|
| Glen Moreno (July 1943) | 1 January 2015 | 1 January 2015 | Chairman and non-executive director of HoldCo and the Bank | Fidelity International Limited; Promotora De Informaciones, S.A. |
| Jayne-Anne Gadhia, CBE (October 1961) | 12 March 2007 | 1 January 2012 | CEO of HoldCo and the Bank | Business in the Community; The Great Steward of Scotland's Dumfries House Trust |
| Marian Martin (September 1967) | N/A | 1 January 2012 | CRO of HoldCo | Northern Rock Limited; Virgin Money Management Services Limited; Virgin Money Nominees Limited; Virgin Money Personal Financial Service Limited; Virgin Money Unit Trust Managers Limited |
| Norman McLuskie (August 1944) | 27 January 2010 | 1 January 2012 | Senior Independent non-executive director of HoldCo and the Bank | None |
| Colin Keogh (July 1953) | 27 January 2010 | 1 January 2012 | Independent non-executive director of HoldCo and the Bank | Hiscox Ltd; Premium Credit Limited; M&G Group Limited |
| Marilyn H. Spearing (November 1954) | 29 January 2014 | 29 January 2014 | Independent non-executive director of HoldCo and the Bank | None |
| Patrick McCall (November 1964) | 22 June 2012 | N/A | Non-executive director of HoldCo | Inter City Railways Limited; Vieco 10 Limited; Virgin Active International Ventures Limited; Virgin Rail Group Holdings Limited; East Coast Main Line Company Limited; Worldvu Satellites Limited; Rail Delivery Group Limited |
| Gordon McCallum | 21 January 1998 | N/A | Non-executive director of | Virgin Atlantic Limited; Virgin Atlantic Airways Limited; Virgin Holidays |

| Name (and date of birth) | Date of appointment (HoldCo) | Date of appointment (Bank) | Business functions within the Virgin Money Group | Principal directorships |
|---|---|---|---|---|
| (April 1960) | | | HoldCo | Limited; Virgin Travel Group Limited; Virgin Atlantic Two Limited; Virgin Atlantic International Limited; Jubilee Film Partnership LLP; The China Navigation Company PTE. LTD.; John Swire & Sons Limited; John Swire & Sons (Green Investments) Limited; Hunter Boot Limited; Mustique Company Limited |
| Geeta Gopalan (July 1964) | 25 June 2015 | 25 June 2015 | Independent non-executive director of HoldCo and the Bank | Vocalink Holdings Limited; Advanced Payment Technology Limited |

The business addresses of the directors are:

(a) Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL (Glen Moreno, Jayne-Anne Gadhia, Marian Martin, Norman McLuskie, Colin Keogh, Marilyn Spearing and Geeta Gopalan); and

(b) The Battleship Building, 179 Harrow Road, London W2 6NB (Patrick McCall and Gordon McCallum).

**MANAGEMENT**

Whilst the HoldCo and Bank boards of directors are responsible for the strategy and policy of the Virgin Money Group, implementation of policy and day-to-day management of the Bank, as the major operating subsidiary, is delegated to the senior managers (the "**Senior Managers**"):

| Name | Age | Position |
|---|---|---|
| Jayne-Anne Gadhia............................ | 54 | Chief Executive Officer |
| Dave Dyer.......................................... | 59 | Chief Financial Officer |
| Marian Martin.................................... | 48 | Chief Risk Officer |
| Richard Hemsley | 51 | Chief Banking Officer |
| Matt Elliott......................................... | 42 | HR Director |
| Michele Greene.................................. | 50 | Director of Strategic Development |
| Andrew Emuss................................... | 46 | General Counsel |
| Caroline Marsh .................................. | 52 | Culture Director |

The business address of the Senior Managers is Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL.

There exist no potential conflicts of interest between (i) any duties owed to the Virgin Money Group by any member of the board of directors or any of the Senior Managers listed above and (ii) their private interests and/or other duties.

**STRATEGY**

In keeping with the Virgin Money Group's positioning as an effective competitor to the large incumbent banks in the UK retail financial sector and the Virgin Money Group's ambition of making "everyone better off", the directors of HoldCo and the Bank have agreed a strategy focused on:

- Continuing strong growth in the Virgin Money Group's core mortgages, savings and credit cards businesses, along with further product extensions over time;
- Maintaining high asset quality and a low cost of risk through a robust risk management approach; and
- Delivering strong returns by increasing net interest margins, rigorous cost management, growing Virgin Money's non-interest income and optimising capital efficiency.

**FINANCIAL PERFORMANCE**

Based on the Virgin Money Group's audited financial information for the year ended 31 December 2015, the Virgin Money Group had total assets of £30,229.0 million, total net loans and advances of £27,723.5 million, total deposits of £26,443.6 million and total shareholder's equity of £1,340.3 million. Underlying profit before tax for the year ended 31 December 2015 was £160.3 million and on an underlying basis total income grew by 19.4 per cent to £523.1 million, reflecting the improved underlying net interest margin as well as the increase in mortgage balances. A 15 basis point increase in net interest margin to 1.65 per cent was principally driven by a reduction in cost of funding and a more favourable asset mix, which more than offset the pressure on mortgage pricing. Statutory profit before tax was £138.0 million. The financial information in this paragraph is extracted from the audited consolidated financial statements of HoldCo for the year ended 31 December 2015.

Based on the Bank's audited financial information for the year ended 31 December 2015, the Bank had total assets of £31,773.7 million, total net loans and advances of £27,488.2 million, total deposits of £26,429.1 million and total shareholder's equity of £1,328.3 million. Statutory profit before tax was £110.3 million. The financial information in this paragraph is extracted from the audited non-consolidated financial statements of the Bank for the year ended 31 December 2015.

**BUSINESS DESCRIPTION**

The Virgin Money Group's core business is providing personal financial services to UK consumers. It operates exclusively within the UK with the exception of wholesale funding and liquidity management activities which are undertaken in both the UK and, on a limited basis, in overseas markets. The Virgin Money Group operates through three business segments:

- Mortgages and savings;
- Credit cards; and
- Current accounts, Insurance and Investments.

These business units are supported by central functions, which provide group and back office functions.

***Residential mortgage lending***

The Virgin Money Group's core lending activity is the provision of residential mortgages to individuals secured on residential properties located in the UK. This lending is principally to borrowers who are owner and occupier of the mortgaged property, with a proportion (17 per cent.) being to borrowers who are landlords in respect of the mortgaged property.

| | 31 December | | |
|---|---|---|---|
| | **2015** | **2014** | **2013** |
| | | *(£ million)* | |
| **Gross loans and advances to customers** | | | |
| Residential mortgage loans | 21,060.3 | 18,759.5 | 17,205.8 |
| Residential buy-to-let mortgage loans | 4,401.9 | 3,135.6 | 2,371.3 |
| **Residential mortgages total** | **25,462.2** | **21,895.1** | **19,577.1** |

The weighted average indexed loan-to-value ratio ("**LTV**") of the Virgin Money Group's residential mortgage portfolio was 55.0 per cent. as at 31 December 2015 (55.7 per cent. and 59.8 per cent. as at 31 December 2014 and 31 December 2013 respectively). The weighted average indexed LTV of the

Virgin Money Group's residential mortgage new lending was 68.0 per cent. to 31 December 2015 (66.9 per cent. and 65.4 per cent. over the years to 31 December 2014 and 31 December 2013). Only 1.0 per cent. of the Virgin Money Group's total residential mortgage book at 31 December 2015 had an indexed LTV ratio in excess of 90 per cent., based on value.

Secured impairment allowances increased from £7.6 million to £8.7 million during 2015 in line with portfolio growth. Provisions as a percentage of impaired loans have increased from 9.9 per cent. in 2014 to 10.3 per cent. as at 31 December 2015.

The Virgin Money Group has experienced a historically low loss experience in its residential mortgage portfolio. While gross mortgage balances grew 16 per cent. to £25.5 billion as at 31 December 2015 (compared to £21.9 billion as at 31 December 2014), the Virgin Money Group's residential mortgage asset quality remained strong, with loans over three months in arrears decreasing to 0.22 per cent. of the book as at 31 December 2015 (compared to 0.31 per cent. of the book as at 31 December 2014 and 0.36 per cent. as at 31 December 2013). The Virgin Money Group's arrears performance significantly outperforms the industry, with the Council of Mortgage Lenders industry average of loans more than three months in arrears as a proportion of total book, at 1.12 per cent as at 31 December 2015 (compared to 1.33 per cent. as at 31 December 2014 and 1.68 per cent. as at 31 December 2013.

***Retail savings***

The Virgin Money Group has a strong and diversified funding platform. Retail deposit balances were £25.1 billion at 31 December 2015 (compared to £22.4 billion at 31 December 2014 and £21.1 billion at 31 December 2013). The Virgin Money Group focuses on maintaining a stable retail deposit base and has developed its loan-to-deposit ratio from 96.4 per cent. as at 31 December 2012 to 107.5 per cent. as at 31 December 2015. As the Virgin Money Group further develops its wholesale funding capabilities, the amount of wholesale funding may rise but will remain relatively low as a proportion of overall funding. Risk appetite has been updated to accommodate a loan-to-deposit ratio of up to 115 per cent., from 110 per cent., giving further flexibility as a result of successful participation in the wholesale funding markets.

The Virgin Money Group offers a range of savings products, including at a fixed interest rate for a fixed term, or a variable interest rate. Unlike some competitors, variable rate customer accounts do not include an introductory bonus rate, which expires after a specified term, on top of the standard variable deposit rate. This is a deliberate policy which is intended, alongside other product features, to encourage a longer-term relationship with the customer, at fair and sustainable rates.

***Credit cards***

In March 2015, the Bank successfully migrated 675,000 customer accounts from MBNA systems to the new Virgin Money credit card business and platform. The Bank began originating its own credit cards in late 2014 and since then has launched a number of new products to the public.

The Virgin Money Group currently offers a number of Virgin Money branded credit card products designed to meet a range of customer spending, borrowing and debt consolidation needs, in respect of which the Bank bears the credit risk on its balance sheet. The Bank has around 700,000 credit card customers and, as at 31 December 2015, had total credit card balances of £1.6 billion.

Credit cards impaired assets as a percentage of balances have reduced due to improved arrears performance. Gross balances grew from £1.1 billion in 2014 to £1.6 billion in 2015 as a result of new loan growth, yet the gross amount of impaired balances in 2015 was £27.4 million which was unchanged from 2014.

***Current accounts, Insurance and Investments***

*Personal current accounts ("**PCAs**")*

As at 31 December 2015, 126,000 customers held a Virgin Money PCA and balances have grown to £230.3 million. Balances and income for PCAs were reported in the mortgages and savings business line in the 2013 and 2014 annual report and accounts.

In July 2014, the Bank launched a current account, the Virgin Money Essential Current Account, which was rolled out nationally during 2015. The product has the features of a "basic bank account".

*Investments*

The Virgin Money Group's unit trust management and investment intermediary subsidiaries act as fund managers in providing investment funds for customers to invest in via investment ISAs and stakeholder pensions, as well as directly via unit trusts. Total Virgin Money funds under management are £3.0 billion as at 31 December 2015.

*Insurance*

The Virgin Money Group offers the following core insurance products; Travel, Home, Motor, Pet and Life, for which it receives a commission for each new and renewing policy sold of the third-party underwritten insurance products that it markets. The Virgin Money Group does not take any underwriting risk in any of its insurance relationships.

In 2015, the Virgin Money Group's total income from Current Accounts, Insurance and Investments increased to £36.6 million (2014: £32.8 million).

## LIQUIDITY AND FUNDING

The Virgin Money Group's Treasury function manages the Virgin Money Group's liquidity, funding and balance sheet risks. The Virgin Money Group does not manage Treasury as a profit centre and Treasury is not engaged in trading activities.

*Liquidity*

As at 31 December 2015, the Virgin Money Group had total liquid assets of £4.7 billion. This included total level 1 assets of £4.2 billion, of which £2.2 billion were held in Treasury bills raised through the Funding for Lending Scheme, £846.3 million were held in Bank of England reserve account and cash, £409.5 million were held in UK Government securities, and £203.7 million were held in supranational securities. Total level 2a and 2b assets and other liquidity resources for the Virgin Money Group were £209.5 million (Bank: £155.5 million) and self-issued Retail Mortgage Backed Securities ("**RMBS**") amounted to a further £326.7 million. Refer to page 197 of the 2015 Virgin Money Group Annual Report and Accounts for a full analysis of the liquidity portfolio.

*Wholesale funding*

Funding diversification is achieved by the use of long-term wholesale funding primarily through the RMBS market. In 2015 and 2014, the Virgin Money Group undertook limited activity in the wholesale funding markets given the strength of its retail deposit flows combined with the introduction of the Funding for Lending Scheme. In April 2015, the Bank issued £300,000,000 2.250 per cent. Notes due 2020.

As at 31 December 2015, Virgin Money had short-term unsecured funding deposits totaling £23.8 million, which are all short-term deposits used to support working capital rather than funding allocated to mortgage lending. Virgin Money has raised funding through the issuance of RMBS as set out in the table below.

| Date of issue | Principal amount sold | Issuer |
|---|---|---|
| 18 April 2011 | £1,282,000,000 | Gosforth Funding 2011-1 plc(1) |
| 9 July 2012 | £1,067,500,000 | Gosforth Funding 2012-1 plc(1) |
| 19 November 2012 | £2,934,900,000 | Gosforth Funding 2012-2 plc(1) |
| 12 September 2014 | £1,388,900.000 | Gosforth Funding 2014-1 plc(1) |
| 8 June 2015 | £1,388,900,000 | Gosforth Funding 2015-1 plc |
| 25 January 2016 | £1,553,158,602(2) | Gosforth Funding 2016-1 plc |

Note:

(1) These securities were sold primarily to raise funding although certain securities have been retained for contingent funding purposes.

(2) GBP Equivalent

*Funding for Lending Scheme*

As at 31 December 2015, the Virgin Money Group had Funding for Lending Scheme drawings, which are off-balance sheet, of £3 billion.

## CAPITAL ADEQUACY

The Virgin Money Group's capital position under CRD IV as at 31 December 2015:

- Common equity tier 1 ratio was 17.5 per cent.;
- Total capital ratio was 20.2 per cent.; and
- Leverage ratio was 4.0 per cent.

The Bank's capital position under CRD IV as at 31 December 2015:

- Common equity tier 1 ratio was 20.3 per cent.;
- Total capital ratio was 20.4 per cent.; and
- Leverage ratio was 4.0 per cent.

## TAXATION

*The following is a general description of certain UK and European Union tax considerations relating to the Notes. It does not purport to be a complete analysis of all tax considerations relating to the Notes, whether in those countries or elsewhere. Prospective purchasers of Notes should consult their own tax advisers as to which countries' tax laws could be relevant to acquiring, holding and disposing of Notes and receiving payments of interest, principal and/or other amounts under the Notes and the consequences of such actions under the tax laws of those countries. This summary is based upon the law as in effect on the date of this Offering Circular and is subject to any change in law that may take effect after such date.*

### UNITED KINGDOM TAXATION

*The following is a summary of the UK withholding taxation treatment at the date hereof in relation to payments of principal and interest in respect of the Notes. It is based on current law and the practice of Her Majesty's Revenue & Customs ("**HMRC**"), which may be subject to change, sometimes with retrospective effect. The comments do not deal with other UK tax aspects of acquiring, holding or disposing of Notes. The comments relate only to the position of persons who are absolute beneficial owners of the Notes. Prospective Noteholders should be aware that the particular terms of issue of any series of Notes as specified in the relevant Final Terms may affect the tax treatment of that and other series of Notes. The following is a general guide and should be treated with appropriate caution. It is not intended as tax advice and it does not purport to describe all of the tax considerations that might be relevant to a prospective purchaser. Noteholders who are in any doubt as to their tax position should consult their professional advisers. Noteholders who may be liable to taxation in jurisdictions other than the UK in respect of their acquisition, holding or disposal of the Notes are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following comments relate only to certain UK taxation aspects of payments in respect of the Notes. In particular, Noteholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Notes even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the UK.*

#### United Kingdom Withholding Tax on United Kingdom Source Interest

Any Notes issued by either of the Issuers which carry a right to interest will constitute "quoted Eurobonds" provided they are and continue to be listed on a recognised stock exchange, within the meaning of Section 1005 Income Tax Act 2007. Whilst the Notes are and continue to be quoted Eurobonds, payments of interest by the relevant Issuer on the Notes may be made without withholding or deduction for or on account of UK income tax.

Notes will be "listed on a recognised stock exchange" for this purpose if they are admitted to trading on a recognised stock exchange designated as such by an order made by the Commissioners for HMRC and either they are included in the UK official list (within the meaning of Part 6 of the Financial Services and Markets Act 2000) or they are officially listed, in accordance with provisions corresponding to those generally applicable in European Economic Area states, in a country outside the UK in which there is a recognised stock exchange.

The London Stock Exchange is a recognised stock exchange for these purposes, and accordingly the Notes will constitute quoted Eurobonds provided they are and continue to be included in the UK official list and admitted to trading on the Professional Securities Market of that Exchange.

In addition to the exemption set out above, interest on the Notes which are not "regulatory capital securities" for the purposes of The Taxation of Regulatory Capital Securities Regulations 2013 (the "**2013 Regulations**") may be paid without withholding or deduction for or on account of UK income tax provided that the relevant Issuer is and continues to be a "bank" within the meaning of section 991 of the Income Tax Act 2007 and the interest on the Notes is paid in the ordinary course of its business within the meaning of section 878 of the Income Tax Act 2007. In accordance with the published practice of HMRC, such payments will be accepted as being made in the ordinary course of business unless either:

(a) the borrowing in question conforms to any of the definitions of tier 1, 2 or 3 capital adopted by the Bank of England whether or not it actually counts towards tier 1, 2 or 3 capital for regulatory purposes; or

(b) the characteristics of the transaction giving rise to the interest are primarily attributable to an intention to avoid UK tax.

The Issuers understand that HMRC are proposing to withdraw the published statement of practice referred to above as part of a package of proposed measures relating to the taxation of regulatory capital securities. It is unclear at present whether a replacement statement of practice will be published and whether there is any change in HMRC's views on the question of when an interest payment is made by a bank in the ordinary course of business.

Interest on the Notes may be paid without withholding or deduction for or on account of UK income tax if the Notes constitute "regulatory capital securities" for the purposes of the 2013 Regulations and there are no arrangements, the main purpose, or one of the main purposes, of which is to obtain a tax advantage for any person as a result of the application of the 2013 Regulations in respect of the Notes.

A Note will constitute a "regulatory capital security" for the purposes of the 2013 Regulations if the Note qualifies, or has qualified, as a Tier 2 instrument under Article 63 of the Commission Regulation (EU) No. 575/2013 and forms, or formed, a component of Tier 2 capital for the purposes of Commission Regulation (EU) No 575/2013.

It should be noted that the exemption described in relation to "regulatory capital securities" above will not currently be relevant in the case of Notes issued by HoldCo.

In all cases falling outside the exemptions described above, interest on the Notes may fall to be paid under deduction of UK income tax at the basic rate (currently 20 per cent.) subject to such relief as may be available following a direction from HMRC pursuant to the provisions of any applicable double taxation treaty or to any other exemption which may apply. However, such withholding or deduction will not apply if the relevant interest is paid on Notes with a maturity of less than one year from the date of issue and which are not issued under arrangements the intention or effect of which is, to render such Notes part of a borrowing with a total term of a year or more.

**Other Rules Relating to UK Withholding Tax**

Notes may be issued at an issue price of less than 100 per cent. of their principal amount. Any discount element of such Notes will not generally be subject to any UK withholding tax pursuant to the provisions mentioned above.

Where Notes are to be, or may fall to be, redeemed at a premium, as opposed to being issued at a discount, then any such element of premium may constitute a payment of interest. Payments of interest are subject to the rules on UK withholding tax and reporting requirements as outlined above.

Where interest has been paid under deduction of UK income tax, Noteholders who are not resident in the UK may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to "interest" above mean "interest" as understood in UK tax law. The statements above do not take any account of any different definitions of "interest" or "principal" which may prevail under any other law or which may be created by the terms and conditions of the Notes or any related documentation. Where a payment on a Note does not constitute (or is not treated as) interest for UK tax purposes, and the payment has a UK source, it would potentially be subject to UK withholding tax if, for example, it constitutes (or is treated as) an annual payment or a manufactured payment for UK tax purposes (which will be determined by, amongst other things, the terms and conditions specified by the Final Terms of the Note). In such a case, the payment may fall to be made under deduction of UK tax (the rate of withholding depending on the nature of the payment), subject to such relief as may be available following a direction from HMRC pursuant to the provisions of any applicable double taxation treaty, or to any other exemption which may apply.

The above description of the UK withholding tax position assumes that there will be no substitution of either of the Issuers as issuer pursuant to Condition 18 (*Meetings of Noteholders; Modification and Waiver; Substitution*) of the Notes or otherwise and does not consider the tax consequences of any such substitution.

## SUBSCRIPTION AND SALE

Notes may be sold from time to time by either of the Issuers to any one or more of Barclays Bank PLC, BNP Paribas, Citigroup Global Markets Limited, Deutsche Bank AG, London Branch, HSBC Bank plc, Merrill Lynch International, Morgan Stanley & Co. International plc and The Royal Bank of Scotland plc (the "**Dealers**"). The arrangements under which Notes may from time to time be agreed to be sold by either of the Issuers to, and subscribed by, Dealers are set out in a Dealer Agreement dated 14 April 2016 (the "**Dealer Agreement**") and made between the Issuers and the Dealers. If in the case of any Tranche of Notes the method of distribution is an agreement between the relevant Issuer and a single Dealer for that Tranche to be issued by such Issuer and subscribed by that Dealer, the method of distribution will be described in the relevant Final Terms as "Non-Syndicated" and the name of that Dealer and any other interest of that Dealer which is material to the issue of that Tranche beyond the fact of the appointment of that Dealer will be set out in the relevant Final Terms. If in the case of any Tranche of Notes the method of distribution is an agreement between the relevant Issuer and more than one Dealer for that Tranche to be issued by such Issuer and subscribed by those Dealers, the method of distribution will be described in the relevant Final Terms as "Syndicated" and the names of those Dealers and any other interests of any of those Dealers which are material to the issue of that Tranche beyond the fact of the appointment of those Dealers (including whether any of those Dealers has also been appointed to act as Stabilising Manager in relation to that Tranche) will be set out in the relevant Final Terms.

Any such agreement will, *inter alia*, make provision for the form and terms and conditions of the relevant Notes, the price at which such Notes will be subscribed by the Dealer(s) and the commissions or other agreed deductibles (if any) payable or allowable by the relevant Issuer in respect of such subscription. The Dealer Agreement makes provision for the resignation or termination of appointment of existing Dealers and for the appointment of additional or other Dealers either generally in respect of the Programme or in relation to a particular Tranche of Notes.

**United States of America**: *Regulation S Category 2; TEFRA D or TEFRA C as specified in the relevant Final Terms or neither if TEFRA is specified as not applicable in the relevant Final Terms.*

**The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons, except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.**

**Bearer Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986, as amended (the "Code"), and regulations thereunder.**

Unless the Final Terms relating to one or more Tranches of Bearer Notes specifies that the applicable TEFRA exemption is either "TEFRA C Rules" or "not applicable", each Dealer represents and agrees in relation to each Tranche of Notes in bearer form (and each additional Dealer named in the Final Terms will be required to represent and agree) that in addition to the relevant U.S. Selling Restrictions set forth below:

(a) except to the extent permitted under U.S. Treasury Regulations section 1.163 5(c)(2)(i)(D) (or any successor rules in substantially the same form) (the "**TEFRA D Rules**"), (i) it has not offered or sold, and during a 40 day restricted period it will not offer or sell, Notes in bearer form to a person who is within the United States or its possessions or to a U.S. person and (ii) it has not delivered and shall not deliver within the United States or its possessions definitive Notes in bearer form during the restricted period;

(b) it has and throughout the restricted period it will have in effect procedures reasonably designed to ensure that its employees or agents who are directly engaged in selling Notes are aware that such Notes may not be offered or sold during the restricted period to a person who is within the United States or its possessions or to a U.S. person (except to the extent permitted under the TEFRA D Rules);

(c) if it is a U.S. person, it is acquiring the Notes in bearer form for purposes of resale in connection with their original issuance, and if it retains Notes in bearer form for its own account, it will do so in accordance with the requirements of the TEFRA D Rules;

(d) with respect to each affiliate that acquires Notes in bearer form from the Dealer for the purpose of offering or selling such Notes during the restricted period, the Dealer either repeats and confirms the representations and agreements contained in paragraphs (a), (b) and (c) above on such affiliate's behalf or agrees that it will obtain from such affiliate for the benefit of the relevant Issuer the representations and agreements contained in such paragraphs; and

(e) it shall obtain for the benefit of the relevant Issuer the representations, undertakings and agreements contained in sub-clauses (a), (b), (c) and (d) of this paragraph from any person other than its affiliate with whom it enters into a written contract, (a "distributor" as defined in U.S. Treasury Regulation section 1.163-5(c)(2)(i)(D)(4)), for the offer or sale during the restricted period of the Notes.

Terms used in this section shall have the meanings given to them by the Internal Revenue Code and the regulations thereunder, including the TEFRA D Rules.

Where the rules under U.S. Treasury Regulations section 1.163-5(c)(2)(i)(C) (or any successor rules in substantially the same form) (the "**TEFRA C Rules**") are specified in the relevant Final Terms as being applicable in relation to any Notes, the Notes must, in connection with their original issuance, be issued and delivered outside the United States and its possessions and, accordingly, each Dealer has represented and agreed (and each additional Dealer named in the Final Terms will be required to represent and agree) that, in connection with the original issuance of the Notes:

(a) it has not offered, sold or delivered, and will not offer, sell or deliver, directly or indirectly, any Notes within the United States or its possessions; and

(b) it has not communicated, and will not communicate, directly or indirectly, with a prospective purchaser if such Dealer or such prospective purchaser is within the United States or its possessions and will not otherwise involve the United States office of such Dealer in the offer and sale of Notes.

Each Dealer has represented and agreed that and each further Dealer appointed under the Programme will be required to represent and agree that, except as permitted by the Dealer Agreement, it has not offered, sold or in the case of Bearer Notes delivered and will not offer, sell or in the case of Bearer Notes deliver the Notes (i) as part of their distribution at any time, or (ii) otherwise until 40 days after completion of the distribution of an identifiable tranche of which such Notes are a part as determined and certified to the Principal Paying Agent by such Dealer (or in the case of a sale of an identifiable tranche of Notes to or through more than one Dealer, by such Dealers with respect to the Notes of an identifiable tranche purchased by or through it, in which case the Principal Paying Agent shall notify each Dealer once all Dealers have so certified), only in accordance with Rule 903 of Regulation S under the Securities Act, Rule 144A or any other available exemption from registration under the Securities Act. Accordingly, neither it, its affiliates nor any persons acting on its or their behalf have engaged or will engage in any directed selling efforts with respect to the Notes, and it and they have complied and will comply with the offering restrictions requirement of Regulation S. Each Dealer also agrees that, at or prior to confirmation of a sale of Notes, it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration to which it sells Notes during the distribution compliance period other than resales pursuant to Rule 144A relating thereto a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. In addition, until 40 days after the commencement of the offering of any identifiable Tranche of Notes, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of such Tranche of Notes) may violate the registration requirements of the Securities Act if such sale is made otherwise than in accordance with Rule 144A. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside the United States to non U.S. persons in reliance on Regulation S. Notwithstanding the foregoing, Dealers nominated by the relevant Issuer may arrange, through their U.S.-registered broker dealer affiliates, for the offer and resale of Registered Notes to QIBs in the United States pursuant to Rule 144A. Each purchaser of such Notes is hereby notified that the offer and sale of such Notes may be made in reliance upon the exemption from the registration requirements of the Securities Act provided by Rule 144A.

This Offering Circular has been prepared by the Issuers for use in connection with the offer and sale of the Notes outside the United States and for the resale of the Notes in the United States. The Issuers and the Dealers reserve the right to reject any offer to purchase the Notes, in whole or in part, for any reason. This Offering Circular does not constitute an offer to any person in the United States or to any U.S. person, other than any qualified institutional buyer within the meaning of Rule 144A to whom an offer has been made directly by one of the Dealers or its U.S. broker-dealer affiliate. Distribution of this Offering Circular by any non-U.S. person outside the United States or by any qualified institutional buyer in the United States to any U.S. person or to any other person within the United States, other than any qualified institutional buyer and those persons, if any, retained to advise such non-U.S. person or qualified institutional buyer with respect thereto, is unauthorised and any disclosure without the prior written consent of the Issuers of any of its contents to any such U.S. person or other person within the United States, other than any qualified institutional buyer and those persons, if any, retained to advise such non- U.S. person or qualified institutional buyer, is prohibited.

**United Kingdom**

Each Dealer has represented, warranted and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that:

(a) *No deposit-taking*: in relation to any Notes issued by HoldCo having a maturity of less than one year:

(i) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business; and

(ii) it has not offered or sold and will not offer or sell any Notes other than to persons:

(A) whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses; or

(B) who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses,

where the issue of the Notes would otherwise constitute a contravention of Section 19 of the FSMA by HoldCo;

(b) *Financial promotion*: it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not, or in the case of the Bank, would not, if it was not an authorised person, apply to the relevant Issuer; and

(c) General compliance: it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the UK.

**Japan**

The Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948), as amended (the "**FIEA**"). Accordingly, each Dealer has represented, warranted and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer to sell any Notes in Japan or to, or for the benefit of, a resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident in Japan (as defined under Item 5, Paragraph 1, Article 6 of the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949, as amended), except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, FIEA and other relevant laws and regulations of Japan.

**General**

Each Dealer has represented, warranted and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that it has complied and will comply with all applicable laws and regulations in each country or jurisdiction in or from which it purchases, offers, sells or delivers Notes or possesses, distributes or publishes this Offering Circular, any Final Terms, any Drawdown Offering Circular or any related offering material, in all cases at its own expense. Other persons into whose hands this Offering Circular, any Final Terms or any Drawdown Offering Circular comes are required by the Issuers and the Dealers to comply with all applicable laws and regulations in each country or jurisdiction in or from which they purchase, offer, sell or deliver Notes or possess, distribute or publish this Offering Circular, any Final Terms, any Drawdown Offering Circular or any related offering material, in all cases at their own expense.

The Dealer Agreement provides that the Dealers shall not be bound by any of the restrictions relating to any specific jurisdiction (set out above) to the extent that such restrictions shall, as a result of change(s) or change(s) in official interpretation, after the date hereof, of applicable laws and regulations, no longer be applicable but without prejudice to the obligations of the Dealers described in the paragraph headed "*General*" above.

Selling restrictions may be supplemented or modified with the agreement of the relevant Issuer. Any such supplement or modification may be set out in a supplement to this Offering Circular or in a Drawdown Offering Circular.

## TRANSFER RESTRICTIONS

### Regulation S Notes

Each purchaser of Notes outside the United States pursuant to Regulation S and each subsequent purchaser of such Notes in resales prior to the expiration of the distribution compliance period, by accepting delivery of this Offering Circular and the Notes, will be deemed to have represented, agreed and acknowledged that:

(a) it is, or at the time Notes are purchased will be, the beneficial owner of such Notes and:

(i) it is not a U.S. person and it is located outside the United States (within the meaning of Regulation S); and

(ii) it is not an affiliate of the relevant Issuer or a person acting on behalf of such an affiliate;

(b) it understands that such Notes have not been and will not be registered under the Securities Act and that, prior to the expiration of the distribution compliance period (as defined in Regulation S), it will not offer, sell, pledge or otherwise transfer such Notes except:

(i) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S; or

(ii) to the relevant Issuer; or

(iii) in the case of Unrestricted Registered Notes only, in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or the account of a QIB,

in each case in accordance with any applicable securities laws of any State of the United States;

(c) it understands that the Issuers, the Trustee, the Registrar, the Dealers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements; and

(d) it understands that any Bearer Notes, the Unrestricted Global Note Certificate and any unrestricted Individual Note Certificate, unless otherwise determined by the relevant Issuer in accordance with applicable law, will bear a legend to the following effect:

"THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE "**SECURITIES ACT**") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT."

On or prior to the fortieth day after the relevant issue date, Notes represented by an interest in an Unrestricted Global Note Certificate may be transferred to a person who wishes to hold such Notes in the form of an interest in a Restricted Global Note Certificate only upon receipt by the Registrar of a written certification from the transferor (in the form set out in Schedule 5 (*Form of Transfer Certificate*) to the Trust Deed) to the effect that such transfer is being made to a person whom the transferor reasonably believes is a QIB, in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of the United States. After such fortieth day, such certification requirements will no longer apply to such transfers, but such transfers will continue to be subject to the transfer restrictions contained in the legend appearing on the face of such Global Note Certificate, as described above under "*Forms of the Notes*".

Notes represented by an interest in a Restricted Global Note Certificate may also be transferred to a person who wishes to hold such Notes in the form of an interest in an Unrestricted Global Note

Certificate, but only upon receipt by the Registrar of a written certification from the transferor (in the form set out in Schedule 5 (*Form of Transfer Certificate*) to the Trust Deed) to the effect that such transfer is being made in accordance with Regulation S or Rule 144 (if available) under the Securities Act.

Any interest in a Note represented by an Unrestricted Global Note Certificate that is transferred to a person who takes delivery in the form of an interest in a Note represented by a Restricted Global Note Certificate will, upon transfer, cease to be an interest in a Note represented by an Unrestricted Global Note Certificate and become an interest in a Note represented by a Restricted Global Note Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to Notes represented by a Restricted Global Note Certificate.

**Rule 144A Notes**

Each purchaser of Notes within the United States pursuant to Rule 144A, by accepting delivery of this Offering Circular, will be deemed to have represented, agreed and acknowledged as follows (terms used in the following paragraphs that are defined in Rule 144A have the respective meanings given to them in Rule 144A):

(a) the purchaser is (a) a QIB, (b) acquiring the Notes for its own account or for the account of one or more QIBs, (c) not formed for the purpose of investing in the Notes or the relevant Issuer and (d) is aware, and each beneficial owner of such Notes has been advised that the sale of the Notes to it is being made in reliance on Rule 144A;

(b) the purchaser understands that (1) the Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it, and any person acting on its behalf, reasonably believes is a QIB purchasing for its own account or for the account of one or more QIBs, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act, (c) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available), (d) pursuant to an effective registration statement under the Securities Act or (e) to HoldCo or the Bank or any of their respective affiliates, in each case in accordance with any applicable securities laws of any State of the United States and (2) it will, and each subsequent holder of the Restricted Registered Notes is required to, notify any purchaser of the Restricted Registered Notes from it of the resale restrictions applicable to the Restricted Registered Notes;

(c) the purchaser understands that the Restricted Global Note Certificate and any restricted Individual Note Certificate (a "**Restricted Individual Note Certificate**") will bear a legend to the following effect, unless the relevant Issuer determines otherwise in accordance with applicable law:

THE NOTES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "**SECURITIES ACT**") OR ANY SECURITIES LAW OF ANY STATE OF THE UNITED STATES. THE HOLDER HEREOF, BY PURCHASING THE NOTES REPRESENTED HEREBY, AGREES FOR THE BENEFIT OF THE ISSUER THAT THE NOTES REPRESENTED HEREBY MAY BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY IN COMPLIANCE WITH THE SECURITIES ACT AND OTHER APPLICABLE LAWS AND ONLY (1) PURSUANT TO RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR A PERSON PURCHASING FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE REOFFER, RESALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (4) TO THE ISSUER OR ITS AFFILIATES.

(d) if it is acquiring any Notes for the account of one or more QIBs the purchaser represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account; and

(e) the purchaser understands that the relevant Issuer, the Trustee, the Registrar, the Dealers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

Upon the transfer, exchange or replacement of a Restricted Global Note Certificate or a Restricted Individual Note Certificate, or upon specific request for removal of the legend, the relevant Issuer will deliver only a Restricted Global Note Certificate or one or more Restricted Individual Note Certificates that bear such legend or will refuse to remove such legend, unless there is delivered to the relevant Issuer and the Registrar such satisfactory evidence (which may include a legal opinion) as may reasonably be required by the relevant Issuer that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Any interest in a Restricted Global Note Certificate that is transferred to a person who takes delivery in the form of an interest in an Unrestricted Global Note Certificate will, upon transfer, cease to be an interest in a Restricted Global Note Certificate and become an interest in an Unrestricted Global Note Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to an interest in an Unrestricted Global Note Certificate.

**Prospective purchasers that are QIBs are hereby notified that sellers of the Restricted Registered Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.**

## GENERAL INFORMATION

### Authorisation

The update of the Programme was authorised by resolutions of the Board of Directors of HoldCo and the Bank passed on 25 February 2016 and resolutions of the Asset and Liability Committee of the Board of Directors of HoldCo and the Bank passed on 14 March 2016. Each Issuer has obtained all necessary consents, approvals and authorisations in connection with the establishment of the Programme and each Issuer will obtain from time to time all necessary consents, approvals and authorisations in connection with the issue and performance of the Notes.

### Legal and Arbitration Proceedings

There are no governmental, legal or arbitration proceedings, (including any such proceedings which are pending or threatened, of which either of the Issuers is aware), which may have, or have had during the 12 months prior to the date of this Offering Circular, a significant effect on the financial position or profitability of HoldCo, the Bank, the Bank Group and/or the Virgin Money Group.

### Significant/Material Change

Since 31 December 2015 there has been no material adverse change in the prospects of HoldCo or the Bank nor any significant change in the financial or trading position of the Virgin Money Group or the Bank Group.

### Auditors

The HoldCo Financial Statements and the audited and unconsolidated financial statements (including the auditor's report thereon and notes thereto) of the Bank in respect of the years ended 31 December 2015 and 31 December 2014 have been audited without qualification by KPMG LLP, chartered accountants (a member of the Institute of Chartered Accountants in England and Wales), who have given, and have not withdrawn, their consent to the inclusion of their report in this Offering Circular in the form and context in which it is included.

During 2015, the Board of Directors of HoldCo and the Bank, on the recommendation of the Audit Committee, appointed PricewaterhouseCoopers LLP as external auditor for the Virgin Money Group's 2016 audit, following a formal competitive tender overseen by the Audit Committee. This appointment will be put to shareholders for approval in May at the 2016 Annual General Meeting.

### Documents on Display

Copies of the following documents may be inspected during normal business hours at the registered office of the Issuers at Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL, United Kingdom and at the specified office of the Principal Paying Agent at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, United Kingdom, for 12 months from the date of this Offering Circular:

(a) the articles of association of each Issuer;

(b) the HoldCo Financial Statements;

(c) the Bank Financial Statements;

(d) the Risk Management Report;

(e) the Trust Deed (which contains the forms of Notes in global and definitive form); and

(f) the Agency Agreement.

### Clearing of the Notes

The Notes may be accepted for clearance through DTC, Euroclear and Clearstream, Luxembourg. The appropriate common code and/or the International Securities Identification Number (ISIN) and/or the Committee on Uniform Security Identification Procedures (CUSIP) Number in relation to the Notes of each Tranche will be specified in the relevant Final Terms. The relevant Final Terms shall specify any other clearing system as shall have accepted the relevant Notes for clearance together with any further appropriate information.

The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy, L-1855 Luxembourg. The address of The Depository Trust Company is 55 Water Street, New York, NY10041-0099, U.S.A.

**Issue Price and Yield**

Notes may be issued at any price. The issue price of each Tranche of Notes to be issued under the Programme will be determined by the relevant Issuer and the relevant Dealer(s) at the time of issue in accordance with prevailing market conditions. In the case of different Tranches of a Series of Notes, the issue price may include accrued interest in respect of the period from the interest commencement date of the relevant Tranche (which may be the issue date of the first Tranche of the Series or, if interest payment dates have already passed, the most recent interest payment date in respect of the Series) to the issue date of the relevant Tranche. The yield of each Tranche of Notes set out in the applicable Final Terms will be calculated as of the relevant issue date on an annual or semi-annual basis using the relevant issue price. It is not an indication of future yield.

**Dealers Transacting with the Issuers**

Certain of the Dealers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services for, the Issuers and their affiliates in the ordinary course of business. Certain of the Dealers and their affiliates may have positions, deal or make markets in the Notes issued under the Programme, related derivatives and reference obligations, including (but not limited to) entering into hedging strategies on behalf of the Issuers and their affiliates, investor clients, or as principal in order to manage their exposure, their general market risk, or other trading activities. In addition, in the ordinary course of their business activities, the Dealers and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of an Issuer or an Issuer's affiliates. Certain of the Dealers or their affiliates that have a lending relationship with the Issuers routinely hedge their credit exposure to the Issuers consistent with their customary risk management policies. Typically, such Dealers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in securities, including potentially the Notes issued under the Programme. Any such positions could adversely affect future trading prices of Notes issued under the Programme. The Dealers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

## INDEX OF DEFINED TERMS

## INDEX TO THE BANK FINANCIAL STATEMENTS

# Independent auditor's report

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF VIRGIN MONEY PLC

We have audited the financial statements of Virgin Money plc for the year ended 31 December 2015 set out on pages 13 to 83. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the Company'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 Company'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 Company and the Company'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 11, 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

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

### Opinion on financial statements

In our opinion the financial statements:

> give a true and fair view of the state of the Company's affairs as at 31 December 2015 and of its profit for the year then ended;
>
> have been properly prepared in accordance with IFRSs as adopted by the EU; and
>
> 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 Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### 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, or returns adequate for our audit have not been received from branches not visited by us; or
>
> the 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.

John Ellacott (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL

1 March 2016

Virgin Money plc

# Income statement

For the year ended 31 December

| | Note | **2015** **£m** | 2014 £m |
|---|---|---|---|
| Interest and similar income | | **864.2** | 795.4 |
| Interest and similar expense | | **(407.0)** | (427.0) |
| **Net interest income** | 2 | **457.2** | 368.4 |
| Fee and commission income | 3 | **21.8** | 29.7 |
| Fair value losses on financial instruments | 10 | **(13.7)** | (19.9) |
| Other operating income | 4 | **8.7** | 5.3 |
| **Other income** | | **16.8** | 15.1 |
| **Total income** | | **474.0** | 383.5 |
| Total operating expenses | 5 | **(333.4)** | (319.3) |
| **Profit before tax from operating activities** | | **140.6** | 64.2 |
| Impairment | 7 | **(30.3)** | (15.8) |
| Distribution | | **—** | 4.5 |
| **Profit before tax** | | **110.3** | 52.9 |
| Taxation | 8 | **(22.0)** | (17.2) |
| **Profit for the year** | | **88.3** | 35.7 |
| Profit attributable to equity shareholders | | **88.3** | 35.7 |
| **Profit for the year** | | **88.3** | 35.7 |

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

Virgin Money plc

# Statement of comprehensive income

For the year ended 31 December

| | Note | **2015 £m** | 2014 £m |
|---|---|---|---|
| **Profit for the year** | | **88.3** | 35.7 |
| **Other comprehensive income** | | | |
| *Items that may subsequently be reclassified to profit or loss:* | | | |
| Movements in revaluation reserve in respect of available-for-sale financial assets: | | | |
| Change in fair value | 28 | **25.1** | 12.1 |
| Income statement transfers in respect of disposals | 28 | **(32.2)** | (5.4) |
| Taxation | 28 | **1.2** | (1.3) |
| | | **(5.9)** | 5.4 |
| Movements in cash flow hedge reserve: | | | |
| Effective portion of changes in fair value taken to other comprehensive income | 28 | **—** | (0.5) |
| Net income statement transfers | 28 | **—** | (1.1) |
| Taxation | 28 | **—** | 0.3 |
| | | **—** | (1.3) |
| **Other comprehensive (expense)/income for the year, net of tax** | | **(5.9)** | 4.1 |
| **Total comprehensive income for the year** | | **82.4** | 39.8 |
| **Total comprehensive income attributable to equity shareholders** | | **82.4** | 39.8 |

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

Virgin Money plc

# Balance sheet

As at 31 December

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | | **888.6** | 851.3 |
| Derivative financial instruments | 10 | **143.5** | 178.0 |
| Loans and receivables: | | | |
| –Loans and advances to banks | 11 | **119.6** | 136.4 |
| –Loans and advances to customers | 12 | **27,368.6** | 23,347.9 |
| –Debt securities | 13 | **1,723.9** | 1,407.4 |
| | | **29,212.1** | 24,891.7 |
| Available-for-sale financial assets | 14 | **1,296.9** | 1,539.6 |
| Intangible assets | 18 | **63.0** | 45.0 |
| Tangible fixed assets | 19 | **74.6** | 72.0 |
| Deferred tax assets | 20 | **34.9** | 46.0 |
| Other assets | 21 | **60.1** | 71.2 |
| **Total assets** | | **31,773.7** | 27,694.8 |

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| **Liabilities** | | | |
| Deposits from banks | 22 | **1,283.8** | 845.5 |
| Customer deposits | 23 | **25,145.3** | 22,368.9 |
| Derivative financial instruments | 10 | **155.3** | 227.9 |
| Amounts due to securitisation special purpose vehicles | 12 | **3,318.4** | 2,766.9 |
| Debt securities in issue | 24 | **297.5** | — |
| Provisions | 25 | **8.2** | 9.1 |
| Other liabilities | 26 | **236.9** | 250.9 |
| **Total liabilities** | | **30,445.4** | 26,469.2 |
| **Equity** | | | |
| Share capital | 27 | **1,400.0** | 1,400.0 |
| Other reserves | 28 | **(0.3)** | 5.6 |
| Retained earnings | | **(71.4)** | (180.0) |
| **Total equity** | | **1,328.3** | 1,225.6 |
| **Total liabilities and equity** | | **31,773.7** | 27,694.8 |

Investment in subsidiaries was £nil in 2015 and 2014, refer to note 16 for further details.

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

The financial statements were approved and authorised for issue by the Board and were signed on its behalf on 1 March 2016.

**Glen Moreno**
Chairman

**Jayne-Anne Gadhia CBE**
Chief Executive

**Virgin Money plc**

# Statement of changes in equity

**Attributable to equity holders**

| | Share capital £m | Other reserves £m | Retained earnings £m | Total equity £m |
|---|---|---|---|---|
| **Balance at 1 January 2015** | **1,400.0** | **5.6** | **(180.0)** | **1,225.6** |
| **Comprehensive income** | | | | |
| Profit for the year | **—** | **—** | **88.3** | **88.3** |
| **Other comprehensive income** | | | | |
| Net movement in available-for-sale reserve | **—** | **(5.9)** | **—** | **(5.9)** |
| Net movement in cash flow hedge reserve | **—** | **—** | **—** | **—** |
| **Total other comprehensive income** | **—** | **(5.9)** | **—** | **(5.9)** |
| **Total comprehensive income for the year** | **—** | **(5.9)** | **88.3** | **82.4** |
| **Transactions with equity holders** | | | | |
| Share based payments – charge for year | **—** | **—** | **20.0** | **20.0** |
| Deferred tax on share based payments | **—** | **—** | **0.3** | **0.3** |
| **Total transactions with equity holders** | **—** | **—** | **20.3** | **20.3** |
| **Balance at 31 December 2015** | **1,400.0** | **(0.3)** | **(71.4)** | **1,328.3** |

| | Share capital £m | Other reserves £m | Retained earnings £m | Total equity £m |
|---|---|---|---|---|
| Balance at 1 January 2014 | 1,400.0 | 1.5 | (232.8) | 1,168.7 |
| Comprehensive income | | | | |
| Profit for the year | — | — | 35.7 | 35.7 |
| Other comprehensive income | | | | |
| Net movement in available-for-sale reserve | — | 5.4 | — | 5.4 |
| Net movement in cash flow hedge reserve | — | (1.3) | — | (1.3) |
| **Total other comprehensive income** | — | 4.1 | — | 4.1 |
| **Total comprehensive income for the year** | — | 4.1 | 35.7 | 39.8 |
| **Transactions with equity holders** | | | | |
| Share based payments – charge for year | — | — | 12.9 | 12.9 |
| Share based payments – reclassification from liabilities | — | — | 4.2 | 4.2 |
| **Total transactions with equity holders** | — | — | 17.1 | 17.1 |
| **Balance at 31 December 2014** | 1,400.0 | 5.6 | (180.0) | 1,225.6 |

Further details of movements in the Company's share capital and reserves are provided in notes 27 and 28.

**Virgin Money plc**

# Cash flow statement

For the year ended 31 December

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| **Profit before taxation** | | **110.3** | 52.9 |
| Adjustments for: | | | |
| Changes in operating assets | 32a | **(4,009.1)** | (2,356.5) |
| Changes in operating liabilities | 32b | **3,674.2** | 1,889.4 |
| Non-cash and other items | 32c | **73.7** | (38.7) |
| Tax paid | | **(5.0)** | - |
| **Net cash used in operating activities** | | **(155.9)** | (452.9) |
| **Cash flows from investing activities** | | | |
| Net investment in intangible assets | | **(29.6)** | (27.0) |
| Purchase of fixed assets | | **(10.2)** | (10.6) |
| Disposal of fixed assets | | — | 0.7 |
| Net investment in securities | | **(1,298.1)** | (956.5) |
| Proceeds from sale and redemption of available-for-sale financial assets | | **1,213.1** | 1,278.5 |
| Net investment in credit card portfolio | | — | (362.7) |
| **Net cash used in investing activities** | | **(124.8)** | (77.6) |
| **Cash flows from financing activities** | | | |
| Issue of debt securities | | **297.5** | - |
| **Net cash provided by financing activities** | | **297.5** | - |
| Change in cash and cash equivalents | | **16.8** | (530.5) |
| Cash and cash equivalents at beginning of year | | **949.7** | 1,480.2 |
| **Cash and cash equivalents at end of year** | 32d | **966.5** | 949.7 |

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

# Notes to the financial statements

## Note 1: Basis of preparation

1.1 Reporting entity

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

1.2 Basis of preparation

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

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

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

1.3 Changes in accounting policy

*New standards, amendments to standards or interpretations adopted*

The following amendment to IFRS 13 is mandatory for annual reporting periods beginning on or after 1 January 2015, has been endorsed for adoption by the EU and has been adopted by the Company during the year ended 31 December 2015:

> *Amendment to IFRS 13, 'Fair value measurement'*

The amendment clarifies that the portfolio exception in IFRS 13, which allows an entity to measure the fair value of a group of financial assets and financial liabilities on a net basis, applies to all contracts (including non-financial contracts) within the scope of IAS 39 or IFRS 9. This amendment did not have a significant impact on the Company when adopted.

There are no other standards, amendments to standards or interpretations that are applicable in the year which have a material impact on these financial statements.

New accounting standards issued by the IASB which are effective in future periods are presented in note 37.

1.4 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments, available-for-sale and other assets held at fair value through profit or loss. A summary of the material accounting policies of the Company are included within note 1.6.

The accounting policies set out in note 1.6 have been applied consistently to all periods presented in these financial statements.

1.5 Foreign currency translation

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

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

# Notes to the financial statements

## Note 1: Basis of preparation (continued)

1.6 Accounting policies

The accounting policies of the Company are set out below:

*1.6.1 Interest income and expense*

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

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

Once a financial asset or Company of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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

*1.6.2 Fees and commissions*

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan.

*1.6.3 Other operating income*

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to credit cards.

The Company recognises ongoing credit card income from strategic partners as other income.

*1.6.4 Total operating expense*

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy 1.6.5.

Staff costs

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

> *Short-term employee benefits*

Short-term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Company has a present obligation to its employees that can be measured reliably and are recognised over the period of service that employees are required to work to qualify for the payment.

> *Other long-term employee benefits*

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

Retirement benefit obligations

A defined contribution plan is a post-employment benefit plan into which the Company pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in the income statement in the periods during which related employee services are fulfilled.

The Company operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Company in independently administered funds.

## Note 1: Basis of preparation (continued)

Leases

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

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

*1.6.5 Share based payments*

The Group puts in place share schemes for employees to reward strong long-term business performance and to incentivise growth for the future.

The Group engages in equity and cash settled share based payment transactions in respect of services received from certain of its employees.

For equity settled share based payments, employees are employed by the Company but receive Virgin Money Holdings (UK) plc Ordinary Shares.

For equity settled share based payment transactions the grant date fair value of the award is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards.

The grant date fair value of the award is determined using valuation models which take into account the terms and conditions attached to the awards. Inputs into valuation models may include the exercise price, the risk-free interest rate, the expected volatility of Virgin Money Holdings (UK) plc's share price and other various factors which relate to performance conditions attached to the awards.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

For share based payment awards with market performance conditions or non-vesting conditions the grant date fair value of the award is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

For cash settled share based payment transactions the fair value of the amount payable to the employee is recognised as an expense with a corresponding increase in liabilities. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value is measured based on a valuation model taking into account the terms and conditions of the grant. The liability is revalued at each balance sheet date and settlement date with any changes to fair value being recognised in profit or loss.

*1.6.6 Impairment losses*

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

Assets held at amortised cost

The Company 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. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Company about the following loss events:

> there is evidence of the customer or issuer experiencing financial difficulty;

> there is a breach of contract, such as a default or delinquency in repayments;

> the customer is granted a concession that would otherwise not be considered;

> the borrower will enter bankruptcy or other financial reorganisation;

## Note 1: Basis of preparation (continued)

- the disappearance of an active market for that financial asset because of financial difficulties; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
    - there are adverse changes in the payment status of borrowers in the portfolio; and
    - economic conditions that correlate with defaults on the assets in the portfolio

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

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

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

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

A provision is also made in the case of accounts, which may not currently be in arrears, where losses may have been incurred but not yet recognised. An increased level of provision is held for accounts where an impairment trigger event has occurred which includes accounts benefitting from forbearance and those in arrears. Refer to note 31 for details of the forbearance policy.

### *1.6.7 Taxation*

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

### *1.6.8 Financial instruments*

Financial assets

Financial assets can be classified in the following categories:

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

Management determines the classification of its financial instruments at initial recognition. The Company measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship. Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Company commits to purchase or sell the asset.

# Notes to the financial statements

## Note 1: Basis of preparation (continued)

Loans and receivables at amortised cost

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

Available-for-sale financial assets

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

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

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

Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Company has the ability and intention to hold to maturity. They are initially measured at fair value including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. No financial assets were classified as held to maturity during either the current or prior year.

Financial assets at fair value through profit or loss

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in profit or loss. The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Company establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Financial liabilities

Borrowings, including deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Company does not hold any financial liabilities classified as held for trading.

Amounts due to securitisation special purpose vehicles are classified as financial liabilities at fair value through profit or loss (FVTPL). The fair value is based on the expected prepayments and maturities of mortgages within the securitised mortgage pool, which determine the repayment of the loans. The loans are valued using a discounted cash flow model.

Offsetting financial instruments

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

# Notes to the financial statements

## Note 1: Basis of preparation (continued)

Sale and repurchase agreements

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

Derecognition of financial assets and liabilities

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

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

*1.6.9 Loans and advances to banks*

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

*1.6.10 Loans and advances to customers*

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

Further details of the application of the effective interest rate method are included in policy 1.6.1 and provision for impairment in policy 1.6.6.

*1.6.11 Debt securities classified as loans and receivables*

Debt securities are designated as either available-for-sale or loans and receivables. Debt securities are principally available-for-sale as they are intended to be held for an indefinite period of time but may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices (refer to 1.6.12 for accounting treatment). Debt securities classified as loans and receivables are asset backed securities for which there is no active market.

*1.6.12 Available-for-sale financial assets*

The Company's debt securities, treasury bills and equity investments not in subsidiary undertakings are held as available-for-sale assets. For available-for-sale financial assets, the Company assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets are impaired. The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The amount of the impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement. If, in a subsequent period, the fair value of an instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

## Note 1: Basis of preparation (continued)

*1.6.13 Derivative financial instruments and hedge accounting*

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

The Company's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates and foreign exchange rates inherent in the Company's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially at fair value and subsequently remeasured to fair value. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models. Where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within hedging relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

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

> Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

> Fair value hedges

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

The most frequently used fair value hedges are:

> hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;

> hedging the interest rate risk of a portfolio of fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;

> hedging the interest rate risk of a portfolio of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for fixed rate investments; and

> hedging the interest rate and foreign currency exchange risk of non- prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps.

*1.6.14 Investments in subsidiaries*

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

## Note 1: Basis of preparation (continued)

*1.6.15 Business combinations*

Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, being when control is transferred to the Company. Control is having the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power to affect those returns.

The Company measures goodwill at the acquisition date as the fair value of the consideration transferred less the fair value of the net identifiable assets acquired and liabilities assumed.

When the excess is negative, the negative goodwill is recognised immediately in profit or loss.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Company incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

*1.6.16 Intangible assets and amortisation*

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

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

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

> an asset is created that can be identified;

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

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

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

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

> Computer software

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

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

> Core banking platforms

Core banking platforms primarily represent the construction of core operating platforms, which are internally generated. Core banking platforms are amortised on a straight line basis over 3-10 years.

> Impairment of intangible assets

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

## Note 1: Basis of preparation (continued)

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

*1.6.17 Tangible fixed assets and depreciation*

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

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

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

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

Impairment of tangible fixed assets

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

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

*1.6.18 Deferred tax*

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

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

*1.6.19 Other assets*

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

## Note 1: Basis of preparation (continued)

*1.6.20 Deposits from banks*

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

*1.6.21 Customer deposits*

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

*1.6.22 Provisions*

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

A provision for bank levies is recognised when the condition that triggers the payment of the levy is met. If a levy obligation is subject to a minimum activity threshold so that the obligating event is reaching a minimum activity, then a provision is recognised when that minimum activity threshold is reached.

*1.6.23 Other liabilities*

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

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

Accrued expenses are amounts that the Company is due to pay to third parties in the normal course of business.

*1.6.24 Share capital*

> Share capital

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

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

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

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

> Share issue costs

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

> Dividends and appropriations

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

*1.6.25 Other reserves*

> Available-for-sale reserve

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

> Cash flow hedge reserve

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

## Note 1: Basis of preparation (continued)

*1.6.26 Contingent liabilities*

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

*1.6.27 Fair value of financial assets and liabilities*

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

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

Refer to note 30 for a description of different levels within the fair value hierarchy. Levels are received at each balance sheet date and this determines where transfers between levels are required.

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

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price—i.e. the fair value of consideration given or received. The Company does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Company's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Company measures assets and long positions at bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Company on the basis of the net exposure to either market or credit risk, are measured on the basis of a price that would be received to sell a net long position (or transferred to sell a net short position) for a particular risk exposure. Those portfolio risk adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

*1.6.28 Cash and cash equivalents*

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

1.7 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, actual results ultimately may differ from those estimates.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the 2015 financial statements as follows:

*1.7.1 Effective interest rates*

IAS 39 requires interest earned from mortgages and credit cards to be measured under the effective interest rate method. Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. The accuracy of the effective interest rate would therefore be affected by unexpected market movements resulting in altered customer behaviour, inaccuracies in the models used compared to actual outcomes and incorrect assumptions.

If the estimated life of secured loans were increased or reduced by one month, the value of such loans on the balance sheet would be increased or decreased by £3.6 million (2014: £2.7 million) and £3.8 million (2014: £2.8 million) respectively.

If the estimated life of credit cards were increased or reduced by one month, the value of such assets on the balance sheet would be increased or decreased by £1.1 million (2014: £0.6 million) and £1.1 million (2014: £0.5 million) respectively.

## Note 1: Basis of preparation (continued)

*1.7.2 Impairment of loans and receivables*

Individual impairment losses on secured loans and advances are calculated based on an individual valuation of the underlying asset. Collective impairment losses on loans and advances are calculated using a statistical model.

The key assumptions used in the model are the probability of default; the probability of this default resulting in possession and/or write off; and the subsequent loss incurred. These key assumptions are monitored regularly to ensure the impairment allowance is entirely reflective of the current portfolio.

The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes. For mortgage loan receivables to the extent that:

> the loss given default differs by +/- 10%, for example if the loss given default is 10% then it is increased to 11%, the impairment allowance would be an estimated £0.3 million (2014: £0.2 million) higher or £0.3 million (2014: £0.2 million) lower respectively;

> the level of house prices differs by +/- 10%, for example a property value of £100,000 is increased to £110,000, the impairment allowance would be an estimated £1.3 million (2014: £0.7 million) lower or £3.0 million (2014: £3.4 million) higher respectively; and

> the emergence period of 6 months differs by +/- 3 months, the impairment allowance would be an estimated £0.2 million (2014: £0.1 million) higher or £0.2 million (2014: £0.1 million) lower respectively.

For credit card receivables, to the extent that the loss given default differs by +/- 10%, the impairment allowance would be an estimated £2.9 million (2014: £2.7 million) higher or £2.9 million (2014: £2.7 million) lower respectively, and to the extent the emergence period of 6 months differs by +/-3 months, the impairment allowance would be an estimated £3.8 million (2014: £2.0 million) higher or £3.8 million (2014: £2.0 million) lower respectively.

*1.7.3 Capitalisation and impairment of intangibles*

Intangibles are initially recognised when they are separable or arise from contractual or other legal rights, the cost can be measured reliably and, in the case of intangible assets not acquired in a business combination, where it is probable that future economic benefits attributable to the assets will flow from their use. Management review and monitor the capitalisation of significant project development costs on a regular basis to ensure that they meet the recognition criteria for capitalisation of an intangible asset and to ensure the costs are directly attributable to the individual projects where an asset is under construction. A review of capitalisation of intangibles has been undertaken to ensure these conditions have been met.

A review of intangible assets which are not yet in use for indications of impairment is undertaken at each reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. Value in use is calculated by discounting the future cash flows (both costs to complete and benefits post completion) generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised.

Through their assessment of intangible assets and review for impairment indicators Management have not identified any assets that have an impairment, therefore a £nil impairment charge has been recognised (2014: £nil).

*1.7.4 Deferred tax*

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is based mainly on a determination of whether the relevant entity will generate sufficient profits within 5 years to realise the deferred tax assets.

This is reviewed at each reporting date by the Directors with a detailed exercise conducted to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise and the deferred tax assets will reverse. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and which are expected to apply when the related deferred tax assets are realised or the deferred tax liabilities are settled.

The judgement required in the assessment of whether to recognise deferred tax assets is set out in policy 1.6.18. Based on their interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards, the Directors conclude that a net deferred tax asset of £34.9 million (2014: £46.0 million) should be recognised at the balance sheet date.

## Note 1: Basis of preparation (continued)

*1.7.5 Fair value of financial assets and liabilities*

Management must use judgement and estimates calculating fair value where not all necessary inputs are observable or where factors specific to the Company's holdings need to be considered. The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions. For example, if Management were to use a tightening in the credit spread of ten basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £21.6 million (2014: £20.0 million).

*1.7.6 Estimates and judgements significant to the 2014 financial statements*

The following were considered as estimates and judgements significant to the financial statements for the year ended 31 December 2014:

> Fair value of share based payments

The fair values of share awards granted in 2014 were calculated using statistical models, requiring application of management judgement on the inputs to these models. The nature of schemes with awards granted in 2015 has are such that there is a reduced the degree of judgement and complexity in calculations for the 2015 financial statements.

> Tax uncertainty

The degree of judgement and uncertainty involved in determining the Company's provision for income taxation, deferred taxation assets and liabilities and potential taxation liabilities was more significant in 2014. The ultimate outcome of certain tax matters is considered more certain.

> Provisions and contingent liabilities

Provision values and determining whether to recognise contingent liabilities are both based on the best information available at the reporting date, and the degree of judgement and uncertainty is not considered as significant as in 2014.

Further information on the above estimates and judgements is provided in the Annual Report and Accounts 2014.

# Notes to the financial statements

### Note 2: Net interest income

Net interest income comprises:

| | 2015 £m | 2014[1] £m |
|---|---|---|
| Interest and similar income: | | |
| Loans and advances to customers | **821.2** | 748.2 |
| Loans and advances to banks | **0.6** | 0.3 |
| Debt securities classified as loans and receivables | **20.8** | 21.3 |
| **Interest receivable on loans and receivables** | **842.6** | 769.8 |
| Available-for sale financial assets | **10.5** | 11.5 |
| Cash and balances at central banks | **4.0** | 5.9 |
| Securitisation subordinated loan | **4.4** | 5.0 |
| Other interest | **2.7** | 3.2 |
| **Total interest and similar income** | **864.2** | 795.4 |
| Interest and similar expense: | | |
| Deposits from banks including liabilities under sale and repurchase agreements | **(6.8)** | (3.3) |
| Customer deposits | **(340.0)** | (370.6) |
| Debt Securities in Issue | **(3.5)** | — |
| Securitisation special purpose vehicles | **(47.4)** | (46.6) |
| Other | **(9.3)** | (6.5) |
| **Total interest and similar expense** | **(407.0)** | (427.0) |
| **Net interest income** | **457.2** | 368.4 |

[1] Items within interest income and expense have been reclassified to better reflect the interest bearing assets and liabilities to which they relate.

Interest accrued on individually impaired assets was £6.8 million (2014: £6.8 million).

### Note 3: Fee and commission income

Fee and commission income comprises:

| | 2015 £m | 2014 £m |
|---|---|---|
| On loans and advances to customers | **21.0** | 28.9 |
| Other fee and commission income | **0.8** | 0.8 |
| **Total fee and commission income** | **21.8** | 29.7 |

### Note 4: Other operating income

Other operating income comprises:

| | 2015 £m | 2014 £m |
|---|---|---|
| Gain on sale of available-for-sale assets (note 14) | **5.0** | 2.3 |
| Other | **3.7** | 3.0 |
| **Total other operating income** | **8.7** | 5.3 |

Total other operating income is derived in the United Kingdom and relates to trade with third parties and continuing operations.

# Notes to the financial statements

## Note 5: Total operating expenses

Total operating expenses comprise:

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| Staff costs: | | | |
| Salaries | | **138.9** | 125.6 |
| Social security costs | | **16.2** | 14.3 |
| Other pension costs | | **10.6** | 9.6 |
| Employee share option schemes | 6 | **20.0** | 13.5 |
| | | **185.7** | 163.0 |
| Premises and equipment: | | | |
| Hire of equipment | | **4.6** | 4.8 |
| Rent and rates | | **8.2** | 7.2 |
| | | **12.8** | 12.0 |
| Other expenses: | | | |
| Marketing costs | | **22.2** | 15.7 |
| FSCS levy | | **12.5** | 16.6 |
| Professional fees | | **10.5** | 8.3 |
| Other | | **70.6** | 92.2 |
| | | **115.8** | 132.8 |
| Depreciation and amortisation: | | | |
| Depreciation of tangible fixed assets | | **7.5** | 6.4 |
| Amortisation of intangible assets | | **11.6** | 5.1 |
| | | **19.1** | 11.5 |
| **Total operating expenses** | | **333.4** | 319.3 |

Average headcount

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

| | 2015 | 2014 |
|---|---|---|
| Full time | **2,359** | 2,244 |
| Part time | **699** | 660 |
| **Total** | **3,058** | 2,904 |

At 31 December 2015, the total number of full time equivalent employees is 2,861 (2014: 2,758).

Retirement benefit obligations

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

The Company made contributions of £10.6 million (2014: £9.6 million) during the year. There were no contributions overdue at the year end (2014: £nil).

Fees payable to the auditor

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

| | 2015 £m | 2014 £m |
|---|---|---|
| Fees payable for the audit of the Company's current year annual report and accounts | **0.5** | 0.4 |
| **Total fees payable to the auditor by the Company** | **0.5** | 0.4 |

Fees paid to the Company's auditor, KPMG LLP, for services other than the statutory audit of the Company are not disclosed in these accounts. Instead they are required to be disclosed in the accounts of Virgin Money Holdings (UK) plc, the Company's parent, on a consolidated basis.

### Note 6: Share based payments

Share based payment charges comprise:

| | 2015 £m | 2014 £m |
|---|---|---|
| Equity settled | **20.0** | 12.9 |
| Cash settled | **—** | 0.6 |
| **Total share based payment charge** | **20.0** | 13.5 |

### Equity settled schemes

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

1 All awards have vesting conditions.

2 Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years.

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

(A) IPO incentive scheme

The IPO incentive scheme was introduced in December 2013 for selected senior employees. Participants were entitled to receive shares in the event of a listing of Virgin Money Holdings (UK) plc. The award was a pre-determined percentage of the listing value of Virgin Money Holdings (UK) plc, which was then converted to a number of Ordinary Shares in Virgin Money Holdings (UK) plc based on the listing price. The fair value of the IPO incentive scheme was determined at grant date using a binomial valuation model and is being recorded in the income statement over the vesting period.

During 2014 modifications were made to the scheme including removal of the minimum listing market value. The impact of each modification was determined at the modification date and is being recorded in the income statement over the remaining vesting period.

(B) Phantom share award

In late 2012 a notional (phantom) share award for senior individuals was established. The award is designed to comply with PRA requirements for deferral and clawback on treatment of variable remuneration. In 2013 the award was a cash payment based on Tangible Net Asset Value (TNAV) and was accounted for as a long-term employee benefit

During 2014 the Remuneration Committee approved that existing awards under this scheme would be converted into awards over Ordinary Shares on listing of Virgin Money Holdings (UK) plc, with no acceleration of vesting. This resulted in a change in accounting treatment to an equity settled share based payment therefore during 2014 the Company reclassified an existing liability of £4.2 million to equity. The fair value of the converted award was recalculated and is being recognised over the remaining vesting period within the income statement through to 2018.

**Note 6: Share based payments (continued)**

(C) Recruitment award

Under the scheme the participants received shares in 2014 and 2015 and will receive the final tranche of shares under this scheme in 2016. No awards were granted in 2015 (2014: none) under this scheme.

(D) Long term incentive plan (LTIP)

The LTIP introduced in 2014 is aimed at delivering shareholder value by linking the receipt of shares to performance measures that are based on delivering the Group's strategic objectives over a 3 year period. Awards are made within limits set by the rules of the plan. The maximum number of shares that can be awarded equates to 120% of total annual remuneration under normal circumstances.

During 2015 selected senior employees of the Company were granted up to a maximum of 1,494,125 Ordinary Shares under the LTIP scheme. To the extent that performance measures are satisfied, the LTIP awards will vest equally on the third, fourth and fifth anniversary of the date of grant. The performance period is three years commencing on 1 January 2015.

Details of the performance measures and weightings can be found in the Directors' Remuneration Report on page 135 of the Virgin Money Holdings (UK) plc Annual Report and Accounts for the year ended 31 December 2014. All performance measures are non-market based conditions. For each performance measure, if performance reaches threshold, target or maximum, then 20%, 80% or 100% respectively, of this element of the award will vest. Vesting between threshold, target and maximum will be on a straight line basis.

During 2015 awards over 233,645 Ordinary Shares were granted under this scheme to three senior employees on recruitment. The awards were granted in recognition that the employees' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Company. Vesting dates replicate those of the forfeited awards. One of the awards is subject to performance conditions. The performance measures mirror those attached to the 2015 LTIP grant discussed above, however in recognition of the earlier vesting dates in March 2016 and March 2017, performance will be assessed against the Group's strategic plan for financial years 2015 and 2016 respectively.

The weighted-average fair value of awards granted during 2015 was £4.04 based on market prices at the date of grant. Participants may be entitled to any dividends paid during the vesting period if the performance measures and service conditions are met.

(E) IPO share award

On listing of Virgin Money Holdings (UK) plc, the Group granted all employees below executive level a one-off share award. A small number of senior employees received an award over Ordinary Shares in Virgin Money Holdings (UK) plc of either 10% or 20% of salary. All other employees received an award over Ordinary Shares in Virgin Money Holdings (UK) plc with a value of £1,000. The majority of awards vested on the first anniversary of the listing, 18 November 2015. Certain awards granted to senior employees were subject to a different vesting schedule, and holding periods, to comply with the PRA Remuneration Code.

(F) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short term incentive plan for Executive Directors and other senior managers of the Company.

Share awards for the deferred element of 2015 bonuses will be granted under this scheme in 2016. During 2015, awards over 1,960,273 Ordinary Shares in Virgin Money Holdings (UK) plc for 2014 bonuses were granted to selected senior employees of the Company. The awards have service conditions, with vesting dates in 2015, 2018 and 2019.

During 2015, awards over 72,410 Ordinary Shares in Virgin Money Holdings (UK) plc were granted under the scheme to three senior employees on recruitment. The awards were granted in recognition that the employees' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Company. The awards have service conditions and vesting dates replicate those of the forfeited awards.

**Note 6: Share based payments (continued)**

The weighted-average fair value of awards granted during 2015 was £4.04 based on market prices at the date of grant. Participants may be entitled to any dividends paid during the vesting period if the service conditions are met.

Cash settled schemes

In 2015 there are no cash settled share based payment schemes.

During 2014 cash payments of £1.7 million were made in relation to cash settled share based payment schemes, resulting in a charge of £0.6 million to the income statement for the year ended 31 December 2014.

Movement in share options and conditional shares

Analysis of the movement in share options and conditional shares for the Group's existing schemes is set out below:

| | Virgin Money Holdings (UK) plc Ordinary Shares | | | |
|---|---|---|---|---|
| | **Former Chairman's interest in share options[1]** | **Recruitment award[2]** | **Phantom share award[2]** | **IPO share award[2]** |
| Outstanding at 1 January 2015 | **625,328** | **327,760** | **3,120,900** | **1,773,880** |
| Granted in year | — | — | — | — |
| Exercised or vested in year | — | **(151,950)** | — | **(1,431,866)** |
| Forfeited in year | — | — | **(59,080)** | **(202,973)** |
| **Outstanding at 31 December 2015** | **625,328** | **175,810** | **3,061,820** | **139,041** |
| Of which exercisable | **625,328** | — | — | — |

| | Virgin Money Holdings (UK) plc Ordinary Shares | | |
|---|---|---|---|
| | **Long term incentive plan[2]** | **Deferred bonus share plan[2]** | **IPO incentive scheme[2]** |
| Outstanding at 1 January 2015 | **—** | **14,918** | **664,658** |
| Granted in year | **1,727,770** | **2,032,683** | — |
| Exercised or vested in year | **(95,075)** | **(761,247)** | **(332,324)** |
| Forfeited in year | **(233,242)** | **(128,554)** | — |
| **Outstanding at 31 December 2015** | **1,399,453** | **1,157,800** | **332,334** |
| Of which exercisable | — | — | — |

1 This scheme was set up for the previous Chairman, Sir David Clementi. All share options granted under the scheme had vested as at 31 December 2014. No share options have been exercised during 2015. The weighted-average exercise price for options outstanding at 1 January 2015 and 31 December 2015 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

2 Awards have vesting conditions.

# Notes to the financial statements

**Note 6: Share based payments (continued)**

| | Virgin Money Holdings (UK) plc Ordinary Shares | | | | |
|---|---|---|---|---|---|
| | Former Chairman's interest in share options[1] | Employee share award plan | Recruitment award[2] | Phantom share award[2] | IPO share award[2] |
| Outstanding at 1 January 2014 | 65,824 | 104,232 | 39,014 | — | — |
| Modification to phantom share award | — | — | — | 312,090 | — |
| Impact of share reorganisation by Virgin Money Holdings (UK) plc[3] | 592,416 | 871,911 | 294,984 | 2,808,810 | — |
| Granted in year | — | — | — | — | 1,773,880 |
| Exercised or vested in year | (32,912) | (968,790) | (6,238) | — | — |
| Forfeited in year | — | (7,353) | — | — | — |
| **Outstanding at 31 December 2014** | 625,328 | — | 327,760 | 3,120,900 | 1,773,880 |
| Of which exercisable | 625,328 | — | — | — | — |

| | Virgin Money Holdings (UK) plc Ordinary Shares | | | Virgin Money Holdings (UK) plc A and B Ordinary Shares |
|---|---|---|---|---|
| | Long term incentive plan | Deferred bonus share plan[2] | IPO incentive scheme[2,4] | Growth shares[5] |
| Shares in existence at 1 January 2014 | — | — | — | 1,123,407 |
| Conversion of A and B Ordinary Shares | — | — | — | (1,123,407) |
| Crystallisation of IPO incentive scheme | — | — | 1,661,631 | — |
| Granted in year | 105,448 | 14,918 | — | — |
| Exercised or vested in year | (105,448) | — | (996,973) | — |
| **Outstanding at 31 December 2014** | — | 14,918 | 664,658 | — |
| Of which exercisable | — | — | — | — |

1 This scheme was set up for the previous Chairman, Sir David Clementi. All share options granted under the scheme had vested as at 31 December 2014. During 2014, 32,912 share options were exercised for a weighted-average exercise price of £2.15. The weighted-average exercise price for options outstanding at 1 January 2014 and 31 December 2014 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

2 Awards have vesting conditions.

3 Immediately prior to listing of Virgin Money Holdings (UK) plc, there was a reorganisation of share capital.

4 The IPO incentive scheme was awarded as a percentage of the listing value of Virgin Money Holdings (UK) plc, which is then converted to a number of shares in Virgin Money Holdings (UK) plc based on the listing price. On listing 1,661,631 Ordinary Shares in Virgin Money Holdings (UK) plc were awarded.

5 Growth shares were A and B Ordinary Shares in Virgin Money Holdings (UK) plc. The return on these shares on listing was calculated as set out in Virgin Money Holdings (UK) plc's Articles of Association. A Ordinary Shares were converted into 38,055 Ordinary Shares and 1,064,927 Deferred Shares. B Ordinary Shares were converted into 9,192 Ordinary Shares and 92,936 Deferred Shares. The Deferred Shares created on the conversion of the A and B Ordinary Shares were then cancelled by Virgin Money Holdings (UK) plc.

# Notes to the financial statements

**Note 7: Allowance for impairment losses on loans and receivables**

| | On secured loans £m | On unsecured loans £m | Total £m |
|---|---|---|---|
| At 1 January 2014 | 7.5 | 27.1 | 34.6 |
| Advances written off | (1.1) | (27.6) | (28.7) |
| Gross charge to the income statement | 1.2 | 23.5 | 24.7 |
| At 31 December 2014 | 7.6 | 23.0 | 30.6 |
| Advances written off | **(1.9)** | **(26.0)** | **(27.9)** |
| Gross charge to the income statement | **3.0** | **34.2** | **37.2** |
| **As at 31 December 2015** | **8.7** | **31.2** | **39.9** |

Of the total allowance in respect of loans and advances to customers, £38.8 million (2014: £27.6 million) was assessed on a collective basis.

During the year sales of credit card receivables which had previously been written off resulted in net recoveries of £6.9 million (2014: £8.9 million). The full amount of the proceeds have been recognised as a gain and the net charge to the income statement is summarised below.

| | **2015 £m** | 2014 £m |
|---|---|---|
| Gross charge to the income statement | **37.2** | 24.7 |
| Debt sale recoveries | **(6.9)** | (8.9) |
| **Net charge to the income statement** | **30.3** | 15.8 |

**Note 8: Taxation**

A. Analysis of the tax charge for the year

| | **2015 £m** | 2014 £m |
|---|---|---|
| **UK corporation tax** | | |
| Current year corporation tax | **(9.0)** | — |
| Group relief payment | **(0.4)** | — |
| (Charge) / credit attributable to available-for-sale reserve | **(2.1)** | 1.3 |
| Adjustments in respect of prior years | **—** | (0.3) |
| Current tax (charge) / credit | **(11.5)** | 1.0 |
| **Deferred tax (refer note 20)** | | |
| Origination and reversal of temporary differences | **(12.3)** | (12.3) |
| Adjustments in respect of prior years | **(0.7)** | (6.0) |
| Effect of changes in tax rates | **2.5** | 0.1 |
| Deferred tax charge to the income statement | **(10.5)** | (18.2) |
| **Tax charge** | **(22.0)** | (17.2) |

Analysis of tax credit / (charge) recognised in Other Comprehensive Income:

| | **2015 £m** | 2014 £m |
|---|---|---|
| Current tax | | |
| Available-for-sale financial assets | **2.1** | (1.3) |
| Deferred tax | | |
| Cash flow hedge | — | 0.3 |
| Available-for-sale financial assets | **(0.9)** | — |
| **Total credit / (charge)** | **1.2** | (1.0) |

# Notes to the financial statements

**Note 8: Taxation (continued)**

B. Factors affecting the tax charge for the year

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

| | 2015 £m | 2014 £m |
|---|---|---|
| **Profit before tax** | **110.3** | 52.9 |
| Tax charge at effective corporation tax rate of 20.25% (2014: 21.5%) | **(22.3)** | (11.4) |
| **Factors affecting (charge) / credit:** | | |
| Disallowed items | **(1.5)** | (0.5) |
| Group relief not paid for | **—** | 0.9 |
| UK corporation tax rate change | **2.5** | 0.1 |
| Adjustments in respect of previous years | **(0.7)** | (6.3) |
| **Total tax charge** | **(22.0)** | (17.2) |

The Group has been engaged in discussion with HM Revenue and Customs (HMRC) regarding the tax treatment of certain commercial funding transactions that were entered into during 2009 by Virgin Money Cards Limited (since renamed Sapphire Cards Limited), which is no longer part of the Group. Tax charges of £8.8m in relation to the settlement of the HMRC enquiry were reflected within the 2014 Adjustments in respect of prior periods. This includes an anticipated benefit from the surrender of up to £62.9 million of tax losses by the Virgin Group for an expected payment in the region of £15.5 million.

The Finance Act 2013 was substantively enacted on 2 July 2013. This reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015. The Finance (No. 2) Act 2015 was substantively enacted on 26 October 2015. This reduced the main rate of corporation tax further to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020.

A bank corporation tax surcharge of 8%, effective from 1 January 2016, was enacted in November 2015. Whilst the surcharge will not apply to the Company's banking profits until 2016, it has been necessary to rebase deferred tax assets and liabilities, where relevant, to ensure that such assets and liabilities continue to be held on the balance sheet using the rate at which they are expected to reverse in the future. As at 31 December 2015, this rate uplift has been reflected for the Company's deferred tax assets and liabilities, except in relation to brought forward trading losses which fall outside of the surcharge rules. The most material element of the rate change impact of £2.5 million, set out above, is accounted for by this surcharge rate uplift.

# Notes to the financial statements

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

| | | | | | | Derivatives designated as hedging instruments | | |
|---|---|---|---|---|---|---|---|---|
| | Held at amortised cost £m | Fair value through profit or loss £m | Loans and receivables £m | Available for sale securities £m | Derivatives not designated as hedging instruments £m | Fair value hedges £m | Cash flow hedges £m | Total £m |
| **2015** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash and balances at central banks | — | — | 888.6 | — | — | — | — | 888.6 |
| Derivative financial instruments | — | — | — | — | 80.0 | 63.5 | — | 143.5 |
| Loans and receivables: | | | | | | | | |
| Loans and advances to banks | — | — | 119.6 | — | — | — | — | 119.6 |
| Loans and advances to customers | — | — | 27,368.6 | — | — | — | — | 27,368.6 |
| Debt securities | — | — | 1,723.9 | — | — | — | — | 1,723.9 |
| Available-for-sale financial assets | — | — | — | 1,296.9 | — | — | — | 1,296.9 |
| Other assets – trade debtors and accrued income | — | — | 15.4 | — | — | — | — | 15.4 |
| **Total financial assets** | — | — | 30,116.1 | 1,296.9 | 80.0 | 63.5 | — | 31,556.5 |
| Non financial assets | | | | | | | | 217.2 |
| **Total assets** | | | | | | | | 31,773.7 |
| **Financial liabilities** | | | | | | | | |
| Deposits from banks | 1,283.8 | — | — | — | — | — | — | 1,283.8 |
| Customer deposits | 25,145.3 | — | — | — | — | — | — | 25,145.3 |
| Derivative financial instruments | — | — | — | — | 15.7 | 139.6 | — | 155.3 |
| Amounts due to securitisation special purpose vehicles | 211.9 | 3,106.5 | — | — | — | — | — | 3,318.4 |
| Debt securities in issue | 297.5 | — | — | — | — | — | — | 297.5 |
| Other liabilities – trade creditors and accrued interest | 152.7 | — | — | — | — | — | — | 152.7 |
| **Total financial liabilities** | 27,091.2 | 3,106.5 | — | — | 15.7 | 139.6 | — | 30,353.0 |
| Non financial liabilities | | | | | | | | 92.4 |
| **Total liabilities** | | | | | | | | 30,445.4 |
| Equity | | | | | | | | 1,328.3 |
| **Total liabilities and equity** | | | | | | | | 31,773.7 |

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

| | Held at amortised cost £m | Fair value through profit or loss £m | Loans and receivables £m | Available for sale securities £m | Derivatives not designated as hedging instruments £m | Derivatives designated as hedging instruments: Fair value hedges £m | Derivatives designated as hedging instruments: Cash flow hedges £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **2014** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash and balances at central banks | — | — | 851.3 | — | — | — | — | 851.3 |
| Derivative financial instruments | — | — | — | — | 102.7 | 75.3 | — | 178.0 |
| Loans and receivables: | | | | | | | | |
| Loans and advances to banks | — | — | 136.4 | — | — | — | — | 136.4 |
| Loans and advances to customers | — | — | 23,347.9 | — | — | — | — | 23,347.9 |
| Debt securities | — | — | 1,407.4 | — | — | — | — | 1,407.4 |
| Available-for-sale financial assets | — | — | — | 1,539.6 | — | — | — | 1,539.6 |
| Other assets – trade debtors and accrued income | — | — | 14.2 | — | — | — | — | 14.2 |
| **Total financial assets** | — | — | 25,757.2 | 1,539.6 | 102.7 | 75.3 | — | 27,474.8 |
| Non financial assets | | | | | | | | 220.0 |
| **Total assets** | | | | | | | | 27,694.8 |
| **Financial liabilities** | | | | | | | | |
| Deposits from banks | 845.5 | — | — | — | — | — | — | 845.5 |
| Customer deposits | 22,368.9 | — | — | — | — | — | — | 22,368.9 |
| Derivative financial instruments | — | — | — | — | 24.2 | 203.7 | — | 227.9 |
| Amounts due to securitisation special purpose vehicles | 317.5 | 2,449.4 | — | — | — | — | — | 2,766.9 |
| Other liabilities - trade creditors and accrued interest | 160.3 | — | — | — | — | — | — | 160.3 |
| **Total financial liabilities** | 23,692.2 | 2,449.4 | — | — | 24.2 | 203.7 | — | 26,369.5 |
| Non financial liabilities | | | | | | | | 99.7 |
| **Total liabilities** | | | | | | | | 26,469.2 |
| Equity | | | | | | | | 1,225.6 |
| **Total liabilities and equity** | | | | | | | | 27,694.8 |

# Notes to the financial statements

## Note 10: Derivative financial instruments

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Contract/ notional amount £m** | **Asset fair value £m** | **Liability fair value £m** | Contract/ notional amount £m | Asset fair value £m | Liability fair value £m |
| **Derivatives in accounting hedge relationships** | | | | | | |
| Derivatives designated as fair value hedges: | | | | | | |
| Interest rate swaps | **23,421.6** | **63.5** | **(139.6)** | 22,160.5 | 74.4 | (203.7) |
| Cross currency interest rate swaps | **—** | **—** | **—** | 21.8 | 0.9 | — |
| **Total derivative assets/(liabilities)—in accounting hedge relationships** | **23,421.6** | **63.5** | **(139.6)** | 22,182.3 | 75.3 | (203.7) |
| **Derivatives in economic hedging relationships but not in accounting hedge relationships** | | | | | | |
| Interest rate contracts: | | | | | | |
| Interest rate swaps | **10,705.9** | **80.0** | **(15.7)** | 9,833.3 | 102.7 | (24.2) |
| **Total derivative assets/(liabilities)—in economic hedging relationship but not in accounting hedge relationships** | **10,705.9** | **80.0** | **(15.7)** | 9,833.3 | 102.7 | (24.2) |
| **Total recognised derivative assets/(liabilities)** | **34,127.5** | **143.5** | **(155.3)** | 32,015.6 | 178.0 | (227.9) |

The principal amount of the derivative contracts does not represent the Company’s real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Company should the counterparty default. To reduce credit risk the Company uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in note 31.

Fair value losses on financial instruments

| | **2015 £m** | 2014 £m |
|---|---|---|
| Derivatives designated as fair value hedges | **53.6** | (156.3) |
| Fair value movement attributable to hedged risk | **(50.7)** | 155.1 |
| Loss from fair value hedges[1] | **2.9** | (1.2) |
| Gain from cash flow hedges | **—** | 0.9 |
| Gain/(loss) from hedge accounting | **2.9** | (0.3) |
| Fair value losses from other derivatives[2] | **(24.0)** | (0.5) |
| Fair value gains/(losses) from other financial instruments[3] | **7.4** | (19.1) |
| **Fair value losses on financial instruments** | **(13.7)** | (19.9) |

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

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

3 Other financial instruments relate to amounts due to securitisation special purpose vehicles which are classified as financial liabilities at fair value through profit or loss.

## Note 11: Loans and advances to banks

Loans and advances to banks comprise variable rate deposits of £119.6 million (2014: £136.4 million).

# Notes to the financial statements

## Note 12: Loans and advances to customers

Loans and advances comprise:

| | 2015 £m | 2014 £m |
|---|---|---|
| Advances secured on residential property not subject to securitisation | **17,386.3** | 15,620.5 |
| Advances secured on residential property subject to securitisation | **3,669.5** | 3,125.8 |
| | **21,055.8** | 18,746.3 |
| Residential buy-to-let loans not subject to securitisation | **4,401.1** | 3,134.3 |
| **Total loans and advances to customers secured on residential property** | **25,456.9** | 21,880.6 |
| Unsecured receivables not subject to securitisation | **1,610.0** | 1,121.3 |
| Amounts due from group companies | **255.9** | 249.8 |
| **Total loans and advances to customers before allowance for impairment losses** | **27,322.8** | 23,251.7 |
| Impairment allowance (refer note 7) | **(39.9)** | (30.6) |
| **Total loans and advances to customers excluding portfolio hedging** | **27,282.9** | 23,221.1 |
| Fair value of portfolio hedging | **85.7** | 126.8 |
| **Total loans and advances to customers** | **27,368.6** | 23,347.9 |

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

For collateral held in respect of the values included in the table above, please refer to note 15.

Securitisation

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

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. Where relevant, the table also 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. There were no transactions in the year where the Company transferred financial assets that should have been derecognised in their entirety.

| | 2015 Carrying value £m | Fair value £m | 2014 Carrying value £m | Fair value £m |
|---|---|---|---|---|
| Transferred assets | **3,669.5** | **3,727.5** | 3,125.8 | 3,197.4 |
| Associated liabilities | **3,318.4** | **3,320.4** | 2,766.9 | 2,775.0 |

### Note 13: Debt securities classified as loans and receivables

Debt securities classified as loans and receivables comprise:

| | **2015 Carrying value £m** | **Fair value £m** | 2014 Carrying value £m | Fair value £m |
|---|---|---|---|---|
| Debt securities | **1,723.9** | **1,690.8** | 1,407.4 | 1,382.4 |

Debt securities classified as loans and receivables under IAS 39 'Financial Instruments: Recognition and Measurement' were all listed.

Further analysis of the composition of debt securities is set out in note 31. All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

### Note 14: Available-for-sale financial assets

| | **2015 £m** | 2014 £m |
|---|---|---|
| At 1 January | **1,539.6** | 1,579.3 |
| Additions | **659.2** | 567.6 |
| Disposals (sales and redemptions) | **(859.9)** | (689.1) |
| Reclassification of equity investments[1] | **1.3** | - |
| Exchange differences | **(0.7)** | (1.4) |
| Net gains on changes in fair value | **(42.6)** | 83.2 |
| **At 31 December** | **1,296.9** | 1,539.6 |

1 Represents investments in unquoted equity securities relating to the Company's participation in banking and credit card operations, previously recognised within Other assets.

Gains on sale of available-for-sale financial assets amounted to £5.0 million (2014: £2.3 million).

Further analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in note 31. All available-for-sale assets have been individually assessed for impairment and following this assessment no write down of assets was required.

For amounts included above which are subject to repurchase agreements refer to note 15.

### Note 15: Collateral pledged and received

The Company receives and accepts collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives;
- sales and repurchase and reverse sale and repurchase agreements; and
- securities lending and borrowing.

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

At 31 December 2015 cash collateral of £94.3 million (2014: £120.0 million) had been pledged by the Company and £8.9 million (2014: £10.2 million) has been received as cash collateral by the Company.

At 31 December 2015 available-for-sale financial assets of £nil (2014: £467.3 million) are pledged as collateral in respect of sale and repurchase agreements under terms that are usual and customary for such activities.

### Note 15: Collateral pledged and received (continued)

At 31 December 2015 loans and advances of £755.0 million (2014: £723.9 million) are pledged as collateral in respect of sale and repurchase agreements under terms that are usual and customary for such activities.

The value of collateral pledged in respect of repurchase agreements that was transferred, accounted for as secured borrowings, where the transferee is permitted by contract or custom to repledge collateral was £nil million (2014: £450.2 million).

### Note 16: Investments in subsidiary undertakings

The following are subsidiaries of the Company:

| Name | Class of share | Holding |
|---|---|---|
| **Direct holdings** | | |
| Northern Rock (Guernsey) Limited[1] | Ordinary | 100% |
| Virgin Card Limited[2] | Ordinary | 100% |
| Northern Rock Limited[3] | Ordinary | 100% |

1 Dissolved 2 January 2015

2 Dormant company, strike off application submitted

3 Dormant company

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

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

1 Company dissolved on 30 March 2015

2 Company dissolved on 27 January 2015

### Note 17: Acquisitions and disposals

A. Purchase of credit card portfolio (2014)

From the point of acquisition of the credit card book from MBNA on 18 January 2013, until 30 November 2014, MBNA agreed to underwrite and administer new Virgin Money branded credit cards on a commission basis. On 30 November 2014 the Company completed an agreement to purchase the assets originated during this period. The portfolio was purchased for a consideration of £362.7 million. The fair value of the assets purchased was £354.5 million (a premium of £8.2 million). This included credit cards that had previously been charged-off. The premium will be unwound over the life of the purchased assets.

The acquisition was determined to be an asset purchase as the assets were purchased without staff contracts or processes or other aspects of the business being transferred to them.

B. Purchase of customer loans from Church House Trust Limited (2014)

On 30 September 2014, the Company purchased £4.3 million customer loans from Church House Trust Limited, a fellow subsidiary of the Group at that time.

### Note 18: Intangible assets

Intangible assets comprise:

| | **Software £m** | **Core banking platform £m** | **Total £m** |
|---|---|---|---|
| **Cost:** | | | |
| Cost at 1 January 2014 | 78.9 | 6.9 | 85.8 |
| Additions | 14.0 | 13.0 | 27.0 |
| **Cost at 31 December 2014** | **92.9** | **19.9** | **112.8** |
| **Additions** | **27.9** | **1.7** | **29.6** |
| **Disposals** | **(24.9)** | **—** | **(24.9)** |
| **At 31 December 2015** | **95.9** | **21.6** | **117.5** |
| **Accumulated amortisation:** | | | |
| Accumulated amortisation at 1 January 2014 | 62.7 | — | 62.7 |
| Charge for the year | 5.1 | — | 5.1 |
| **Accumulated amortisation at 31 December 2014** | **67.8** | **—** | **67.8** |
| **Charge for the year** | **8.7** | **2.9** | **11.6** |
| **Disposals** | **(24.9)** | **—** | **(24.9)** |
| **At 31 December 2015** | **51.6** | **2.9** | **54.5** |
| **Balance sheet amount at 31 December 2015** | **44.3** | **18.7** | **63.0** |
| Balance sheet amount at 31 December 2014 | 25.1 | 19.9 | 45.0 |

Additions during the year relate to software and core banking platform intangible assets. Software additions primarily relate to the purchase of new office software for employee workstations, as well as further development of the Company’s digital banking channel.

# Notes to the financial statements

## Note 19: Tangible fixed assets

Tangible fixed assets comprise:

| | Land and buildings £m | Plant, equipment, fixtures, fittings and vehicles £m | Total £m |
|---|---|---|---|
| **Cost:** | | | |
| Cost at 1 January 2014 | 55.3 | 39.5 | 94.8 |
| Additions | 4.2 | 6.4 | 10.6 |
| Disposals | (1.2) | (0.1) | (1.3) |
| **Cost at 31 December 2014** | **58.3** | **45.8** | **104.1** |
| **Additions** | **2.1** | **8.1** | **10.2** |
| **Disposals** | **—** | **(10.2)** | **(10.2)** |
| **At 31 December 2015** | **60.4** | **43.7** | **104.1** |
| **Accumulated depreciation and impairment:** | | | |
| Accumulated depreciation and impairment at 1 January 2014 | 3.7 | 22.4 | 26.1 |
| Depreciation charge for the year | 1.5 | 4.9 | 6.4 |
| Disposals | (0.3) | (0.1) | (0.4) |
| **Accumulated depreciation and impairment at 31 December 2014** | **4.9** | **27.2** | **32.1** |
| **Depreciation charge for the year** | **1.7** | **5.8** | **7.5** |
| **Disposals** | **—** | **(10.1)** | **(10.1)** |
| **At 31 December 2015** | **6.6** | **22.9** | **29.5** |
| **Balance sheet amount at 31 December 2015** | **53.8** | **20.8** | **74.6** |
| Balance sheet amount at 31 December 2014 | 53.4 | 18.6 | 72.0 |

## Note 20: Deferred tax asset

Deferred tax assets and liabilities comprise:

| | **2015 £m** | 2014 £m |
|---|---|---|
| Deferred tax assets / (liabilities): | | |
| Accelerated capital allowances | **13.7** | 5.6 |
| Tax losses carried forward | **21.9** | 40.3 |
| Change in accounting basis on adoption of IFRS | **(5.0)** | (3.2) |
| Other temporary differences | **5.2** | 3.3 |
| Available-for-sale financial assets | **(0.9)** | — |
| **Total deferred tax assets** | **34.9** | 46.0 |

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

| | **2015 £m** | 2014 £m |
|---|---|---|
| At 1 January | **46.0** | 62.9 |
| Income statement credit/(charge) (refer note 8) | | |
| Accelerated capital allowances | **8.1** | (1.2) |
| Tax losses carried forward | **(18.4)** | (21.7) |
| Other temporary differences | **(0.2)** | 4.7 |
| | **(10.5)** | (18.2) |
| Deferred tax balance transferred in | **—** | 1.0 |
| Amounts credited/(charged) to equity: | | |
| Cash flow hedges | **—** | 0.3 |
| Share based payments | **0.3** | — |
| Available-for-sale financial assets | **(0.9)** | — |
| | **(0.6)** | 0.3 |
| **At 31 December** | **34.9** | 46.0 |

### Note 21: Other assets

Other assets comprise:

| | 2015 £m | 2014 £m |
|---|---|---|
| Trade debtors | **6.8** | 6.5 |
| Prepayments and accrued income | **24.5** | 19.1 |
| Amounts owed from related parties | **6.3** | 18.5 |
| Other | **22.5** | 27.1 |
| **Total other assets** | **60.1** | 71.2 |

The Company's exposure to credit risk and impairment losses related to trade and other receivables is shown in note 31.

### Note 22: Deposits from banks

Deposits from banks comprise:

| | 2015 £m | 2014 £m |
|---|---|---|
| Liabilities in respect of securities sold under repurchase agreements | **1,274.9** | 835.3 |
| Other deposits from banks | **8.9** | 10.2 |
| **Total deposits from banks** | **1,283.8** | 845.5 |

### Note 23: Customer deposits

Customer deposits comprise:

| | 2015 £m | 2014 £m |
|---|---|---|
| Savings and investment accounts | **24,915.0** | 22,167.3 |
| Personal current accounts | **230.3** | 201.6 |
| **Total customer deposits** | **25,145.3** | 22,368.9 |

### Note 24: Debt securities in issue

On 16 April 2015, the Company issued 5 year Medium Term Notes with a nominal value of £300 million at a coupon of 2.25% per annum. The notes were issued as part of the Company's recently launched £3 billion Global Medium Term Note programme, which was established to diversify the Company's wholesale funding base further.

### Note 25: Provisions

The movement in provisions was as follows:

| | FSCS £m | Other £m | Total £m |
|---|---|---|---|
| At 1 January 2015 | **8.7** | **0.4** | **9.1** |
| Provisions applied | **(14.6)** | **(0.2)** | **(14.8)** |
| Charge for the year | **12.5** | **1.4** | **13.9** |
| **At 31 December 2015** | **6.6** | **1.6** | **8.2** |

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund the compensation costs associated with institutions that failed

### Note 25: Provisions (continued)

in 2008 and will receive the receipts from asset sales, surplus cash flows and other recoveries from these institutions in the future. The FSCS meets its obligations by raising management expense and compensation levies. These include amounts to cover the interest on its borrowings and ongoing management expenses. Each deposit taking institution contributes in proportion to its share of total protected deposits.

The FSCS can only raise a levy within its scheme year (which commences 1 April) and under IFRIC 21 'Levies' the Company recognises its FSCS provision in the scheme year itself.

### Note 26: Other liabilities

Other liabilities comprise:

| | **2015** | 2014 |
|---|---|---|
| | **£m** | £m |
| Trade creditors | **24.3** | 26.1 |
| Deferred income | **4.9** | 4.7 |
| Amounts owed to subsidiary undertakings | **—** | 11.1 |
| Other creditors and accruals | **201.4** | 206.7 |
| Current tax liabilities | **6.3** | 2.3 |
| **Total other liabilities** | **236.9** | 250.9 |

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

Accrued interest included within 'Other creditors and accruals' primarily represents interest which has accrued on retail funds and deposits.

The Company's exposure to liquidity risk related to trade and other payables is disclosed in note 31.

### Note 27: Share capital

Share capital comprises:

| | **2015** | 2014 |
|---|---|---|
| | **£m** | £m |
| Share capital (allotted, called up and fully paid)[1] | **1,400.0** | 1,400.0 |
| **At 31 December** | **1,400.0** | 1,400.0 |

[1] Total Ordinary Shares by number 1,400 million with a nominal value of £1, amounting to £1,400 million.

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

No dividends were paid in 2015 or 2014.

### Note 28: Other reserves

Other reserves comprise:

| Available-for-sale reserve | **2015** | 2014 |
|---|---|---|
| | **£m** | £m |
| At 1 January | **5.6** | 0.2 |
| Net gains from changes in fair value | **(0.8)** | 86.9 |
| Net gains on disposal transferred to net income | **(32.2)** | (5.4) |
| Amounts transferred to net income due to hedge accounting | **25.9** | (74.8) |
| Taxation | **1.2** | (1.3) |
| **At 31 December** | **(0.3)** | 5.6 |

### Note 28: Other reserves (continued)

| Cash flow hedge reserve | **2015 £m** | 2014 £m |
|---|---|---|
| At 1 January | **—** | 1.3 |
| Amounts recognised in equity | **—** | (0.5) |
| Amounts transferred to income statement | **—** | (1.1) |
| Deferred tax | **—** | 0.3 |
| **At 31 December** | **—** | — |

### Note 29: Contingent liabilities and commitments

#### Contingent liabilities

The Board is not aware of any significant contingent liabilities as at 31 December 2015 (2014: £nil). The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

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

#### Loan commitments

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

| | **2015 £m** | 2014 £m |
|---|---|---|
| Not later than 1 year | **3,958.7** | 3,100.4 |
| Later than one year and not later than 5 years | **—** | — |
| Later than 5 years | **521.1** | 593.8 |
| **Total loan commitments** | **4,479.8** | 3,694.2 |

#### Operating lease commitments – land and buildings

Minimum future lease payments under non-cancellable operating leases.

| | **2015 £m** | 2014 £m |
|---|---|---|
| Not later than 1 year | **6.7** | 5.5 |
| Later than one year and not later than 5 years | **23.5** | 18.4 |
| Later than 5 years | **23.8** | 19.8 |
| **Total operating lease commitments – land and buildings** | **54.0** | 43.7 |

#### Operating lease commitments – other operating leases

Minimum future lease payments under non-cancellable operating leases.

| | **2015 £m** | 2014 £m |
|---|---|---|
| Not later than 1 year | **4.6** | 4.6 |
| Later than one year and not later than 5 years | **9.2** | 13.8 |
| Later than 5 years | **—** | — |
| **Total operating lease commitments – other operating leases** | **13.8** | 18.4 |

# Notes to the financial statements

### Note 29: Contingent liabilities and commitments (continued)

#### Capital commitments

Capital commitments for the acquisition of buildings and equipment.

| | 2015 £m | 2014 £m |
|---|---|---|
| Not later than 1 year | **2.9** | 5.6 |
| Later than one year and not later than 5 years | **—** | — |
| Later than 5 years | **—** | — |
| **Total capital commitments** | **2.9** | 5.6 |

### Note 30: Fair value of financial assets and liabilities

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

The following table summarises the fair values of those financial assets and liabilities not presented on the Company's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy 1.6.8 sets out the key principles for estimating the fair values of the financial instruments.

| | Level 1 £m | Level 2 £m | Level 3 £m | Total fair value £m | Total carrying value £m |
|---|---|---|---|---|---|
| **2015** | | | | | |
| Cash and balances at central banks | **—** | **888.6** | **—** | **888.6** | **888.6** |
| Loans and advances to banks | **—** | **119.6** | **—** | **119.6** | **119.6** |
| Loans and advances to customers | **—** | **255.9** | **27,243.2** | **27,499.1** | **27,368.6** |
| Debt securities classified as loans and receivables | **1.2** | **1,689.6** | **—** | **1,690.8** | **1,723.9** |
| Available-for-sale financial assets | **—** | **—** | **1.3** | **1.3** | **1.3** |
| Other assets – trade debtors and accrued income | **—** | **15.4** | **—** | **15.4** | **15.4** |
| **Total financial assets** | **1.2** | **2,969.1** | **27,244.5** | **30,214.8** | **30,117.4** |
| Deposits from banks | **—** | **1,283.8** | **—** | **1,283.8** | **1,283.8** |
| Customer deposits | **—** | **25,162.5** | **—** | **25,162.5** | **25,145.3** |
| Debt securities in issue | **292.1** | **—** | **—** | **292.1** | **297.5** |
| Amounts due to securitisation special purpose vehicles | **—** | **—** | **213.9** | **213.9** | **211.9** |
| Other liabilities – trade creditors and accrued interest | **—** | **152.7** | **—** | **152.7** | **152.7** |
| **Total financial liabilities** | **292.1** | **26,599.0** | **213.9** | **27,105.0** | **27,091.2** |

| | Level 1 £m | Level 2 £m | Level 3 £m | Total fair value £m | Total carrying value £m |
|---|---|---|---|---|---|
| **2014** | | | | | |
| Cash and balances at central banks | — | 851.3 | — | 851.3 | 851.3 |
| Loans and advances to banks | — | 136.4 | — | 136.4 | 136.4 |
| Loans and advances to customers | — | 249.8 | 23,197.3 | 23,447.1 | 23,347.9 |
| Debt securities classified as loans and receivables | 10.0 | 1,372.4 | — | 1,382.4 | 1,407.4 |
| Other assets - trade debtors and accrued income | — | 14.2 | — | 14.2 | 14.2 |
| **Total financial assets** | 10.0 | 2,624.1 | 23,197.3 | 25,831.4 | 25,757.2 |
| Deposits from banks | — | 845.5 | — | 845.5 | 845.5 |
| Customer deposits | — | 22,424.3 | — | 22,424.3 | 22,368.9 |
| Amounts due to securitisation special purpose vehicles | — | — | 325.7 | 325.7 | 317.5 |
| Other liabilities - trade creditors and accrued interest | — | 160.3 | — | 160.3 | 160.3 |
| **Total financial liabilities** | — | 23,430.1 | 325.7 | 23,755.8 | 23,692.2 |

## Note 30: Fair value of financial assets and liabilities (continued)

Fair value hierarchy

There are three levels to the hierarchy as follows:

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

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

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

Valuation methods for calculations of fair values of financial assets and liabilities recognised at cost are set out below:

Cash and balances at central banks

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

Loans and advances to banks

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

Loans and advances to customers

The Company provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Company. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Company's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Company has an exposure to this difference in value. However, were the Company to dispose of a portfolio of mortgages, it would be likely the fair value would be lower than disclosed, as there is currently no active market for the sale of mortgage books. The fair value of a loan takes into account credit risk at the balance sheet date. Loans and advances to customers are categorised as level 3 as unobservable prepayment rates are applied.

Debt securities classified as loans and receivables

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

Available-for-sale financial assets

These are unquoted equity securities held by the Company and relating to participation in banking and credit card operations (refer note 14). They are categorised as level 3 as the fair value of these securities cannot be reliably measured, due to the lack of equivalent instruments with observable prices.

Other assets and liabilities – trade debtors/creditors, accrued income and accrued interest

Fair value is deemed to approximate to the carrying value.

Deposits from banks and customer deposits

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

## Note 30: Fair value of financial assets and liabilities (continued)

Amounts due to securitisation special purpose vehicles

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

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

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy 1.6.8 sets out the key principles for estimating the fair values of financial instruments.

| 2015 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial instruments | **—** | **80.7** | **62.8** | **143.5** |
| Available-for-sale financial assets | **1,233.3** | **59.0** | **3.3** | **1,295.6** |
| **Financial liabilities** | | | | |
| Derivative financial instruments | **—** | **155.3** | **—** | **155.3** |
| Amounts due to securitisation special purpose vehicles[1] | **—** | **—** | **3,106.5** | **3,106.5** |

| 2014 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial instruments | — | 100.1 | 77.9 | 178.0 |
| Available-for-sale financial assets | 1,539.6 | — | — | 1,539.6 |
| **Financial liabilities** | | | | |
| Derivative financial instruments | — | 227.9 | — | 227.9 |
| Amounts due to securitisation special purpose vehicles[1] | — | — | 2,449.4 | 2,449.4 |

1 The contractual amount due to securitisation special purpose vehicles was £3,050.5 million (2014: £2,386.1)

Level 1 Valuations

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

Level 2 Valuations

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

The fair value of level 2 available-for-sale securities are calculated using valuation techniques, including discounted cash flow models.

Level 3 Valuations

A. Reconciliation

The following shows a reconciliation of recurring level 3 fair value measurements from the beginning to the end of the period:

| 2015 | Financial assets derivative financial instruments £m | Financial liabilities amounts due to securitisation special purpose vehicles £m |
|---|---|---|
| **Balance at 1 January** | **77.9** | **(2,449.4)** |
| Total gains or losses: | | |
| In profit or loss | **27.1** | **7.3** |
| Transactions with group undertakings | — | **(1,388.9)** |
| Settlements | **(42.2)** | **724.5** |
| **Balance at 31 December** | **62.8** | **(3,106.5)** |

# Notes to the financial statements

### Note 30: Fair value of financial assets and liabilities (continued)

| 2015 | Financial assets derivative financial instruments £m | Financial liabilities amounts due to securitisation special purpose vehicles £m |
|---|---|---|
| Total gains and losses recognised in profit or loss: | | |
| Fair value movements | **(13.0)** | **(7.4)** |
| Net interest income | **40.1** | **—** |

| 2014 | Financial assets derivative financial instruments £m | Financial liabilities amounts due to securitisation special purpose vehicles £m |
|---|---|---|
| Balance at 1 January | 64.8 | (2,192.4) |
| Total gains or losses: | | |
| In profit or loss | 47.5 | (19.1) |
| Transactions with group undertakings | — | (1,388.9) |
| Settlements | (34.4) | 1,151.0 |
| Balance at 31 December | 77.9 | (2,449.4) |

| 2014 | Financial assets derivative financial instruments £m | Financial liabilities amounts due to securitisation special purpose vehicles £m |
|---|---|---|
| Total gains and losses recognised in profit or loss: | | |
| Fair value movements | 10.9 | (19.1) |
| Net interest income | 36.6 | — |

B. Unobservable inputs used in measuring fair value

The table below sets out information about significant unobservable inputs used at 31 December 2015 in measuring financial instruments categorised as level 3 on a recurring basis.

| Type of financial instrument | Fair value at 31 December 2015 £m | Value technique | Significant unobservable input | Range of estimates for unobservable input | Fair value measurement to unobservable inputs |
|---|---|---|---|---|---|
| Derivative financial instruments | 62.8 | Discounted cash flow | Expected prepayment rate of underlying mortgages | 28%-50% | Significant increases and decreases in expected prepayment rates of underlying mortgages will cause the fair value of derivative financial instruments to move favourably and unfavourably depending upon the timing of the cash flows |
| Amounts due to securitisation special purpose vehicles | (3,106.4) | Discounted cash flow | Expected prepayment rate of underlying mortgages | 28%-50% | Significant increases and decreases in expected prepayment rates of underlying mortgages will cause the fair value of amounts due to securitisation special purpose vehicles to move favourably and unfavourably depending upon the timing of the cash flows |

Expected prepayment rates of underlying mortgages are derived from historical prepayment trends, adjusted to reflect current expected prepayment behaviours.

# Notes to the financial statements

**Note 30: Fair value of financial assets and liabilities (continued)**

C. The effect of unobservable inputs on fair value measurement

Although the Company believes that its estimates of fair values are appropriate, the use of different methodologies or assumptions could lead to different measurements of fair value. For fair value measurements of derivative financial instruments and amounts due to securitisation special purpose vehicles in level 3, changing the expected prepayment rate to reasonably possible alternative rates would have the following impacts:

| **2015** | **Impact on profit or loss** | |
|---|---|---|
| | **25% increase in expected prepayment rate £m** | **25% decrease in expected prepayment rate £m** |
| Derivative financial instruments | **0.9** | **(1.1)** |
| Amounts due to securitisation special purpose vehicles | **(0.8)** | **0.9** |
| | **0.1** | **(0.2)** |

| 2014 | Impact on profit or loss | |
|---|---|---|
| | 25% increase in expected prepayment rate £m | 25% decrease in expected prepayment rate £m |
| Derivative financial instruments | (2.2) | 2.3 |
| Amounts due to securitisation special purpose vehicles | 2.3 | (2.5) |
| | 0.1 | (0.2) |

The favourable and unfavourable impacts of using reasonably possible expected prepayment rates for the valuation of derivative financial instruments and amounts due to securitisation special purpose entities have been recalculated by using unobservable expected prepayment rates 25% higher and lower than those used in the fair value calculation. Key inputs and assumptions used in the models at 31 December 2015 include an expected prepayment rate of 28% to 50% (2014: 25% to 36%), with reasonably possible alternative expected prepayments average rates in the range of 22% to 46% (2014: 19% to 40%).

D. Available-for-sale financial assets

This represents the Company's best estimate of the value of its equity investment in Visa Europe Limited. Management has assessed that a reliable estimate of fair value is possible at the year end, following correspondence from Visa Inc. of the consideration expected to be received by the Company from its proposed acquisition of Visa Europe Limited, expected to complete in 2016.

The Company's share of the sale proceeds will comprise upfront consideration and preferred stock. The preferred stock is convertible into Class A common stock, at a future date, subject to the satisfaction of certain conditions. The Company may be entitled to additional deferred consideration four years post completion of the sale, contingent on a number of variable factors including the performance of Visa over that period.

The most significant unobservable input to the valuation is the discount applied to the value of the preferred stock to reflect the risks of future reduction in conversion to Visa Inc. Class A common stock and restrictions on transferability.

### Note 31: Financial risk management

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

### (1) Market risk

The Company uses various market risk measures for risk reporting and setting risk appetite limits and triggers. These measures include Capital at Risk and Earnings at Risk.

A. Interest rate mismatch risk

Interest rate mismatch risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes and bear rates which may be varied at the Company's discretion. There is a significant proportion of deposits with contractually fixed rates for their term to maturity.

Many assets are sensitive to interest rate movements. Some managed rate assets such as variable rate mortgages may be considered as a partial offset to the interest rate risk arising from the managed rate liabilities. A significant proportion of the Company's lending assets (mortgages) bear interest rates which are contractually fixed for periods of up to five years or longer.

The Company establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Company is exposed to fair value interest rate risk on fixed rate customer loans, fixed rate customer deposits and to cash flow interest rate risk on variable rate loans and deposits.

The following tables give an analysis of the repricing periods of assets and liabilities on the balance sheet. Mismatches in the repricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in Capital at Risk and Earnings at Risk.

## Note 31: Financial risk management (continued)

| 2015<br>Interest rate repricing mismatch of assets and liabilities[1] | Within 3 months £m | After 3 months and within 6 months £m | After 6 months and within 1 year £m | After 1 year and within 5 years £m | After 5 years £m | Non-interest bearing instruments £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | **835.5** | **—** | **—** | **—** | **—** | **53.1** | **888.6** |
| Loans and receivables: | | | | | | | |
| Loans and advances to banks | **115.1** | **—** | **—** | **—** | **—** | **4.5** | **119.6** |
| Loans and advances to customers | **7,315.6** | **1,710.6** | **3,132.4** | **14,407.3** | **516.9** | **285.8** | **27,368.6** |
| Debt securities | **1,557.3** | **—** | **—** | **166.6** | **—** | **—** | **1,723.9** |
| Available-for-sale financial assets | **373.2** | **4.7** | **59.0** | **178.0** | **612.7** | **69.3** | **1,296.9** |
| Other assets | **—** | **99.1** | **—** | **—** | **—** | **277.0** | **376.1** |
| **Total assets** | **10,196.7** | **1,814.4** | **3,191.4** | **14,751.9** | **1,129.6** | **689.7** | **31,773.7** |
| **Liabilities** | | | | | | | |
| Deposits from banks | **1,283.8** | **—** | **—** | **—** | **—** | **—** | **1,283.8** |
| Customer deposits | **14,679.3** | **1,661.6** | **3,443.6** | **5,348.4** | **—** | **12.4** | **25,145.3** |
| Debt Securities in issue | **-** | **-** | **-** | **300.0** | **—** | **(2.5)** | **297.5** |
| Amounts due to securitisation special purpose vehicles | **1,021.6** | **263.7** | **476.3** | **1,555.1** | **29.5** | **(27.8)** | **3,318.4** |
| Other liabilities | **—** | **—** | **—** | **—** | **—** | **400.4** | **400.4** |
| Equity | **—** | **—** | **—** | **—** | **—** | **1,328.3** | **1,328.3** |
| **Total liabilities and equity** | **16,984.7** | **1,925.3** | **3,919.9** | **7,203.5** | **29.5** | **1,710.8** | **31,773.7** |
| Notional values of derivatives affecting interest rate sensitivity | **5,534.1** | **463.5** | **1,067.5** | **(5,708.3)** | **(1,356.8)** | **—** | **—** |
| **Total interest rate sensitivity gap** | **(1,253.9)** | **352.6** | **339.0** | **1,840.1** | **(256.7)** | **(1,021.1)** | **—** |
| **Cumulative interest rate sensitivity gap** | **(1,253.9)** | **(901.3)** | **(562.3)** | **1,277.8** | **1,021.1** | **—** | **—** |

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

| 2014<br>Interest rate repricing mismatch of assets and liabilities[1] | Within 3 months £m | After 3 months and within 6 months £m | After 6 months and within 1 year £m | After 1 year and within 5 years £m | After 5 years £m | Non-interest bearing instruments £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | 803.7 | — | — | — | — | 47.6 | 851.3 |
| Loans and receivables: | | | | | | | |
| Loans and advances to banks | 133.3 | — | — | — | — | 3.1 | 136.4 |
| Loans and advances to customers | 6,946.0 | 1,247.2 | 2,522.1 | 12,004.4 | 324.1 | 304.1 | 23,347.9 |
| Debt securities | 1,324.1 | — | — | 83.3 | — | — | 1,407.4 |
| Available-for-sale financial assets | 230.1 | — | 41.7 | 311.7 | 841.8 | 114.3 | 1,539.6 |
| Other assets | — | 106.5 | — | — | — | 305.7 | 412.2 |
| **Total assets** | 9,437.2 | 1,353.7 | 2,563.8 | 12,399.4 | 1,165.9 | 774.8 | 27,694.8 |
| **Liabilities** | | | | | | | |
| Deposits from banks | 845.5 | — | — | — | — | — | 845.5 |
| Customer deposits | 14,381.1 | 1,108.4 | 1,827.4 | 5,025.0 | 2.0 | 25.0 | 22,368.9 |
| Amounts due to securitisation special purpose vehicles | 1,138.7 | 136.8 | 226.3 | 1,206.0 | 59.1 | — | 2,766.9 |
| Other liabilities | — | — | — | — | — | 487.9 | 487.9 |
| Equity | — | — | — | — | — | 1,225.6 | 1,225.6 |
| **Total liabilities and equity** | 16,365.3 | 1,245.2 | 2,053.7 | 6,231.0 | 61.1 | 1,738.5 | 27,694.8 |
| Notional values of derivatives affecting interest rate sensitivity | 6,093.1 | 282.7 | (291.4) | (4,593.3) | (1,488.7) | (2.4) | — |
| **Total interest rate sensitivity gap** | (835.0) | 391.2 | 218.7 | 1,575.1 | (383.9) | (966.1) | — |
| **Cumulative interest rate sensitivity gap** | (835.0) | (443.8) | (225.1) | 1,350.0 | 966.1 | — | — |

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

The interest rate re-pricing tables shown above reflect the re-pricing of assets and liabilities without adjustments to the re-pricing profile that reflect future pricing assumptions or taking into account expected future business that the Company hedges ahead of becoming contractually bound. The Company manages interest rate risk taking these factors into account. Therefore, the increased gap profile shown above does not directly translate to the Capital at Risk and Earnings at Risk term mismatch quantification.

**Note 31: Financial risk management (continued)**

B. Foreign currency risk

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than sterling as a result of banking activities. This includes maintaining liquid assets and wholesale funding. The Company has minimal appetite for foreign currency risk. The Company does allow the purchase of liquid assets denominated in both US dollars and Euros within a well controlled limit framework.

At 31 December 2015 the Company had negligible net foreign exchange risk positions. Potential exposures to changes in exchange rates are minimised by using cross currency swaps and forward foreign exchange contracts. The table below shows assets and liabilities in foreign currency at sterling carrying values.

| **Assets and liabilities in foreign currency at sterling carrying values** | **2015** | | 2014 | |
|---|---|---|---|---|
| | **US$ in £m** | **€ in £m** | US$ in £m | € in £m |
| **Assets** | | | | |
| Loans and advances to banks | **—** | **—** | — | — |
| Available-for-sale financial assets | **—** | **3.3** | — | 19.4 |
| Other assets | **0.1** | **0.1** | 0.1 | — |
| **Total assets** | **0.1** | **3.4** | 0.1 | 19.4 |
| **Liabilities** | | | | |
| Other liabilities | **0.1** | **0.1** | 0.1 | — |
| **Total liabilities** | **0.1** | **0.1** | 0.1 | — |
| Notional value of derivatives affecting currency exposures | **—** | **—** | — | 19.5 |
| **Net position** | **—** | **3.3** | — | (0.1) |

**Note 31: Financial risk management (continued)**

### (2) Credit risk

The Company has appetite for high-quality and affordable lending. Credit risk appetite is reported through a comprehensive suite of metrics, supported by triggers, limits and policies. The Company uses a range of approaches to mitigate credit risk, including credit principles and policies, obtaining collateral and using master netting agreements to permit the offset of exposures.

Loans and advances to customers comprise:

| **Loans and advances to customers** | **2015 £m** | 2014 £m |
|---|---|---|
| Advances secured on residential property not subject to securitisation | **17,386.3** | 15,620.5 |
| Advances secured on residential property subject to securitisation | **3,669.5** | 3,125.8 |
| | **21,055.8** | 18,746.3 |
| Residential buy to let loans not subject to securitisation | **4,401.1** | 3,134.3 |
| **Total loans and advances secured on residential property** | **25,456.9** | 21,880.6 |
| Impairment allowance – secured | **(8.7)** | (7.6) |
| **Loans and advances – secured** | **25,448.2** | 21,873.0 |
| Credit cards not subject to securitisation | **1,609.8** | 1,121.1[1] |
| Overdrafts not subject to securitisation | **0.2** | 0.2 |
| **Total unsecured receivables not subject to securitisation** | **1,610.0** | 1,121.3 |
| Impairment allowance – unsecured | **(31.2)** | (23.0) |
| **Loans and advances – unsecured** | **1,578.8** | 1,098.3 |
| Amounts due from group companies | **255.9** | 249.8 |
| **Total loans and advances to customers excluding fair value of portfolio hedging** | **27,282.9** | 23,221.1 |

1. Of which £5.4 million (£5.9 million on acquisition) relates to the fair value of expected losses on credit card assets transferred on to the Company's balance sheet in November 2014

A. Maximum credit exposure

The maximum credit risk exposure of the Company in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held, other credit enhancements or provisions for impairment.

The maximum credit risk exposure for off-balance sheet items relates to applications that have been approved and have not yet been drawn by the customer and undrawn loan commitments (pipeline). These commitments represent agreements to lend in the future and may be decreased or removed by the Company, subject to product notice requirements.

| **2015**<br>**Maximum exposure to credit risk by credit quality** | **Low risk £m** | **Medium risk £m** | **Higher risk £m** | **Total exposures £m** | **Low risk %** | **Medium risk %** | **Higher risk %** |
|---|---|---|---|---|---|---|---|
| **On-balance sheet** | | | | | | | |
| **Wholesale** | | | | | | | |
| Cash and balances at central banks | **888.6** | **—** | **—** | **888.6** | **100.0** | **—** | **—** |
| Debt securities classified as loans and receivables | **1,222.6** | **—** | **501.3** | **1,723.9** | **70.9** | **—** | **29.1** |
| Available-for-sale financial assets | **1,296.9** | **—** | **—** | **1,296.9** | **100.0** | **—** | **—** |
| Loans and advances to banks | **119.6** | **—** | **—** | **119.6** | **100.0** | **—** | **—** |
| Derivative financial instruments | **143.5** | **—** | **—** | **143.5** | **100.0** | **—** | **—** |
| Loans and advances to customers – amounts due from group companies | **255.9** | **—** | **—** | **255.9** | **100.0** | **—** | **—** |
| **Retail** | | | | | | | |
| Gross loans and advances to customers – secured | **22,911.8** | **1,652.4** | **892.7** | **25,456.9** | **90.0** | **6.5** | **3.5** |
| Gross loans and advances to customers – unsecured | **1,579.7** | **2.9** | **27.4** | **1,610.0** | **98.1** | **0.2** | **1.7** |
| **Total on-balance sheet** | **28,418.6** | **1,655.3** | **1,421.4** | **31,495.3** | **90.2** | **5.3** | **4.5** |
| **Off-balance sheet** | | | | | | | |
| Loan commitments (pipeline and undrawn commitments) | **4,479.8** | **—** | **—** | **4,479.8** | **100.0** | **—** | **—** |

## Note 31: Financial risk management (continued)

| **2014**<br>**Maximum exposure to credit risk by credit quality** | Low risk £m | Medium risk £m | Higher risk £m | Total exposures £m | Low risk % | Medium risk % | Higher risk % |
|---|---|---|---|---|---|---|---|
| **On-balance sheet** | | | | | | | |
| **Wholesale** | | | | | | | |
| Cash and balances at central banks | 851.3 | — | — | 851.3 | 100.0 | — | — |
| Debt securities classified as loans and receivables | 989.4 | — | 418.0 | 1,407.4 | 70.3 | — | 29.7 |
| Available-for-sale financial assets | 1,539.6 | — | — | 1,539.6 | 100.0 | — | — |
| Loans and advances to banks | 136.4 | — | — | 136.4 | 100.0 | — | — |
| Derivative financial instruments | 178.0 | — | — | 178.0 | 100.0 | — | — |
| Loans and advances to customers – amounts due from group companies | 249.8 | — | — | 249.8 | 100.0 | — | — |
| **Retail** | | | | | | | |
| Gross loans and advances to customers – secured | 19,623.4 | 1,573.4 | 683.8 | 21,880.6 | 89.7 | 7.2 | 3.1 |
| Gross loans and advances to customers – unsecured[1] | 1,090.7 | 3.2 | 27.4 | 1,121.3 | 97.3 | 0.3 | 2.4 |
| **Total on-balance sheet** | 24,658.6 | 1,576.6 | 1,129.2 | 27,364.4 | 90.1 | 5.8 | 4.1 |
| **Off-balance sheet** | | | | | | | |
| Loan commitments (pipeline and undrawn commitments) | 3,694.2 | — | — | 3,694.2 | 100.0 | — | — |

1. The December 2014 forbearance balance was restated to reflect a change in the definition to include customers categorised as in hardship and on a payment plan or vulnerable.

B. Credit risk concentration

Retail secured credit concentration

The table below shows the geographical concentration of the mortgage portfolio

| **Geographical concentration** | **2015 £m** | **%** | 2014 £m | % |
|---|---|---|---|---|
| East Anglia | **605.6** | **2.5** | 517.5 | 2.4 |
| East Midlands | **1,287.6** | **5.1** | 1,070.8 | 4.9 |
| North | **956.8** | **3.8** | 918.6 | 4.2 |
| Yorkshire & Humberside | **1,412.7** | **5.5** | 1,231.2 | 5.6 |
| North West | **1,890.4** | **7.4** | 1,651.0 | 7.5 |
| West Midlands | **1,302.0** | **5.1** | 1,077.5 | 4.9 |
| South West | **1,935.8** | **7.6** | 1,695.2 | 7.7 |
| South East | **6,138.1** | **24.1** | 5,175.4 | 23.7 |
| Greater London | **7,228.5** | **28.4** | 6,033.0 | 27.6 |
| Wales | **597.3** | **2.3** | 546.6 | 2.5 |
| Scotland | **1,685.2** | **6.6** | 1,615.2 | 7.4 |
| Northern Ireland | **416.4** | **1.6** | 347.7 | 1.6 |
| Other | **0.5** | **—** | 0.9 | — |
| **Total** | **25,456.9** | **100.0** | 21,880.6 | 100.0 |

The table below shows retail secured credit concentrations by loan size

| **Retail secured credit concentrations by loan size** | **2015 £m** | **%** | 2014 £m | % |
|---|---|---|---|---|
| 0-£100k | **4,940.5** | **19.4** | 4,719.6 | 21.5 |
| £100k-£250k | **11,875.6** | **46.6** | 10,017.2 | 45.8 |
| £250k-£500k | **6,076.8** | **23.9** | 4,848.0 | 22.2 |
| £500k-£1m | **2,333.8** | **9.2** | 2,066.7 | 9.4 |
| £1m-£2.5m | **211.3** | **0.8** | 210.0 | 1.0 |
| >£2.5m | **18.9** | **0.1** | 19.1 | 0.1 |
| **Total** | **25,456.9** | **100.0** | 21,880.6 | 100.0 |

# Notes to the financial statements

**Note 31: Financial risk management (continued)**

The tables below show retail secured credit concentrations by loan type

| **2015** Retail secured credit concentrations by loan type | Residential mortgage loans | | Buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| Capital repayment | **15,797.3** | **75.0** | **760.9** | **17.3** | **16,558.2** | **65.0** |
| Part and part | **1,235.2** | **5.9** | **26.5** | **0.6** | **1,261.7** | **5.0** |
| Interest only | **4,023.3** | **19.1** | **3,613.7** | **82.1** | **7,637.0** | **30.0** |
| **Total** | **21,055.8** | **100.0** | **4,401.1** | **100.0** | **25,456.9** | **100.0** |

| **2014** Retail secured credit concentrations by loan type | Residential mortgage loans | | Buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| Capital repayment | 12,703.6 | 67.7 | 556.7 | 17.7 | 13,260.3 | 60.6 |
| Part and part | 1,418.9 | 7.6 | 23.9 | 0.8 | 1,442.8 | 6.6 |
| Interest only | 4,623.8 | 24.7 | 2,553.7 | 81.5 | 7,177.5 | 32.8 |
| **Total** | 18,746.3 | 100.0 | 3,134.3 | 100.0 | 21,880.6 | 100.0 |

Loan to value (LTV)

The tables below show the retail secured loan-to-value (LTV)% of the portfolio using the indexed values at the financial year ends.

| **2015** Retail secured loan to value LTV (%) – indexed value at financial year end | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| <50% | **8,124.2** | **38.6** | **1,443.1** | **32.8** | **9,567.3** | **37.6** |
| 50%-<60% | **4,679.6** | **22.2** | **1,202.7** | **27.3** | **5,882.3** | **23.1** |
| 60%-<70% | **4,025.3** | **19.1** | **1,069.6** | **24.3** | **5,094.9** | **20.0** |
| 70%-<80% | **2,247.2** | **10.7** | **680.4** | **15.5** | **2,927.6** | **11.5** |
| 80%-<90% | **1,719.7** | **8.2** | **3.4** | **0.1** | **1,723.1** | **6.8** |
| 90%-<100% | **250.4** | **1.2** | **1.4** | **—** | **251.8** | **1.0** |
| >100% | **9.4** | **—** | **0.5** | **—** | **9.9** | **—** |
| **Total** | **21,055.8** | **100.0** | **4,401.1** | **100.0** | **25,456.9** | **100.0** |
| Average loan-to-value of stock - indexed[1] | | **54.9** | | **55.4** | | **55.0** |
| Average loan-to-value of new business | | **69.8** | | **62.7** | | **68.0** |

| **2014** Retail secured loan to value LTV (%) – indexed value at financial year end | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| <50% | 6,247.8 | 33.3 | 909.5 | 29.0 | 7,157.3 | 32.7 |
| 50%-<60% | 4,646.5 | 24.8 | 977.9 | 31.2 | 5,624.4 | 25.7 |
| 60%-<70% | 4,129.2 | 22.0 | 842.1 | 26.9 | 4,971.3 | 22.7 |
| 70%-<80% | 2,463.1 | 13.1 | 395.8 | 12.6 | 2,858.9 | 13.1 |
| 80%-<90% | 1,063.6 | 5.7 | 5.3 | 0.2 | 1,068.9 | 4.9 |
| 90%-<100% | 180.7 | 1.0 | 2.4 | 0.1 | 183.1 | 0.8 |
| >100% | 15.4 | 0.1 | 1.3 | — | 16.7 | 0.1 |
| **Total** | 18,746.3 | 100.0 | 3,134.3 | 100.0 | 21,880.6 | 100.0 |
| Average loan-to-value of stock - indexed[1] | | 55.8 | | 55.6 | | 55.7 |
| Average loan-to-value of new business | | 64.5 | | 64.5 | | 66.9 |

1. The average loan to value of stock and new business is balance weighted.

**Note 31: Financial risk management (continued)**

C. Credit quality of assets

Loans and receivables

Virgin Money defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures. These are based on the following criteria for the different credit risk exposure types.

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

Exposures are categorised as:

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

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

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

Unsecured exposures are categorised as:

> higher risk where assets are past due;

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

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

Wholesale credit exposures are assessed by reference to credit rating. All of Virgin Money's wholesale exposures are investment grade and therefore classified as low risk with the exception of debt securities reported as high risk, which relate to retained subordinated notes of Gosforth Funding Residential Mortgage-Backed Securities (RMBS) debt issuances sponsored by the Company.

No wholesale loans and receivables credit exposures are past due or impaired as at 31 December 2015 or 31 December 2014.

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

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

## Note 31: Financial risk management (continued)

The credit quality of retail assets is detailed in the tables below

| 2015 Gross loans and advances to customers by credit quality | Secured: Residential mortgage loans £m | % | Secured: Residential buy-to-let mortgage loans £m | % | Unsecured: Credit cards £m | % | Overdrafts £m | % | Total £m | % |
|---|---|---|---|---|---|---|---|---|---|---|
| Neither past due nor impaired | **20,833.0** | **98.9** | **4,379.1** | **99.5** | **1,582.4** | **98.3** | **0.2** | **100.0** | **26,794.7** | **99.0** |
| – *of which in receipt of forbearance*[1] | **238.5** | **1.1** | **8.8** | **0.2** | **2.9** | **0.2** | **—** | **—** | **250.2** | **0.9** |
| Past due and not impaired | **145.2** | **0.7** | **15.0** | **0.3** | **—** | **—** | **—** | **—** | **160.2** | **0.6** |
| Impaired | **77.6** | **0.4** | **7.0** | **0.2** | **27.4** | **1.7** | **—** | **—** | **112.0** | **0.4** |
| **Total** | **21,055.8** | **100.0** | **4,401.1** | **100.0** | **1,609.8** | **100.0** | **0.2** | **100.0** | **27,066.9** | **100.0** |

1. This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation.

| 2014 Gross loans and advances to customers by credit quality | Secured: Residential mortgage loans £m | % | Secured: Residential buy-to-let mortgage loans £m | % | Unsecured: Credit cards £m | % | Overdrafts £m | % | Total £m | % |
|---|---|---|---|---|---|---|---|---|---|---|
| Neither past due nor impaired | 18,495.0 | 98.6 | 3,109.1 | 99.2 | 1,093.7 | 97.6 | 0.2 | 100.0 | 22,698.0 | 98.6 |
| – *of which in receipt of forbearance*[1] | *241.5* | *1.3* | *7.2* | *0.2* | *3.2* | *0.3* | — | — | *251.9* | *1.1* |
| Past due and not impaired | 182.5 | 1.0 | 17.6 | 0.6 | — | — | — | — | 200.1 | 0.9 |
| Impaired | 68.8 | 0.4 | 7.6 | 0.2 | 27.4 | 2.4 | — | — | 103.8 | 0.5 |
| **Total** | 18,746.3 | 100.0 | 3,134.3 | 100.0 | 1,121.1 | 100.0 | 0.2 | 100.0 | 23,001.9 | 100.0 |

1. This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. The December 2014 forbearance balance has been restated to reflect a change in the definition to include customers categorized as in hardship and on a payment plan or vulnerable.

The criteria that the Company uses to determine that there is objective evidence of an impairment loss are disclosed in accounting policy 1.6.6. All loans where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

The table below shows the reconciliation of retail impairment provisions during the year.

| Impairment provisions on loans and advances | Secured: Residential mortgage loans £m | Secured: Residential buy-to-let property £m | Unsecured: Credit cards £m | Overdrafts £m | Total £m |
|---|---|---|---|---|---|
| As at 1 January 2014 | 6.9 | 0.6 | 27.0 | 0.1 | 34.6 |
| Advances written off | (1.0) | (0.1) | (27.6) | — | (28.7) |
| Gross charge to the income statement[1] | 0.3 | 0.9 | 23.5 | — | 24.7 |
| **As at 31 December 2014** | **6.2** | **1.4** | **22.9** | **0.1** | **30.6** |
| Advances written off | **(1.7)** | **(0.2)** | **(26.0)** | **—** | **(27.9)** |
| Gross charge to the income statement[1] | **3.2** | **(0.2)** | **34.2** | — | **37.2** |
| **As at 31 December 2015** | **7.7** | **1.0** | **31.1** | **0.1** | **39.9** |

1. The net charge to the income statement in 2015 was £30.3m (2014: £15.8m). The difference between the gross and net charge represents sales of credit card receivables which had previously been written-off resulting in net recoveries of £6.9 million (2014: £8.9 million).

### Note 31: Financial risk management (continued)

Loans and advances which are neither past due nor impaired

The table below shows the details of the credit quality of assets that are neither past due nor impaired, as shown in the gross secured loans and advances to customers by credit quality table.

| **2015** | **Residential mortgage loans** | | **Residential buy-to-let mortgage loans** | | **Total** | |
|---|---|---|---|---|---|---|
| **Credit quality for neither past due nor impaired loans** | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| PD by internal ratings | | | | | | |
| Low risk | **18,677.0** | **89.6** | **4,234.8** | **96.7** | **22,911.8** | **90.8** |
| Medium risk | **1,518.7** | **7.3** | **133.7** | **3.1** | **1,652.4** | **6.6** |
| Higher risk | **637.3** | **3.1** | **10.6** | **0.2** | **647.9** | **2.6** |
| **Total neither past due nor impaired** | **20,833.0** | **100.0** | **4,379.1** | **100.0** | **25,212.1** | **100.0** |

| 2014 | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| Credit quality for neither past due nor impaired loans | £m | % | £m | % | £m | % |
| PD by internal ratings | | | | | | |
| Low risk | 16,586.1 | 89.7 | 3,037.3 | 97.6 | 19,623.4 | 90.8 |
| Medium risk | 1,506.4 | 8.1 | 67.0 | 2.2 | 1,573.4 | 7.3 |
| Higher risk | 402.5 | 2.2 | 4.8 | 0.2 | 407.3 | 1.9 |
| **Total neither past due nor impaired** | 18,495.0 | 100.0 | 3,109.1 | 100.0 | 21,604.1 | 100.0 |

Loans and advances which are past due and not impaired

Mortgages past due and not impaired can also be analysed by overdue term as shown below. These assets represent 0.6% of secured balances (2014: 0.9%).

| **2015** | **Residential mortgage loans** | | **Residential buy-to-let mortgage loans** | | **Total** | |
|---|---|---|---|---|---|---|
| **Past due and not impaired loans** | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| Up to one month | **44.4** | **30.6** | **4.3** | **28.7** | **48.7** | **30.4** |
| One to three months | **63.5** | **43.7** | **8.3** | **55.3** | **71.8** | **44.8** |
| Three to six months | **24.1** | **16.6** | **1.3** | **8.7** | **25.4** | **15.9** |
| Over six months | **13.2** | **9.1** | **1.1** | **7.3** | **14.3** | **8.9** |
| **Total past due and not impaired** | **145.2** | **100.0** | **15.0** | **100.0** | **160.2** | **100.0** |

| 2014 | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| Past due and not impaired loans | £m | % | £m | % | £m | % |
| Up to one month | 59.3 | 32.5 | 5.2 | 29.5 | 64.5 | 32.2 |
| One to three months | 72.0 | 39.5 | 8.2 | 46.6 | 80.2 | 40.1 |
| Three to six months | 29.6 | 16.2 | 2.6 | 14.8 | 32.2 | 16.1 |
| Over six months | 21.6 | 11.8 | 1.6 | 9.1 | 23.2 | 11.6 |
| **Total past due and not impaired** | 182.5 | 100.0 | 17.6 | 100.0 | 200.1 | 100.0 |

**Note 31: Financial risk management (continued)**

The table below reconciles the movement throughout the year of all impaired secured and unsecured loans. The balance shown represents the entire financial asset rather than just the overdue elements.

| **2015** | **Secured** | | **Unsecured** | |
|---|---|---|---|---|
| **Reconciliation of impaired loans** | **Residential mortgage loans £m** | **Residential buy-to-let mortgage loans £m** | **Credit cards £m** | **Total £m** |
| As at 1 January 2015 | **68.8** | **7.6** | **27.4** | **103.8** |
| Classified as impaired during the year | **174.7** | **22.2** | **81.6** | **278.5** |
| Transferred from impaired to unimpaired | **(150.9)** | **(21.6)** | **(42.4)** | **(214.9)** |
| Amounts written off | **(1.7)** | **(0.2)** | **(26.0)** | **(27.9)** |
| Repayments | **(13.3)** | **(1.0)** | **(13.2)** | **(27.5)** |
| **As at 31 December 2015** | **77.6** | **7.0** | **27.4** | **112.0** |

| 2014 | Secured | | Unsecured | |
|---|---|---|---|---|
| Reconciliation of impaired loans | Residential mortgage loans £m | Residential buy-to-let mortgage loans £m | Credit cards £m | Total £m |
| As at 1 January 2014 | 102.6 | 8.4 | 26.6 | 137.6 |
| Classified as impaired during the year | 121.6 | 14.5 | 77.0 | 213.1 |
| Transferred from impaired to unimpaired | (136.3) | (13.7) | (39.4) | (189.4) |
| Amounts written off | (1.0) | (0.1) | (27.6) | (28.7) |
| Repayments | (18.1) | (1.5) | (9.2) | (28.8) |
| **As at 31 December 2014** | 68.8 | 7.6 | 27.4 | 103.8 |

Details of the Company's impaired assets and provisions are provided in the table below:

| **2015**<br>**Impaired assets and impairment provisions** | **Gross balances £m** | **Impaired balances £m** | **Impaired balances as a % of gross balances %** | **Impairment provisions £m** | **Impairment provisions as a % of impaired balances %** |
|---|---|---|---|---|---|
| Residential mortgage loans | **21,055.8** | **77.6** | **0.4** | **7.7** | **9.9** |
| Residential buy-to-let mortgage loans | **4,401.1** | **7.0** | **0.2** | **1.0** | **14.3** |
| **Total secured** | **25,456.9** | **84.6** | **0.4** | **8.7** | **10.3** |
| Credit cards | **1,609.8** | **27.4** | **1.7** | **31.1** | **113.5** |
| Overdrafts | **0.2** | — | — | **0.1** | — |
| **Total unsecured** | **1,610.0** | **27.4** | **1.7** | **31.2** | **113.9** |
| Wholesale treasury assets | **4,284.9** | — | — | — | — |
| Wholesale derivative assets | **143.5** | — | — | — | — |
| **Total** | **31,495.3** | **112.0** | **0.4** | **39.9** | **35.6** |

# Notes to the financial statements

### Note 31: Financial risk management (continued)

| 2014<br>Impaired assets and impairment provisions | Gross balances £m | Impaired balances £m | Impaired balances as a % of gross balances % | Impairment provisions £m | Impairment provisions as a % of impaired balances % |
|---|---|---|---|---|---|
| Residential mortgage loans | 18,746.3 | 68.8 | 0.4 | 6.2 | 9.0 |
| Residential buy-to-let mortgage loans | 3,134.3 | 7.6 | 0.2 | 1.4 | 18.4 |
| **Total secured** | 21,880.6 | 76.4 | 0.3 | 7.6 | 9.9 |
| Credit cards[1] | 1,121.1 | 27.4 | 2.4 | 22.9 | 83.6 |
| Overdrafts | 0.2 | — | — | 0.1 | — |
| **Total unsecured** | 1,121.3 | 27.4 | 2.4 | 23.0 | 83.9 |
| Wholesale treasury assets | 4,184.5 | — | — | — | — |
| Wholesale derivative assets | 178.0 | — | — | — | — |
| **Total** | 27,364.4 | 103.8 | 0.4 | 30.6 | 29.5 |

1 A fair value adjustment of £5.9m was made to the purchase price to take account of expected losses on these assets. These losses therefore do not appear as part of the impairment provision total as at December 2014, with only losses incurred after purchase being charged.

Impaired assets by overdue term

| **2015**<br>**Impaired assets by overdue term and possession status – secured** | **Residential mortgage loans £m** | **%** | **Residential buy-to-let mortgage loans £m** | **%** | **Total £m** | **%** |
|---|---|---|---|---|---|---|
| Up to one month | **50.7** | **65.3** | **4.5** | **64.3** | **55.2** | **65.3** |
| One to three months | **13.7** | **17.7** | **1.4** | **20.0** | **15.1** | **17.8** |
| Three to six months | **5.2** | **6.7** | **0.3** | **4.3** | **5.5** | **6.5** |
| Over six months | **7.2** | **9.3** | **0.7** | **10.0** | **7.9** | **9.3** |
| Possession | **0.8** | **1.0** | **0.1** | **1.4** | **0.9** | **1.1** |
| **Total impaired assets** | **77.6** | **100.0** | **7.0** | **100.0** | **84.6** | **100.0** |

| 2014<br>Impaired assets by overdue term and possession status – secured | Residential mortgage loans £m | % | Residential buy-to-let mortgage loans £m | % | Total £m | % |
|---|---|---|---|---|---|---|
| Up to one month | 44.0 | 63.9 | 4.0 | 52.7 | 48.0 | 62.8 |
| In one to three months | 10.3 | 15.0 | 2.3 | 30.3 | 12.6 | 16.5 |
| In three to six months | 4.5 | 6.5 | 0.3 | 3.9 | 4.8 | 6.3 |
| Over six months | 9.0 | 13.1 | 0.7 | 9.2 | 9.7 | 12.7 |
| Possession | 1.0 | 1.5 | 0.3 | 3.9 | 1.3 | 1.7 |
| **Total impaired assets** | 68.8 | 100.0 | 7.6 | 100.0 | 76.4 | 100.0 |

| **2015**<br>**Impaired assets by overdue term – unsecured** | **£m** | **%** |
|---|---|---|
| **Credit cards** | | |
| Up to one month | **11.8** | **43.1** |
| One to three months | **7.6** | **27.7** |
| Three to six months | **7.7** | **28.1** |
| Over six months | **0.3** | **1.1** |
| **Total** | **27.4** | **100.0** |

### Note 31: Financial risk management (continued)

| 2014<br>Impaired assets by overdue term – unsecured | £m | % |
|---|---|---|
| Credit cards | | |
| Up to one month | 11.0 | 40.1 |
| One to three months | 8.0 | 29.2 |
| Three to six months | 8.4 | 30.7 |
| Over six months | — | — |
| **Total** | 27.4 | 100.0 |

D. Wholesale Credit Risk

| **Wholesale credit exposures** | **2015 £m** | 2014 £m |
|---|---|---|
| Loans and advances to banks | **119.6** | 136.4 |
| Bank of England | **888.6** | 851.3 |
| Debt securities classified as loans and receivables | **1,723.9** | 1,407.4 |
| Debt securities classified as available-for-sale financial assets | **1,292.3** | 1,539.6 |
| Gross positive fair value of derivative contracts | **143.5** | 178.0 |
| Loans and advances to customers – amounts due from group companies | **255.9** | 249.8 |
| **Total** | **4,423.8** | 4,362.5 |

At 31 December 2015 the single largest exposure to any single counterparty which is not a sovereign, a supranational or a Gosforth Funding securitisation vehicle obligor was £117.6 million (2014: £104.4 million). The exposure was to a large counterparty with a credit rating of A. The table below shows the loans and advances to banks excluding the Bank of England.

| **Loans and advances to banks excluding Bank of England** | **2015 £m** | 2014 £m |
|---|---|---|
| AA- | **23.8** | 15.3 |
| A+ | **15.9** | 15.8 |
| A | **33.3** | 61.7 |
| A- | **6.1** | 6.6 |
| BBB+ | **40.5** | 37.0 |
| **Total** | **119.6** | 136.4 |

The Company's exposure to the Bank of England was £888.6 million and £851.3 million as at year end 2015 and 2014, respectively. These exposures were rated AA+ at both respective dates.

The table below shows debt securities classified as loans and receivables and available-for-sale financial assets.

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | **Debt securities classified as loans and receivables £m** | **Debt securities classified as available-for-sale financial assets £m** | Debt securities classified as loans and receivables £m | Debt securities classified as available-for-sale financial assets £m |
| UK sovereign exposures | — | **409.5** | — | 795.0 |
| Non-domestic sovereign exposures | — | — | — | — |
| Supranational | — | **203.7** | — | 310.7 |
| Residential mortgage-backed securities | **1.2** | **59.4** | 11.1 | 62.9 |
| Covered bonds | — | **535.3** | — | 265.7 |
| Debt securities issued by banks | — | **84.4** | — | 105.3 |
| Securities issued by other Group companies | **1,722.7** | — | 1,396.3 | — |
| **Total** | **1,723.9** | **1,292.3** | 1,407.4 | 1,539.6 |

### Note 31: Financial risk management (continued)

| **Credit rating on debt securities classified as loans and receivables debt securities classified as and available-for-sale financial assets** | **2015 £m** | 2014 £m |
|---|---|---|
| AAA | **1,908.5** | 1,272.5 |
| AA+ | **434.9** | 978.2 |
| AA | **111.2** | 214.2 |
| AA- | **30.0** | 20.9 |
| A+ | **29.0** | 34.2 |
| A | **1.3** | — |
| A- | — | 9.0 |
| Not rated | **501.3** | 418.0 |
| **Total** | **3,016.2** | 2,947.0 |

The changes to debt securities reflect a reduction from the high liquidity surplus held at year end 2014. Continued alignment of the Company's liquid asset portfolio to the evolving regulatory definition of high-quality liquid assets is reflected in the decrease in gilt holdings, increase in covered bonds and disposal of unsecured bank debt. Debt securities reported as 'Not rated' relate to the retained subordinated notes of Gosforth Funding RMBS debt issuances sponsored by the Company.

| **Exposures by country** | **2015 £m** | 2014 £m |
|---|---|---|
| Australia | **14.4** | 39.9 |
| Canada | **30.0** | — |
| France | **12.7** | 14.9 |
| UK | **4,118.8** | 3,896.7 |
| Germany | **10.9** | 6.6 |
| Netherlands | **25.3** | 84.4 |
| USA | **8.0** | 9.3 |
| Supranational | **203.7** | 310.7 |
| **Total** | **4,423.8** | 4,362.5 |

E. Derivative financial instruments

An analysis of derivative assets is given in note 10. The Company reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Company's maximum credit risk relating to derivative assets of £143.5 million (2014: £178.0 million), cash collateral of £8.9 million (2014: £10.2 million) was held.

Virgin Money measures exposure in over the counter (OTC) derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, IAS 32 requires that they are represented on the balance sheet on a gross basis. Contracts with positive fair value are disclosed as assets in the balance sheet under 'derivative financial instruments', those with negative fair value are disclosed as liabilities under the same title.

Collateral received is shown as deposits by banks, with collateral posted shown as loans and advances to banks (refer note 15). The notes to the financial statements provide further information on collateral.

| **OTC derivative exposures** | **2015 (unaudited) £m** | 2014 (unaudited) £m |
|---|---|---|
| Gross positive fair value of derivative contracts | **143.5** | 178.0 |
| Netting with gross negative fair value of derivative contracts[1] | **(70.4)** | (89.9) |
| Potential future incremental exposure | **48.0** | 48.0 |
| Collateral received | **(8.9)** | (10.2) |
| **Net OTC derivative exposures** | **112.2** | 125.9 |

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

### Note 31: Financial risk management (continued)

| OTC derivative liabilities | **2015 (unaudited) £m** | 2014 (unaudited) £m |
|---|---|---|
| Gross negative fair value of derivative contracts | **(150.3)** | (222.8) |
| Netting with gross positive fair value of derivative contracts[1] | **70.4** | 89.9 |
| Collateral pledged (loans and advances to banks) | **76.4** | 111.6 |
| **Net OTC derivative liability** | **(3.5)** | (21.3) |

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

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

The table on the following page provides credit quality analysis of the gross OTC derivative exposures by credit rating of the counterparties.

| | **2015** | | 2014 | |
|---|---|---|---|---|
| **Gross OTC derivative exposures by credit rating** | **£m** | **%** | £m | % |
| AA- | **20.6** | **14.4** | 33.6 | 18.9 |
| A+ | **6.8** | **4.7** | 9.6 | 5.4 |
| A | **42.0** | **29.3** | 42.2 | 23.7 |
| A- | **6.3** | **4.4** | 11.2 | 6.3 |
| BBB+ | **5.0** | **3.5** | 3.5 | 1.9 |
| Not rated | **62.8** | **43.7** | 77.9 | 43.8 |
| **Total** | **143.5** | **100.0** | 178.0 | 100.0 |

Gross OTC derivative exposures reported as ‘Not rated’ relate to interest rate derivative transactions between Gosforth Funding securitisation special purpose vehicles and the Company.

F. Collateral held as security for financial assets

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

Loans and receivables to customers

The Company holds collateral in respect of loans and advances to customers as set out below. The Company does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

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

| **2015** Fair value of collateral against secured loans – capped at loan value[1] | **Residential mortgage loans** | | **Residential buy-to-let mortgage loans** | | **Total** | |
|---|---|---|---|---|---|---|
| | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| Neither past due nor impaired | **20,832.4** | **100.0** | **4,379.1** | **100.0** | **25,211.5** | **100.0** |
| – *of which in receipt of forbearance* | ***238.5*** | ***100.0*** | ***8.8*** | ***100.0*** | ***247.3*** | ***100.0*** |
| Past due and not impaired | **145.2** | **100.0** | **15.0** | **100.0** | **160.2** | **100.0** |
| Impaired | **77.3** | **99.6** | **7.0** | **100.0** | **84.3** | **99.6** |
| – *of which in possession* | ***0.8*** | ***100.0*** | ***0.1*** | ***100.0*** | ***0.9*** | ***100.0*** |
| **Total** | **21,054.9** | **100.0** | **4,401.1** | **100.0** | **25,456.0** | **100.0** |

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

### Note 31: Financial risk management (continued)

| 2014<br>Fair value of collateral against secured loans – capped at loan value[1] | Residential mortgage loans £m | % | Residential buy-to-let mortgage loans £m | % | Total £m | % |
|---|---|---|---|---|---|---|
| Neither past due nor impaired | 18,493.5 | 100.0 | 3,109.0 | 100.0 | 21,602.5 | 100.0 |
| *– of which in receipt of forbearance* | *241.5* | *100.0* | *7.2* | *100.0* | *248.7* | *100.0* |
| Past due and not impaired | 182.5 | 100.0 | 17.6 | 100.0 | 200.1 | 100.0 |
| Impaired | 68.4 | 99.4 | 7.6 | 100.0 | 76.0 | 99.5 |
| *– of which in possession* | *1.0* | *100.0* | *0.3* | *100.0* | *1.3* | *100.0* |
| **Total** | 18,744.4 | 100.0 | 3,134.2 | 100.0 | 21,878.6 | 100.0 |

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

| **2015**<br>**Negative equity on secured loans** | **Residential mortgage loans £m** | **Residential buy-to-let mortgage loans £m** | **Total £m** |
|---|---|---|---|
| Neither past due nor impaired | 0.6 | — | 0.6 |
| – *of which in receipt of forbearance* | — | — | — |
| Past due and not impaired | — | — | — |
| Impaired | 0.3 | — | 0.3 |
| – *of which in possession* | — | — | — |
| **Total** | **0.9** | — | **0.9** |

| 2014<br>Negative equity on secured loans | Residential mortgage loans £m | Residential buy-to-let mortgage loans £m | Total £m |
|---|---|---|---|
| Neither past due nor impaired | 1.5 | 0.1 | 1.6 |
| – *of which in receipt of forbearance* | — | — | — |
| Past due and not impaired | — | — | — |
| Impaired | 0.4 | — | 0.4 |
| – *of which in possession* | — | — | — |
| **Total** | 1.9 | 0.1 | 2.0 |

The proportion of secured balances in negative equity has fallen below 0.1% at 31 December 2015 (2014: 0.1%). This relates to £9.9 million of asset balances in the mortgage portfolio that are exposed to negative equity (2014: £16.7 million). The amount of negative equity has decreased from £2.0 million in 2014 to £0.9 million as at 31 December 2015 as a result of positive house price index movements observed in the portfolio.

Loans and advances to banks

The Company requires collateral posting arrangements to be in place as part of entering into a derivative transaction with another bank, depending on the type of financial product and the counterparty involved, and netting arrangements are obtained. The Company's derivative exposures to Gosforth Funding securitisation special purpose vehicles are an exception to collateral requirements.

Other

No collateral is held in respect of retail credit cards or overdrafts.

## Note 31: Financial risk management (continued)

G. Collateral repossessed

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

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

| | **2015** | | 2014 | |
|---|---|---|---|---|
| **Possessions as a percentage of total book (number of properties)** | **Number** | **%** | Number | % |
| Properties in possession | **12** | **0.01** | 18 | 0.01 |
| CML industry average[1] | **3,200** | **0.03** | 6,400 | 0.06 |

[1] CML possession as at Q4 2015. The CML industry average includes banks with portfolios significantly larger than Virgin Money plc that drive up the industry average, so the percentage comparisons are more meaningful than the pure number comparisons.

H. Debt management for customers in financial difficulty

The Company operates a number of treatments to assist borrowers who are experiencing financial stress. Further details relating to those cases where the Company has granted a concession, whether temporarily or permanently, are set out below.

Retail customers – Forbearance activities

The Company classifies the treatments offered to retail customers who have experienced financial distress into the following categories:

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

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

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

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

Customers receiving support from UK Government sponsored programmes

The Company participates in a UK Government sponsored programme designed to support households (Income Support for Mortgage Interest). Where this scheme provides borrowers with a state benefit that is used to service the loan, there is no change in the reported status of the loan which is managed and reported in accordance with its original terms.

The Company assesses whether a loan benefitting from a UK Government sponsored programme is impaired using the same accounting policies and practices as it does for loans not benefitting from such a programme. Loans included within the Income Support for Mortgage Interest scheme may be impaired, in accordance with the normal definition of impairment.

# Notes to the financial statements

## Note 31: Financial risk management (continued)

Customers in financial difficulty receiving support under other schemes

The Company measures the success of forbearance schemes for secured loans. This is based upon the proportion of customers who remain neither past due nor impaired or repay their loan fully over the 12 months following the exit from a forbearance treatment. For temporary treatments, 100% of customers accepting reduced payment arrangements have remained within contractual terms following the end of their treatment, and are either fully up to date or had redeemed their loan as at 31 December 2015. For permanent treatments, 94% of customers who have accepted interest only concessions, 96% of customers who have had a discretionary payment holiday and 95% of customers who have accepted term extensions, remained within contractual terms following the end of their treatment as at 31 December 2015.

Forbearance identification and classification

The Company classifies a retail account as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty. Where the treatment involves a permanent change to the contractual basis of the customer's account such as conversion to interest only or term extension, the Company classifies the balance as forborne for a period of 12 months, after which no distinction is made between these accounts and others where no change has been made.

Secured retail lending

At 31 December 2015, retail secured loans and advances currently or recently subject to forbearance were £259.4 million (2014: £267.3 million) of total retail secured loans and advances.

Collective impairment assessment of retail secured loans subject to forbearance

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

The Company's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Company uses sophisticated behavioural scoring to assess customers' credit risk. The underlying behavioural scorecards consider many different characteristics of customer behaviour, both static and dynamic, from internal sources and also from credit bureau data, including characteristics that may identify when a customer has been in arrears on products held with other firms. Hence, these models take a range of potential indicators of customer financial distress into account.

The performance of provision models is monitored and challenged on an ongoing basis, in line with the Retail Credit Provisioning Policy. The models are also regularly recalibrated to reflect up to date customer behaviour and market conditions. Specifically, regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected. Where this is not the case, additional provisions are applied to capture the risk.

Unsecured retail lending

At 31 December 2015, total retail unsecured loans and advances benefitting from forbearance totalled £10.7 million (2014: £12.9 million).

Collective impairment assessment of retail unsecured loans and advances subject to forbearance

Credit risk provisioning for the retail unsecured portfolio is undertaken on a collective basis, except for fraud cases which are fully provided for. The approach used is based on roll rates for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge- off given default.

Following the migration of the credit card portfolio, the Company widened its definition of forbearance. The migration of the credit card portfolio to the Company's infrastructure has resulted in improved management information to better identify individual customer circumstances.

# Notes to the financial statements

## Note 31: Financial risk management (continued)

| 2015 | Neither past due nor impaired | | Past due not impaired | | Impaired | | Total | |
|---|---|---|---|---|---|---|---|---|
| Forbearance stock | £m | % | £m | % | £m | % | £m | % |
| **Secured** | | | | | | | | |
| Payment arrangement | **3.0** | **1.2** | **0.3** | **3.1** | **0.3** | **12.5** | **3.6** | **1.4** |
| Transfer to interest only | **17.5** | **7.1** | **3.3** | **34.0** | **0.8** | **33.3** | **21.6** | **8.3** |
| Term extension | **171.9** | **69.5** | **5.3** | **54.6** | **0.7** | **29.2** | **177.9** | **68.6** |
| Payment holiday | **54.9** | **22.2** | **0.8** | **8.3** | **0.6** | **25.0** | **56.3** | **21.7** |
| **Total secured forbearance** | **247.3** | **100.0** | **9.7** | **100.0** | **2.4** | **100.0** | **259.4** | **100.0** |
| **Unsecured** | | | | | | | | |
| Accounts where the customer has been approved on a repayment plan | **2.9** | **100.0** | **—** | **—** | **7.8** | **100.0** | **10.7** | **100.0** |
| **Total unsecured forbearance** | **2.9** | **100.0** | **—** | **—** | **7.8** | **100.0** | **10.7** | **100.0** |
| **Total forbearance** | **250.2** | **100.0** | **9.7** | **100.0** | **10.2** | **100.0** | **270.1** | **100.0** |

The value of forbearance stock totalled £270.1 million at 31 December 2015, representing a 3.6% (£10.1 million) reduction on 31 December 2014.

| 2014 | Neither past due nor impaired | | Past due not impaired | | Impaired | | Total | |
|---|---|---|---|---|---|---|---|---|
| Forbearance stock | £m | % | £m | % | £m | % | £m | % |
| Secured | | | | | | | | |
| Payment arrangement | 2.8 | 1.1 | 0.4 | 2.4 | 0.1 | 4.8 | 3.3 | 1.2 |
| Transfer to interest only | 19.7 | 7.9 | 8.6 | 52.2 | 0.6 | 28.6 | 28.9 | 10.8 |
| Term extension | 162.4 | 65.3 | 4.0 | 24.2 | 0.9 | 42.8 | 167.3 | 62.6 |
| Payment holiday | 63.8 | 25.7 | 3.5 | 21.2 | 0.5 | 23.8 | 67.8 | 25.4 |
| **Total secured forbearance** | 248.7 | 100.0 | 16.5 | 100.0 | 2.1 | 100.0 | 267.3 | 100.0 |
| Unsecured | | | | | | | | |
| Accounts where the customer has been approved on a repayment plan[1] | 3.2 | 100.0 | — | — | 9.7 | 100.0 | 12.9 | 100.0 |
| **Total unsecured forbearance** | 3.2 | 100.0 | — | — | 9.7 | 100.0 | 12.9 | 100.0 |
| **Total forbearance** | 251.9 | 100.0 | 16.5 | 100.0 | 11.8 | 100.0 | 280.2 | 100.0 |

[1] The December 2014 forbearance balance has been restated to reflect a change in the definition to include customers categorised as in hardship and on a payment plan or vulnerable.

### Note 31: Financial risk management (continued)

### (3) Funding and Liquidity risk

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

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

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

The table below shows an analysis of total liquidity. The table is not equivalent to the balance sheet position as it includes off balance sheet liquidity and excludes encumbered assets:

| Composition of the liquidity portfolio | 2015 £m | 2015 Average £m | 2014 £m | 2014 Average £m |
|---|---|---|---|---|
| **Level 1** | | | | |
| Cash and balances at central banks | **846.3** | **796.4** | 813.3 | 1,120.9 |
| UK Government securities | **409.5** | **392.6** | 586.2 | 637.8 |
| Other HQLA level 1 eligible | **25.4** | **15.8** | — | 33.9 |
| Supranational securities | **203.7** | **294.6** | 310.7 | 350.1 |
| Treasury bills raised through FLS | **2,174.0** | **2,150.6** | 2,260.0 | 1,598.5 |
| Covered bonds (Level 1 eligible)[1] | **498.2** | **248.2** | — | — |
| **Total level 1** | **4,157.1** | **3,898.2** | 3,970.2 | 3,741.2 |
| **Level 2a** | | | | |
| Covered bonds (Level 2a eligible)[1] | **22.1** | **133.5** | 225.7 | 127.9 |
| **Total level 2a** | **22.1** | **133.5** | 225.7 | 127.9 |
| **Level 2b** | | | | |
| Eligible RMBS | **59.4** | **44.7** | 40.0 | 42.1 |
| **Total level 2b** | **59.4** | **44.7** | 40.0 | 42.1 |
| **High Quality Liquid Assets (Level 1 + 2a + 2b)** | **4,238.6** | **4,076.4** | 4,235.9 | 3,911.2 |
| **Other liquidity resources** | | | | |
| Covered Bonds | **15.0** | **2.3** | — | — |
| Non-eligible RMBS | **—** | **3.7** | 11.1 | 11.5 |
| Certificates of deposit | **59.0** | **4.5** | — | 43.8 |
| Floating rate notes | **—** | **—** | — | 11.1 |
| Fixed rate bonds | **—** | **17.0** | 55.3 | 120.3 |
| **Total other liquidity resources** | **74.0** | **27.5** | 66.4 | 186.7 |
| Self-issued RMBS | **326.7** | **197.6** | 92.8 | 433.4 |
| **Total liquidity** | **4,639.3** | **4,301.5** | 4,395.1 | 4,531.3 |

[1] During 2015, the Group reclassified covered bonds to align with the European Commission's delegated act with regard to the liquidity coverage requirement. The legislation prescribes a liquidity classification based on several criteria, including the credit quality and indicators of liquidity performance under stress conditions of the instrument.

The table on the following page analyses assets and liabilities of the Company into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Company's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms, and readers are therefore advised to use caution when using this data to evaluate the Company's liquidity position. In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity.

**Note 31: Financial risk management (continued)**

| **2015**<br>**Assets and liabilities by maturity profile** | **Within 3 months £m** | **3-12 months £m** | **1-5 years £m** | **After 5 years £m** | **Total £m** |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances at central banks | **846.9** | — | — | **41.7** | **888.6** |
| Derivative financial instruments | **16.1** | **13.2** | **46.0** | **68.2** | **143.5** |
| Loans and receivables: | | | | | |
| Loans and advances to banks | **119.6** | — | — | — | **119.6** |
| Loans and advances to customers | **1,919.6** | **572.6** | **3,335.1** | **21,541.3** | **27,368.6** |
| Debt securities | — | — | — | **1,723.9** | **1,723.9** |
| Available-for-sale financial assets | **47.5** | **4.7** | **424.4** | **820.3** | **1,296.9** |
| Other assets | **47.9** | **20.3** | **11.7** | **152.7** | **232.6** |
| **Total assets** | **2,997.6** | **610.8** | **3,817.2** | **24,348.1** | **31,773.7** |
| **Liabilities** | | | | | |
| Deposits from banks | **758.8** | **525.0** | — | — | **1,283.8** |
| Customer deposits | **20,776.8** | **2,630.3** | **1,738.2** | — | **25,145.3** |
| Amounts due to securitisation special purpose vehicles | **65.4** | **102.2** | **592.1** | **2,558.7** | **3,318.4** |
| Derivative financial instruments | **6.0** | **12.1** | **102.5** | **34.7** | **155.3** |
| Debt securities in issue | — | — | **297.5** | — | **297.5** |
| Other liabilities | **154.1** | **47.1** | **39.5** | **4.4** | **245.1** |
| **Total liabilities** | **21,761.1** | **3,316.7** | **2,769.8** | **2,597.8** | **30,445.4** |
| **Net liquidity (gap)/surplus** | **(18,763.5)** | **(2,705.9)** | **1,047.4** | **21,750.3** | **1,328.3** |

| 2014<br>Assets and liabilities by maturity profile | Within 3 months £m | 3-12 months £m | 1-5 years £m | After 5 years £m | Total £m |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances at central banks | 813.3 | — | — | 38.0 | 851.3 |
| Derivative financial instruments | 6.7 | 11.7 | 70.7 | 88.9 | 178.0 |
| Loans and receivables: | | | | | |
| Loans and advances to banks | 136.4 | — | — | — | 136.4 |
| Loans and advances to customers | 1,313.0 | 567.5 | 2,860.3 | 18,607.1 | 23,347.9 |
| Debt securities in issue | — | — | — | 1,407.4 | 1,407.4 |
| Available-for-sale financial assets | 20.1 | 122.2 | 406.0 | 991.3 | 1,539.6 |
| Other assets | 56.7 | 29.6 | 30.4 | 117.5 | 234.2 |
| **Total assets** | 2,346.2 | 731.0 | 3,367.4 | 21,250.2 | 27,694.8 |
| Liabilities | | | | | |
| Deposits from banks | 282.5 | 563.0 | — | — | 845.5 |
| Customer deposits | 18,043.6 | 2,356.7 | 1,967.7 | 0.9 | 22,368.9 |
| Amounts due to securitisation special purpose vehicles | 24.9 | 73.5 | 480.7 | 2,187.8 | 2,766.9 |
| Derivative financial instruments | 6.3 | 6.6 | 133.1 | 81.9 | 227.9 |
| Other liabilities | 194.7 | 42.5 | 19.1 | 3.7 | 260.0 |
| **Total liabilities** | 18,552.0 | 3,042.3 | 2,600.6 | 2,274.3 | 26,469.2 |
| **Net liquidity (gap)/surplus** | (16,205.8) | (2,311.3) | 766.8 | 18,975.9 | 1,225.6 |

The composition of the Company's wholesale funding is shown in the table below:

| **Source of wholesale funding** | **2015 £m** | 2014 £m |
|---|---|---|
| Amounts due to securitisation special purpose vehicles | **3,318.4** | 2,766.9 |
| Debt securities in issue | **297.5** | — |
| Term repo | **1,274.9** | 835.3 |
| **Total on-balance sheet sources of funds** | **4,890.8** | 3,602.2 |
| FLS drawings | **2,960.0** | 2,260.0 |
| **Total** | **7,850.8** | 5,862.2 |

### Note 31: Financial risk management (continued)

| **2015**<br>**Residual maturity of the wholesale funding book** | **Within 3 months £m** | **3-12 months £m** | **1-5 years £m** | **After 5 years £m** | **Total £m** |
|---|---|---|---|---|---|
| Amounts due to securitisation special purpose vehicles | **65.4** | **102.2** | **592.1** | **2,558.7** | **3,318.4** |
| Debt securities in issue | **—** | **—** | **297.5** | **—** | **297.5** |
| Term repo | **749.9** | **525.0** | **—** | **—** | **1,274.9** |
| **Total on-balance sheet sources of funds** | **815.3** | **627.2** | **889.6** | **2,558.7** | **4,890.8** |
| FLS drawings | **—** | **510.0** | **2,450.0** | **—** | **2,960.0** |
| **Total** | **815.3** | **1,137.2** | **3,339.6** | **2,558.7** | **7,850.8** |

| 2014<br>Residual maturity of the wholesale funding book | Within 3 months £m | 3-12 months £m | 1-5 years £m | After 5 years £m | Total £m |
|---|---|---|---|---|---|
| Amounts due to securitisation special purpose vehicles | 24.9 | 73.5 | 480.7 | 2,187.8 | 2,766.9 |
| Term repo | 272.3 | 563.0 | — | — | 835.3 |
| **Total on-balance sheet sources of funds** | 297.2 | 636.5 | 480.7 | 2,187.8 | 3,602.2 |
| FLS drawings | — | — | 2,260.0 | — | 2,260.0 |
| **Total** | 297.2 | 636.5 | 2,740.7 | 2,187.8 | 5,862.2 |

Encumbered assets

Virgin Money's assets can be used to support funding collateral requirements for central bank operations or third-party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes.

| **2015** | **Encumbered assets** | | **Unencumbered assets** | | **Total** |
|---|---|---|---|---|---|
| **Asset encumbrance** | **Pledged as collateral £m** | **Other[1] £m** | **Available as collateral[2] £m** | **Other[3] £m** | **£m** |
| Cash balances at central banks[4] | **160.5** | **—** | **—** | **728.1** | **888.6** |
| Debt securities classified as loans and receivables | **624.9** | **—** | **327.9** | **771.1** | **1,723.9** |
| Available-for-sale financial assets | **—** | **—** | **1,292.3** | **4.6** | **1,296.9** |
| Derivative financial assets | **—** | **—** | **—** | **143.5** | **143.5** |
| Loans and advances to banks | **—** | **94.0** | **—** | **25.6** | **119.6** |
| Loans and advances to customers[5] | **7,850.8** | **—** | **2,826.8** | **16,691.0** | **27,368.6** |
| Other assets | **—** | **—** | **—** | **232.6** | **232.6** |
| **Total assets** | **8,636.2** | **94.0** | **4,447.0** | **18,596.5** | **31,773.7** |
| Treasury bills raised through FLS held off balance sheet[6] | **786.0** | **—** | **2,174.0** | **—** | **2,960.0** |
| **Total assets plus off balance sheet FLS** | **9,422.2** | **94.0** | **6,621.0** | **18,596.5** | **34,733.7** |

1 Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These include cash reserves supporting secured funding structures.

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

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

4 Encumbered cash and balances at central banks includes the minimum reserve collateralisation requirement for the BACS payment system, introduced in September 2015.

5 Loans and advances to customers includes collateral pledged to the Bank of England and securitised mortgage pools.

6 These include Treasury Bills received by the Company through FLS which are not recognised on the balance sheet. These are classified as unencumbered when the Company is permitted to re-pledge.

### Note 31: Financial risk management (continued)

| 2014<br>Asset encumbrance | Encumbered assets<br>Pledged as collateral<br>£m | <br>Other[1]<br>£m | Unencumbered assets<br>Available as collateral[2]<br>£m | <br>Other[3]<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| Cash balances at central banks[4] | 38.0 | — | — | 813.3 | 851.3 |
| Debt securities classified as loans and receivables | 671.3 | — | 103.9 | 632.2 | 1,407.4 |
| Available-for-sale financial assets | 321.7 | — | 1,217.9 | — | 1,539.6 |
| Derivative financial assets | — | — | — | 178.0 | 178.0 |
| Loans and advances to banks | — | 120.0 | — | 16.4 | 136.4 |
| Loans and advances to customers[5] | 6,609.4 | — | 2,075.0 | 14,663.5 | 23,347.9 |
| Other assets | — | — | — | 234.2 | 234.2 |
| **Total assets** | 7,640.4 | 120.0 | 3,396.8 | 16,537.6 | 27,694.8 |
| Treasury bills raised through FLS held off balance sheet[6] | — | — | 2,260.0 | — | 2,260.0 |
| **Total assets plus off balance sheet FLS** | 7,640.4 | 120.0 | 5,656.8 | 16,537.6 | 29,954.8 |

1 Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These include cash reserves supporting secured funding structures.

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

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

4 Encumbered cash and balances at central banks includes the minimum reserve collateralisation requirement for the BACS payment system, introduced in September 2015.

5 Loans and advances to customers includes collateral pledged to the Bank of England and securitised mortgage pools.

6 These include Treasury Bills received by the Company through FLS which are not recognised on the balance sheet. These are classified as unencumbered when the Company is permitted to re-pledge.

Cash flow profile

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

| **2015<br>Maturity groupings for non-derivative cash outflows** | **Within 3 months<br>£m** | **3-6 months<br>£m** | **6-12 months<br>£m** | **1-5 years<br>£m** | **Over 5 years<br>£m** | **Total<br>£m** |
|---|---|---|---|---|---|---|
| Deposits from banks | **760.9** | **526.3** | — | — | — | **1,287.2** |
| Customer deposits | **21,229.0** | **895.0** | **1,604.5** | **1,962.0** | — | **25,690.5** |
| Amounts due to securitisation special purpose vehicles | **367.3** | **622.8** | **465.0** | **2,668.9** | — | **4,124.0** |
| **Total** | **22,357.2** | **2,044.1** | **2,069.5** | **4,630.9** | — | **31,101.7** |

| 2014<br>Maturity groupings for non-derivative cash outflows | Within 3 months<br>£m | 3-6 months<br>£m | 6-12 months<br>£m | 1-5 years<br>£m | Over 5 years<br>£m | Total<br>£m |
|---|---|---|---|---|---|---|
| Deposits from banks | 283.1 | 565.0 | — | — | — | 848.1 |
| Customer deposits | 18,154.1 | 1,372.6 | 1,141.0 | 2,204.9 | 1.0 | 22,873.6 |
| Amounts due to securitisation special purpose vehicles | 260.9 | 235.7 | 406.0 | 1,987.4 | 370.1 | 3,260.1 |
| **Total** | 18,698.1 | 2,173.3 | 1,547.0 | 4,192.3 | 371.1 | 26,981.8 |

Fixed rate ISAs have been the main source of retail funding throughout 2015. As the table reflects deposits on a contractual basis, these are disclosed in the 'within 3 months' category, resulting in a shortening of the Company's contractual cash flow profile of customer deposits.

# Notes to the financial statements

**Note 31: Financial risk management (continued)**

The tables below divide the derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. Cash flows for the floating legs of derivative transactions are calculated based on market indications of future interest rates. As a result totals in this table are not intended to be identical to tables on OTC derivatives or other notes to the financial statements by definition.

| **2015 Maturity groupings for derivative cash outflows** | **Within 3 months £m** | **3-6 months £m** | **6-12 months £m** | **1-5 years £m** | **Over 5 years £m** | **Total £m** |
|---|---|---|---|---|---|---|
| **Settled on a net basis** | | | | | | |
| Derivatives in economic and not accounting hedges | **(1.3)** | — | **(1.0)** | **(12.0)** | **(0.9)** | **(15.2)** |
| Derivatives in accounting hedge relationships | **(30.9)** | **(25.0)** | **(35.8)** | **(41.6)** | **(3.2)** | **(136.5)** |
| | **(32.2)** | **(25.0)** | **(36.8)** | **(53.6)** | **(4.1)** | **(151.7)** |
| **Settled on a gross basis** | | | | | | |
| Outflows | — | — | — | — | — | — |
| Inflows | — | — | — | — | — | — |
| **Total** | **(32.2)** | **(25.0)** | **(36.8)** | **(53.6)** | **(4.1)** | **(151.7)** |

| 2014 Maturity groupings for derivative cash outflows | Within 3 months £m | 3-6 months £m | 6-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|---|---|---|---|---|---|---|
| Settled on a net basis | | | | | | |
| Derivatives in economic and not accounting hedges | (3.1) | (3.4) | (7.4) | (8.6) | (2.2) | (24.7) |
| Derivatives in accounting hedge relationships | (31.3) | (21.7) | (43.7) | (92.0) | (12.9) | (201.6) |
| | (34.4) | (25.1) | (51.1) | (100.6) | (15.1) | (226.3) |
| Settled on a gross basis | — | — | — | — | — | — |
| Outflows | — | — | — | — | — | — |
| Inflows | — | — | — | — | — | — |
| **Total** | (34.4) | (25.1) | (51.1) | (100.6) | (15.1) | (226.3) |

External credit ratings

The Company's short and long-term credit ratings as at 31 December 2015 are as follows.

| | **Long Term** | **Short Term** | **Outlook** | **Date of last rating action** | **Rating action type** |
|---|---|---|---|---|---|
| Fitch | BBB+ | F2 | Positive | 19 November 2015 | Affirmed |

In November 2015 the rating agency Fitch revised the Company's outlook to Positive from Stable and affirmed the Company's long-term rating at BBB+.

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

| | **Cumulative adjustment for a one-notch downgrade £m** | **Cumulative adjustment for a two-notch downgrade £m** |
|---|---|---|
| **31 December 2015** | **—** | **10.0** |
| 31 December 2014 | — | 10.0 |

# Notes to the financial statements

## Note 32: Cash flow statements

(a) Change in operating assets

| | 2015 £m | 2014 £m |
|---|---|---|
| Changes in loans and advances to customers | **(4,051.0)** | (2,402.1) |
| Change in derivative financial assets | **34.5** | 74.0 |
| Change in other operating assets | **7.4** | (28.4) |
| **Change in operating assets** | **(4,009.1)** | (2,356.5) |

(b) Change in operating liabilities

| | 2015 £m | 2014 £m |
|---|---|---|
| Changes in customer deposits | **2,776.4** | 1,241.7 |
| Change in derivative financial liabilities | **(72.6)** | 82.7 |
| Change in other operating liabilities | **970.4** | 565.0 |
| **Change in operating liabilities** | **3,674.2** | 1,889.4 |

(c) Non-cash and other items

| | 2015 £m | 2014 £m |
|---|---|---|
| Depreciation and amortisation | **19.1** | 11.5 |
| Other non-cash items | **54.6** | (50.2) |
| **Total non-cash and other items** | **73.7** | (38.7) |

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

| | 2015 £m | 2014 £m |
|---|---|---|
| Cash and balances at central banks | **888.6** | 851.3 |
| Less: mandatory reserve deposits[1] | **(41.7)** | (38.0) |
| | **846.9** | 813.3 |
| Loans and advances to banks | **119.6** | 136.4 |
| **Total cash and cash equivalents** | **966.5** | 949.7 |

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

## Note 33: Capital resources

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

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

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

The tables below analyse the composition of the regulatory capital resources of the Company on a CRD IV basis in both 2015 and 2014. Throughout 2014, transitional rules for calculating capital under CRD IV were in place and capital resources under those transitional rules were disclosed in the 2014 Annual Report and Accounts.

For regulatory capital purposes, the special purpose vehicles detailed in note 16 form part of the Virgin Money plc regulated entity. As such, these companies have been consolidated within these capital disclosures.

Own funds

| | **2015 £m** | 2014 £m |
|---|---|---|
| **Common Equity Tier 1** | | |
| Ordinary share capital | **1,400.0** | 1,400.0 |
| Retained earnings | **(71.4)** | (180.0) |
| Other reserves | **(0.3)** | 5.6 |
| **Total equity** | **1,328.3** | 1,225.6 |
| **Regulatory capital adjustments (unaudited)** | | |
| Net assets/(liabilities) of special purpose vehicles | **15.7** | 4.5 |
| Intangible assets | **(63.0)** | (45.0) |
| Excess of expected loss over impairment | **(35.4)** | (33.4) |
| Deferred tax - tax losses carried forward[1] | **(18.0)** | (38.1) |
| **Common Equity Tier 1 capital (unaudited)** | **1,227.6** | 1,113.6 |
| **Tier 1 capital (unaudited)** | **1,227.6** | 1,113.6 |
| **Tier 2 capital (unaudited)** | | |
| General credit risk adjustments | **7.6** | 5.9 |
| **Tier 2 capital** | **7.6** | 5.9 |
| **Total own funds (unaudited)** | **1,235.2** | 1,119.5 |

[1] after consolidation of special purpose vehicles

Movements in Common Equity Tier 1 capital are summarised below.

Common Equity Tier 1

| **(unaudited)** | **2015 £m** | 2014 £m |
|---|---|---|
| **Common Equity Tier 1 capital at 1 January** | **1,113.6** | 1,030.4 |
| Movement in retained earnings | **108.6** | 52.8 |
| Movement in available-for-sale reserve | **(5.9)** | 5.4 |
| Movement in net liabilities of SPVs | **11.2** | 15.3 |
| Movement in intangible assets | **(18.0)** | (21.9) |
| Movement in excess of expected loss over impairment | **(2.0)** | 7.7 |
| Movement in deferred tax on tax losses carried forward | **20.1** | 23.9 |
| **Common Equity Tier 1 capital at 31 December** | **1,227.6** | 1,113.6 |

**Note 33: Capital resources (continued)**

Risk-weighted assets – Pillar 1

| (unaudited) | **2015 £m** | 2014 £m |
|---|---|---|
| Retail mortgages | **3,952.9** | 3,489.7 |
| Retail unsecured lending | **1,192.7** | 830.0 |
| Treasury | **205.1** | 182.6 |
| Other assets | **281.2** | 282.2 |
| Credit valuation adjustments | **13.9** | 13.4 |
| Operational risk | **413.7** | 284.8 |
| Market risk | **—** | — |
| **Total risk-weighted assets** | **6,059.5** | 5,082.7 |

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

Capital ratios

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

| (unaudited) | **2015 %** | 2014 % |
|---|---|---|
| Common Equity Tier 1 ratio | **20.3** | 21.9 |
| Tier 1 ratio | **20.3** | 21.9 |
| **Total capital ratio** | **20.4** | 22.0 |

**Note 34: Related party transactions**

(a) Key Management personnel

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

| Compensation | **2015 £m** | 2014 £m |
|---|---|---|
| Salaries and other short-term benefits | **7.9** | 6.3 |
| Amounts received under long-term incentive plans | **—** | 1.2 |
| Share based payments (refer note 6) | **12.2** | 10.2 |
| Pension contributions | **0.9** | 0.6 |
| **Total compensation** | **21.0** | 18.3 |

Aggregate contributions in respect of Key Management personnel to defined contribution pension schemes £0.9 million (2014: £0.6 million).

| Deposits | **2015 £m** | 2014 £m |
|---|---|---|
| At 1 January | **0.7** | 0.8 |
| Placed | **2.0** | 0.1 |
| Withdrawn | **(0.7)** | (0.2) |
| **Deposits outstanding at 31 December** | **2.0** | 0.7 |

Deposits placed by Key Management personnel attracted interest rates of up to 2.8% (2014: 2.8%). At 31 December 2015, the Company did not provide any guarantees in respect of Key Management personnel (2014: none).

At 31 December 2015, transactions, arrangements and agreements entered into with Key Management personnel included amounts outstanding in respect of loans and credit card transactions of £0.3 million with 5 Key Management personnel (2014: £nil with 4 Key Management personnel).

### Note 34: Related party transactions (continued)

(b) Directors' emoluments

Aggregate compensation in respect of the Company's directors were £9.2 million (2014: £8.4 million) comprising salaries and other short-term benefits of £3.6 million (2014: £3.2 million), amounts received under long-term incentive plans of £nil (2014: £0.6 million), share-based payments of £5.2 million (2014: £4.3 million) and contributions to defined contribution pensions schemes £0.4 million (2014: £0.3 million).

The total compensation of the highest paid director was £3.5 million (2014: £3.6 million) comprising salaries and other short-term benefits of £1.0 million (2014: £1.0 million), amounts received under long-term incentive plans of £nil (2014: £0.4 million), share-based payments of £2.3 million (2014: £2.1 million) and contributions to defined contribution pensions schemes £0.2 million (2014: £0.1 million).

(c) Group Companies and other transactions

Details of subsidiaries are presented in note 16.

Transaction value at year end:

| | **2015 £m** | 2014 £m |
|---|---|---|
| Amounts owed by parent company | **(5.2)** | (4.6) |
| Amounts owed by fellow Group Companies | **(8.9)** | (4.9) |
| Amounts owed to parent company | **—** | — |
| Amounts owed to fellow Group Companies | **—** | — |
| Trademark licence fees to Virgin Enterprises Limited | **4.8** | 4.1 |
| Purchase of customer loans from Church House Trust Limited | **—** | 4.3 |
| Virgin Atlantic Airways | **—** | 2.8 |
| Other costs to Virgin Management Group Companies | **0.4** | 0.2 |

Balance outstanding at year end:

| | **2015 £m** | 2014 £m |
|---|---|---|
| Amounts owed by parent company | **100.6** | 113.1 |
| Amounts owed by fellow Group Companies | **5.4** | 11.8 |
| Amounts owed to parent company | **(0.5)** | (0.5) |
| Amounts owed to fellow Group Companies | **—** | (11.1) |
| Trademark licence fees to Virgin Enterprises Limited | **(0.4)** | (0.4) |
| Purchase of customer loans from Church House Trust Limited | **—** | — |
| Virgin Atlantic Airways | **—** | — |
| Other balances with Virgin Management Group Companies | **(0.1)** | (0.1) |

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

Interest was charged on monies loaned to the parent company and fellow Group Companies at 2% over 6 Month Sterling LIBOR until 5 October 2015 (2014: 2% over 6 Month Sterling LIBOR). Following the adoption of revised intercompany loan agreements on 5 October 2015, interest was subsequently charged at 1.5% over 3 Month Sterling LIBOR.

B. Virgin Enterprises Limited

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

C. Purchase of customer loans from Church House Trust Limited

On 30 September 2014, the Company purchased £4.3 million customer loans from Church House Trust Limited, a fellow subsidiary of the Group at that time.

D. Virgin Atlantic Airways

The Company incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. Prior to 2014, there was a tripartite agreement between the Group, VAA and MBNA for the credit card commission and air mile charges to VAA.

**Note 34: Related party transactions (continued)**

E. Other costs to Virgin Management Group Companies

Other Virgin Management Group Companies include amounts due to Companies with the Virgin Group.

The Company incurs credit card point of sale discount fees to Virgin Holidays Limited.

A number of banking transactions are entered into with related parties as part of normal banking business. These include deposits.

(d) Securitisation special purpose vehicles

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

| **2015** | **Interest income £m** | **Interest expense £m** | **Fair value gains and (losses) on financial instruments £m** | **Debt securities classified as loans and receivables £m** | **Derivative financial instruments £m** | **Amounts due from SPVs £m** | **Prepayments and accrued interest £m** | **Amounts due to SPVs £m** |
|---|---|---|---|---|---|---|---|---|
| Gosforth Funding 2011-1 plc | **4.3** | **8.6** | **5.2** | **140.9** | **3.3** | **20.1** | **0.8** | **259.8** |
| Gosforth Funding 2012-1 plc | **4.4** | **6.2** | **0.3** | **133.5** | **4.7** | **17.3** | **0.1** | **171.3** |
| Gosforth Funding 2012-2 plc | **6.4** | **7.9** | **(0.2)** | **420.5** | **10.8** | **4.0** | **0.6** | **409.3** |
| Gosforth Funding 2014-1 plc | **5.6** | **15.6** | **(0.4)** | **388.9** | **23.4** | **70.3** | **1.2** | **1,152.7** |
| Gosforth Funding 2015-1 plc | **4.5** | **9.1** | **0.8** | **638.9** | **20.6** | **43.7** | **0.4** | **1,325.3** |
| **Total** | **25.2** | **47.4** | **5.7** | **1,722.7** | **62.8** | **155.4** | **3.1** | **3,318.4** |

| 2014 | Interest income £m | Interest expense £m | Fair value gains and (losses) on financial instruments £m | Debt securities classified as loans and receivables £m | Derivative financial instruments £m | Amounts due from SPVs £m | Prepayments and accrued interest £m | Amounts due to SPVs £m |
|---|---|---|---|---|---|---|---|---|
| Gosforth Funding 2011-1 plc | 4.6 | 11.7 | 7.9 | 140.9 | 9.0 | 23.1 | 0.8 | 376.8 |
| Gosforth Funding 2012-1 plc | 6.2 | 12.0 | 0.1 | 164.2 | 9.6 | 17.6 | 0.2 | 288.7 |
| Gosforth Funding 2012-2 plc | 13.6 | 17.4 | (0.8) | 702.4 | 21.9 | 19.0 | 1.1 | 746.7 |
| Gosforth Funding 2014-1 plc | 1.9 | 5.5 | 1.0 | 388.9 | 37.4 | 53.0 | 1.9 | 1,354.7 |
| Total | 26.3 | 46.6 | 8.2 | 1,396.4 | 77.9 | 112.7 | 4.0 | 2,766.9 |

**Note 35: Events after balance sheet date**

On 25 January 2016, the Company raised £803.0 million from institutional investors through the Gosforth Funding 2016-1 Residential Mortgage Backed Securities transaction.

**Note 36: Parent undertaking**

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

Virgin Money Holdings (UK) plc is the largest and smallest group in which the financial statements of the Company are consolidated. The consolidated financial statements of Virgin Money Holdings (UK) plc may be obtained from Companies House, Crown Way, Cardiff, CF4 3ZU.

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

# Notes to the financial statements

## ote 37: Future accounting developments

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

| Pronouncement | Nature of change | IASB effective date |
|---|---|---|
| IFRS 9 'Financial Instruments' | IFRS 9 Financial Instruments, published in July 2014, replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 is split over 3 phases:<br><br>- Phase 1 includes revised guidance on the classification and measurement of financial instruments. Financial assets will be classified and measured based on the business model under which they are held and the characteristics of their contractual cash flows. Financial liabilities designated under the fair value option will be required to generally present fair value change e rather than profit or loss.<br><br>- Phase 2 is a new expected credit loss model for calculating impairment on financial assets Under this approach, it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, the Company will always account for expected credit losses and changes in those expected credit losses.<br><br>- Phase 3 is the new general hedge accounting requirements. These requirements aim to more closely align hedge accounting with the Company's risk management strategy. The work on macro hedging by the IASB is still at a preliminary stage and has not yet been issued as part of the finalised standard.<br><br>A project team has been mobilised to begin work on assessing the impact of IFRS 9 across the Company, with particular emphasis on phase 2 - the new impairment expected credit loss model. At this stage a full assessment of the impact of IFRS 9 has not been made by the Company. The Company is on track to successfully deliver the changes required to adopt IFRS 9 on 1 January 2018 (subject to EU endorsement). | 1 January 2018 (has not been EU endorsed) |
| IFRS 15 'Revenue from Contracts with Customers' | Current revenue recognition accounting standards have led to inconsistencies in accounting for similar transactions and inadequate disclosures. IFRS 15 specifies comprehensive principles on whether, how much and when an entity should recognise revenue arising from customer contracts. In addition, extensive disclosure requirements have been introduced to provide more informative and relevant disclosures, particularly around estimates and judgements.<br><br>The Company is reviewing the requirements of the new standard to determine its effect on its financial reporting. | 1 January 2018 (has not been EU endorsed) |
| IFRS 16 'Leases' | This standard replaces IAS 17 'Leases' and will result in most leases for lessees being brought on to the Balance Sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged.<br><br>The Company is reviewing the requirements of the new standard to determine its effect on its financial reporting. | 1 January 2019 (has not been EU endorsed) |

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

Registered No. 06952311

# Virgin Money plc

## Annual Report and Accounts
**2014**

# Independent auditor's report

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF VIRGIN MONEY PLC**

We have audited the financial statements of Virgin Money plc for the year ended 31 December 2014 set out on pages 13 to 125. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the company'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 Company'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 Company and the Company'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 Statement of Directors' responsibility set out on pages 9-10, 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**

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

**Opinion on financial statements**

In our opinion the financial statements:

> give a true and fair view of the state of the Company's affairs as at 31 December 2014 and of its profit for the year then ended;

> have been properly prepared in accordance with IFRSs as adopted by the EU; and

> 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 Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**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, or returns adequate for our audit have not been received from branches not visited by us: or

> the 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.

John Ellacott (Senior Statutory Auditor)
for and on behalf of KPMG LLP. Statutory Auditor
*Chartered Accountants*
i5 Canada Square
London
Ei4 5Gl
4 March 20i5

Virgin Money plc

# Income statement

For the year ended 31 December

| | Note | **2014 £ million** | 2013[1] £ million |
|---|---|---|---|
| Interest and similar income | | **795.4** | 825.8 |
| Interest and similar expense | | **(427.0)** | (512.4) |
| **Net interest income** | 2 | **368.4** | **313.4** |
| Fee and commission income | | **29.7** | 32.8 |
| Fee and commission expense | | **—** | (0.2) |
| Net fee and commission income | 3 | **29.7** | 32.6 |
| Fair value losses on financial instruments | 14 | **(19.9)** | (10.2) |
| Other operating income | 4 | **5.3** | 7.2 |
| **Other income** | | **15.1** | **29.6** |
| **Total income** | | **383.5** | **343.0** |
| Total operating expenses | 5 | **(319.3)** | (319.3) |
| **Profit before tax from operating activities** | | **64.2** | **23.7** |
| Impairment | 7 | **(15.8)** | (50.7) |
| Dividends | | **—** | 109.1 |
| Distribution | 16 | **4.5** | — |
| Gain on sale of subsidiary | 17 | **—** | 193.8 |
| **Profit before tax** | | **52.9** | **275.9** |
| Taxation | 8 | **(17.2)** | 0.4 |
| **Profit for the year** | | **35.7** | **276.3** |
| Profit attributable to equity shareholders | | **35.7** | 276.3 |
| **Profit for the year** | | **35.7** | **276.3** |

[1] Restated (refer notes 1 and 36).

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

Virgin Money plc

# Statement of comprehensive income

For the year ended 31 December

| | Note | 2014 £ million | 2013[1] £ million |
|---|---|---|---|
| **Profit for the year** | | **35.7** | 276.3 |
| **Other comprehensive income** | | | |
| *Items that may subsequently be reclassified to profit or loss:* | | | |
| Movements in revaluation reserve in respect of available-for-sale financial assets: | | | |
| Change in fair value | 27 | **12.1** | 5.6 |
| Income statement transfers in respect of disposals | 27 | **(5.4)** | (3.5) |
| Taxation | 27 | **(1.3)** | (0.5) |
| | | **5.4** | 1.6 |
| Movements in cash flow hedge reserve: | | | |
| Effective portion of changes in fair value taken to other comprehensive income | 27 | **(0.5)** | 7.0 |
| Net income statement transfers | 27 | **(1.1)** | 4.8 |
| Taxation | 27 | **0.3** | (0.3) |
| | | **(1.3)** | 11.5 |
| **Other comprehensive income for the year, net of tax** | | **4.1** | **13.1** |
| **Total comprehensive income for the year** | | **39.8** | **289.4** |
| **Total comprehensive income attributable to equity shareholders** | | **39.8** | **289.4** |

[1] Restated (refer notes 1 and 36).

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

Virgin Money plc

# Balance sheet

As at 31 December

| | Note | **2014** **£ million** | 2013[1] £ million |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | | **851.3** | 1,423.5 |
| Derivative financial instruments | 14 | **178.0** | 252.0 |
| Loans and receivables: | | | |
| –Loans and advances to banks | 10 | **136.4** | 91.8 |
| –Loans and advances to customers | 11 | **23,347.9** | 20,598.9 |
| –Debt securities | 12 | **1,407.4** | 1,602.6 |
| | | **24,891.7** | 22,293.3 |
| Available-for-sale financial assets | 13 | **1,539.6** | 1,579.3 |
| Intangible assets | 18 | **45.0** | 23.1 |
| Tangible fixed assets | 19 | **72.0** | 68.7 |
| Deferred tax assets | 20 | **46.0** | 62.9 |
| Other assets | 21 | **71.2** | 45.7 |
| **Total assets** | | **27,694.8** | **25,748.5** |

[1] Restated (refer notes 1 and 36).

Investment in subsidiaries was £nil in 2014 and 2013, refer to note 16 for further details.

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

Virgin Money pic

# Balance sheet

As at 31 December

| liabilities | Note | 2014 £million | 2013[1] £million |
|---|---|---|---|
| Deposits from banks | 22 | 845.5 | 382.2 |
| Customer deposits | 23 | 22,368.9 | 21.127.2 |
| Amounts due to securitisation special purpose vehicles | 11 | 2,766.9 | 2.678.6 |
| Derivative financial instruments | 14 | 227.9 | 145.2 |
| Other liabilities | 25 | 250.9 | 239.1 |
| Provisions | 24 | 9.1 | 7.5 |
| Total llablillles | | 26,469.2 | 24,579.8 |
| Equity | | | |
| Share capital | 26 | 1.400.0 | 1.400.0 |
| Other reserves | 27 | 5.6 | 1.5 |
| Retained earnings | | (180.0) | (232.8) |
| Total equity | | 1,225.6 | 1,168.7 |
| Total liabilities and equity | | 27,694.8 | 25,748.5 |

1 Restated (refer notes 1 and 36).

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

The financial statements were approved and authorised for issue by the Board and were signed on its behalf on 4 March 2015.

**Sir David Clementi**
Chairman

**Jayne-Anne Gadhia CBE**
Chief Executive Officer

**Lee Rochford**
Chief Financial Officer

# Statement of changes in equity

| Attributable to equity holders | Share capital £ million | Other reserves £ million | Retained earnings[1] £ million | Total equity £ million |
|---|---|---|---|---|
| **Balance at 1 January 2014** | **1,400.0** | **1.5** | **(232.8)** | **1,168.7** |
| **Comprehensive income** | | | | |
| Profit for the year | **—** | **—** | **35.7** | **35.7** |
| **Other comprehensive income** | | | | |
| Net movement in available-for-sale reserve | **—** | **5.4** | **—** | **5.4** |
| Net movement in cash flow hedge reserve | **—** | **(1.3)** | **—** | **(1.3)** |
| **Total other comprehensive income** | **—** | **4.1** | **—** | **4.1** |
| **Total comprehensive income for the year** | **—** | **4.1** | **35.7** | **39.8** |
| **Transactions with equity holders** | | | | |
| Share based payments – charge for year | **—** | **—** | **12.9** | **12.9** |
| Share based payments – reclassification from liabilities | **—** | **—** | **4.2** | **4.2** |
| **Total transactions with equity holders** | **—** | **—** | **17.1** | **17.1** |
| **Balance at 31 December 2014** | **1,400.0** | **5.6** | **(180.0)** | **1,225.6** |

| | Share capital £ million | Other reserves £ million | Retained earnings[1] £ million | Total equity £ million |
|---|---|---|---|---|
| Balance at 1 January 2013 | | | | |
| As previously reported | 1,400.0 | (11.6) | (519.3) | 869.1 |
| Restatement | — | — | 9.8 | 9.8 |
| Restated | 1,400.0 | (11.6) | (509.5) | 878.9 |
| Comprehensive income | | | | |
| Profit for the year | — | — | 276.3 | 276.3 |
| Other comprehensive income | | | | |
| Net movement in available-for-sale reserve | — | 1.6 | — | 1.6 |
| Net movement in cash flow hedge reserve | — | 11.5 | — | 11.5 |
| **Total other comprehensive income** | **—** | **13.1** | **—** | **13.1** |
| **Total comprehensive income for the year** | **—** | **13.1** | **276.3** | **289.4** |
| **Transactions with equity holders** | | | | |
| Share based payments | — | — | 0.4 | 0.4 |
| **Total transactions with equity holders** | **—** | **—** | **0.4** | **0.4** |
| **Balance at 31 December 2013** | **1,400.0** | **1.5** | **(232.8)** | **1,168.7** |

[1] Restated (refer notes 1 and 36).

Further details of movements in the Company's share capital and reserves are provided in notes 26 and 27.

Virgin Money plc

# Cash flow statement

For the year ended 31 December

| | Note | 2014 £ million | 2013 £ million[1] |
|---|---|---|---|
| **Profit before taxation** | | **52.9** | 275.9 |
| Adjustments for: | | | |
| Changes in operating assets | 31a | **(2,356.5)** | (2,509.4) |
| Changes in operating liabilities | 31b | **1,889.4** | 896.5 |
| Non-cash and other items | 31c | **(38.7)** | (29.1) |
| **Net cash used in operating activities** | | **(452.9)** | **(1,366.1)** |
| **Cash flows from investing activities** | | | |
| Net investment in intangible assets | | **(27.0)** | (32.8) |
| Purchase of fixed assets | | **(10.6)** | (2.0) |
| Disposal of fixed assets | | **0.7** | — |
| Disposal of subsidiary undertaking | | **—** | 192.5 |
| Net investment in securities | | **(956.5)** | (746.3) |
| Proceeds from sale and redemption of available-for-sale financial assets | | **1,278.5** | 1,876.7 |
| Net investment in credit card portfolio | | **(362.7)** | (1,019.6) |
| **Net cash (used in)/ provided by investing activities** | | **(77.6)** | **268.5** |
| Change in cash and cash equivalents | | **(530.5)** | (1,097.6) |
| Cash and cash equivalents at beginning of year | | **1,480.2** | 2,577.8 |
| **Cash and cash equivalents at end of year** | 31d | **949.7** | **1,480.2** |

[1] Restated (refer notes 1 and 36).

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

# Notes to the financial statements

**Note 1: Basis of preparation**

1.1 Reporting entity

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

The Company is the major operating subsidiary of Virgin Money Holdings (UK) plc (the Group). Virgin Money Holdings (UK) plc listed on the London Stock Exchange on 18 November 2014. A number of employee share scheme awards vested during the year and £10.7 million of the total share based payment charge of the Company is attributable to awards made on listing Virgin Money Holdings (UK) plc. Refer to note 6 for details.

1.2 Basis of preparation

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

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

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

1.3 Changes in accounting policy

*New standards, amendments to standards or interpretations adopted*

The following interpretation was endorsed by the EU and is mandatory for annual reporting periods beginning on or after 17 July 2014. The Company has voluntarily adopted this during the year ended 31 December 2014:

(i) IFRIC 21 'Levies'

IFRIC 21 'Levies' clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. This has resulted in a change in the timing of recognition of the Financial Services Compensation Scheme (FSCS) levy which impacts the Company. Therefore, the full FSCS levy provision should be recognised on the trigger date, 1 April of each year. The Company participates in the FSCS to enable the Scheme to meet interest, capital and administrative costs of safeguarding protected deposits in failed financial institutions. The scheme year is from 1 April to 31 March. Historically, the Company accounted for the FSCS levy provision at 31 December for the following Scheme year, however as a result of adopting IFRIC 21, the provision is recognised in the same period as the scheme year.

**Note 1: Basis of preparation (continued)**

The Company assessed that the liability for the FSCS levy recognised at 31 December 2013 of £17.8 million for the Scheme year 2014/2015 should be reversed as the trigger event date has now moved from 31 December 2013 to 1 April 2014. Refer to note 36 for details of the impact of this change on prior year comparatives.

The following new standards and amendments to standards are mandatory for annual reporting periods on or after 1 January 2014, have been endorsed for adoption by the EU and have been adopted by the Company during the year ended 31 December 2014:

(i) IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure of interests in Other Entities'

IFRS 10 introduces a new control model that focuses on whether the Company has power over an investee, exposure or rights to variable returns from its involvement with the investee and ability to use its power to affect those returns.

The Company has changed its accounting policy for determining whether it has control over and consequently whether it consolidates its investees through the adoption of IFRS 10. These new requirements in IFRS 10 have the potential to affect which of the Company's investees are considered to be subsidiaries and therefore change the scope of consolidation.

Management has reviewed its control assessments in accordance with IFRS 10 and has concluded that there is no impact on the classification (as subsidiaries or otherwise) of any of the Company's investees held during the period or comparative periods covered by these financial statements.

IFRS 11 introduces a revised model for accounting for joint arrangements. The Company is not currently involved in any joint arrangements and IFRS 11 does not have any impact on the Company.

IFRS 12 does not affect the amounts recognised in the financial statements, but requires new disclosures about the judgements made by management to determine whether control exists and to require summarised information on the Company's subsidiaries (refer notes 1.7.14 and 16).

These standards are required to be applied retrospectively.

This amendment did not have a significant impact on the Company when adopted.

(ii) Amendments to IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28, Consolidation

These amendments introduce the concept of an 'investment entity'. Where a subsidiary qualifies as an investment entity it is not required to be consolidated by the Company, but should be recorded at fair value through profit or loss.

This amendment did not have a significant impact on the Company when adopted.

**Note 1: Basis of preparation (continued)**

(iii) Amendment to IAS 36 'Impairment of Assets', Recoverable Amount Disclosures for Non-Financial Assets

The circumstances in which the recoverable amount of assets or cash-generating units are required to be disclosed is reduced by these amendments. Disclosure requirements are also clarified and an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique is introduced.

This amendment did not have a significant impact on the Company when adopted.

(iv) Amendment to IAS 32, 'Financial Instruments: Presentation' on Offsetting Financial Assets and Financial Liabilities'

The amendments to IAS 32 clarify the criteria when an entity currently has a legal right to set off and when gross settlement is equivalent to net settlement.

This amendment did not have a significant impact on the Company when adopted.

(v) Amendment to IAS 39, 'Financial Instruments: Recognition and Measurement'

IAS 39 has been amended to provide an exception to the requirement to discontinue hedge accounting in certain circumstances in which there is a change in counterparty to a hedging instrument.

This amendment did not have a significant impact on the Company when adopted.

There are no other standards, amendments to standards or interpretations that are applicable in the year which have a material impact on the financial statements.

New accounting standards issued by the IASB which are effective in future periods are presented in note 37.

1.4 Presentation of information

*Presentational reclassifications*

During the year, the Company undertook a review of the allocation and classification of both costs and income. Following this review, the Company has realigned elements of net fee and commission income and operating expenses to reflect better the nature of these costs. The impact of this on the prior year comparatives is detailed in note 36. This exercise had no impact on the overall profit reported by the Company. Please note that the adoption of IFRIC 21 'Levies' required a prior period restatement of balances which had an impact on the prior year overall profit reported by the Company (refer note 36).

**Note 1: Basis of preparation (continued)**

1.5 Basis of measurement

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

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

1.6 Foreign currency translation

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

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in profit or loss. Non-monetary items (which are assets or liabilities which do not attach to a right to receive or an obligation to pay currency) measured at amortised cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss.

1.7 Accounting policies

The accounting policies of the Company are set out below:

*1.7.1 Interest income and expense*

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

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

Once a financial asset or Company of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

**Note 1: Basis of preparation (continued)**

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accrual basis in interest receivable or payable. Interest on available-for-sale (AFS) securities is recorded in interest receivable on an amortised cost basis.

*1.7.2 Fees and commissions*

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan. Insurance commissions are recognised in the period in which they are earned.

*1.7.3 Other operating income*

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to credit cards and life insurance products.

The Company was party to an arrangement in relation to Virgin Atlantic Airways branded credit cards and income on this contract which was recognised in accordance with the contract terms. With effect from 1 December 2013 the existing contract was terminated and replaced with a new arrangement for these cards. The Company will continue to recognise income in relation to the new arrangement under the new terms of the revised contract.

The Company recognises ongoing credit card income from other strategic partners as other income.

*1.7.4 Total operating expense*

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy 1.7.5.

Staff costs

The Company applies IAS 19 ‘Employee Benefits’ in its accounting for the following components of employee costs:

> *Short-term employee benefits*

Short-term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Company has a present obligation to its employees that can be measured reliably and are recognised over the period of service that employees are required to work to qualify for the payment.

**Note 1: Basis of preparation (continued)**

> *Other long-term employee benefits*

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

Retirement benefit obligations

A defined contribution plan is a post-employment benefit plan into which the Company pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in the income statement in the periods during which related employee services are fulfilled.

The Company operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Company in independently administered funds.

Leases

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

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

*1.7.5 Share based payments*

The Group puts in place share schemes for employees to reward strong long-term business performance and to incentivise growth for the future.

The Group engages in equity settled or cash settled share based payment transactions in respect of services received from certain of its employees.

For equity settled share based payments, employees are employed by the Company but receive Virgin Money Holdings (UK) plc Ordinary Shares.

For equity settled share based payment transactions the grant date fair value is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards.

**Note 1: Basis of preparation (continued)**

The fair value of the award granted is determined using valuation models which take into account the terms and conditions attached to the awards. Inputs into valuation models may include the exercise price, the risk free interest rate, the expected volatility of Virgin Money Holding (UK) plc's share price and other various factors which relate to performance conditions attached to the awards.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

For share based payment awards with market performance conditions or non-vesting conditions the grant date fair value of the share based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

For cash settled share based payment transactions the fair value of the amount payable to the employee is recognised as an expense with a corresponding increase in liabilities. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value is measured based on a valuation model taking into account the terms and conditions upon which the instruments were granted. The liability is revalued at each balance sheet date and settlement date with any changes to fair value being recognised in the profit and loss account.

*1.7.6 Impairment losses*

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

Assets held at amortised cost

The Company 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. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Company about the following loss events:

> there is evidence of the customer or issuer experiencing financial difficulty

> there is a breach of contract, such as a default or delinquency in repayments

> the customer is granted a concession that would otherwise not be considered

**Note 1: Basis of preparation (continued)**

> the borrower will enter bankruptcy or other financial reorganisation

> the disappearance of an active market for that financial asset because of financial difficulties

> observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:

    > there are adverse changes in the payment status of borrowers in the portfolio

    > economic conditions that correlate with defaults on the assets in the portfolio.

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

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

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

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

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

**Note 1: Basis of preparation (continued)**

*1.7.7 Taxation*

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

*1.7.8 Financial instruments*

Financial assets

Financial assets can be classified in the following categories:

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

Management determines the classification of its financial instruments at initial recognition. The Company measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship. Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Company commits to purchase or sell the asset.

Loans and receivables at amortised cost

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

Available-for-sale financial assets

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

**Note 1: Basis of preparation (continued)**

prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models. Subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Company has the ability and intention to hold to maturity. They are initially measured at fair value including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. No financial assets were classified as held to maturity during either the current or prior year.

Financial assets at fair value through profit or loss

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in profit or loss. The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Company establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Financial liabilities

Borrowings, including shares, deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Company does not hold any financial liabilities classified as held for trading.

Amounts due to securitisation special purpose vehicles are classified as financial liabilities at fair value through profit or loss (FVTPL). The fair value is based on the expected prepayments and maturities of mortgages within the securitised mortgage pool, which determine the repayment of the loans. The loans are valued using a discounted cash flow model.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and

**Note 1: Basis of preparation (continued)**

there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Sale and repurchase agreements

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

Derecognition of financial assets and liabilities

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

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

*1.7.9 Loans and advances to banks*

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

*1.7.10 Loans and advances to customers*

The Company's loans and advances to customers are classified as loans and receivables in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'. They are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Company has no intention of trading the loan or receivable.

**Note 1: Basis of preparation (continued)**

Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment. Further details of the application of the effective interest rate method are included in policy 1.7.1 and provision for impairment in policy 1.7.6.

*1.7.11 Debt securities classified as loans and receivables*

Debt securities are designated as either available-for-sale or loans and receivables. Debt securities are principally available-for-sale as they are intended to be held for an indefinite period of time but may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. Debt securities classified as loans and receivables are asset backed securities for which there is no active market.

Debt securities classified as loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

*1.7.12 Available-for-sale financial assets*

Debt securities are designated as either available-for-sale or loans and receivables. Debt securities are principally available-for-sale as they are intended to be held for an indefinite period of time but may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. Debt securities classified as loans and receivables are asset backed securities for which there is no active market, refer to policy 1.7.11 for accounting treatment.

Debt securities classified as available-for-sale are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models. Subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in the income statement. Upon derecognition of the asset, or where there is objective evidence that the debt security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

Impairment of available-for-sale financial assets

The Company's debt securities and treasury bills are held as available-for-sale assets. For available-for-sale financial assets, the Company assesses at each balance sheet date whether there is objective evidence that a financial asset, or Company of financial assets are impaired. The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The amount of the impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

**Note 1: Basis of preparation (continued)**

*1.7.13 Derivative financial instruments and hedge accounting*

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

The Company's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates and foreign exchange rates inherent in the Company's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and so it is therefore decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially at fair value and subsequently remeasured to fair value. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models. Where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within hedging relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

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

> Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

> Fair value hedges

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

**Note 1: Basis of preparation (continued)**

If derivatives are not designated as hedges then changes in fair values are recognised immediately in the income statement.

The most frequently used fair value hedges are:

> hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages

> hedging the interest rate risk of a portfolio of fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings

> hedging the interest rate risk of a portfolio of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for fixed rate investments

> hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps.

> Embedded derivatives

Certain derivatives are embedded within other non-derivative host instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risk of the host instrument, and where the hybrid instrument is not measured at fair value, the Company separates the embedded derivative from the host instrument and measures it at fair value with the changes in fair value recognised in profit or loss. There are no embedded derivatives held by the Company.

*1.7.14 Investments in subsidiaries*

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

*1.7.15 Business combinations*

Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, being when control is transferred to the Company. Control is having the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power to affect those returns.

**Note 1: Basis of preparation (continued)**

The Company measures goodwill at the acquisition date as the fair value of the consideration transferred less the fair value of the net identifiable assets acquired and liabilities assumed.

When the excess is negative, the negative goodwill is recognised immediately in profit or loss.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Company incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

*1.7.16 Intangible assets and amortisation*

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

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

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

> an asset is created that can be identified;

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

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

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

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

> Computer software

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an

**Note 1: Basis of preparation (continued)**

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

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

> Core banking platforms

Core banking platforms primarily represent the construction of core operating platforms, which are internally generated. Core banking platforms are amortised on a straight line basis over 3-10 years.

> Impairment of intangible assets

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

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

*1.7.17 Tangible fixed assets and depreciation*

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

**Note 1: Basis of preparation (continued)**

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

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

Assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated. Tangible fixed assets are subject to impairment testing, if deemed appropriate.

Impairment of tangible fixed assets

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

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

*1.7.18 Deferred tax*

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

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

**Note 1: Basis of preparation (continued)**

*1.7.19 Other assets*

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

*1.7.20 Deposits from banks*

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

*1.7.21 Customer deposits*

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

*1.7.22 Provisions*

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

*1.7.23 Other liabilities*

> Deferred income

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

> Other creditors and accruals

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

*1.7.24 Share capital*

> Share capital

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

> they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company.

**Note 1: Basis of preparation (continued)**

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

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

> Share issue costs

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

> Dividends and appropriations

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

*1.7.25 Other reserves*

Available-for-sale reserve

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

Cash flow hedge reserve

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

*1.7.26 Contingent liabilities*

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

*1.7.27 Fair value of financial assets and liabilities*

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

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

**Note 1: Basis of preparation (continued)**

Refer to note 29 for a description of different levels within the fair value hierarchy. Levels are received at each balance sheet date and this determines where transfers between levels are required.

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

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price—i.e. the fair value of consideration given or received. The Company does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Company's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Company measures assets and long positions at bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Company on the basis of the net exposure to either market or credit risk, are measured on the basis of a price that would be received to sell a net long position (or transferred to sell a net short position) for a particular risk exposure. Those portfolio risk adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

*1.7.28 Cash and cash equivalents*

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

1.8 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, actual results ultimately may differ from those estimates.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements as follows:

*1.8.1 Effective interest rates*

IAS 39 'Financial Instruments: Recognition and Measurement' requires interest earned from mortgages and credit cards to be measured under the effective interest rate method. Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. The accuracy of the effective interest rate would therefore be affected by unexpected market movements

**Note 1: Basis of preparation (continued)**

resulting in altered customer behaviour, inaccuracies in the models used compared to actual outcomes and incorrect assumptions.

For the mortgage book Management has reviewed expected lives in the year and the catch-up adjustment resulted in a gain in the income statement of £2.0 million (2013: £15.0 million) driven by an expectation that, on an overall basis, loan lives have lengthened during 2014 as a consequence of continuing low interest rates.

If the estimated life of secured loans were increased or reduced by one month, the value of such loans on the balance sheet would be increased or decreased by £2.7 million (2013: £2.8 million) and £2.8 million (2013: £2.9 million) respectively.

For the credit card book Management has reviewed the expected lives of the credit card balances in the year and the catch up adjustment resulted in a loss in the income statement of £0.2 million (2013: £nil).

If the estimated life of credit cards were increased or reduced by one month, the value of such assets on the balance sheet would be increased or decreased by £0.6 million (2013: £0.1 million) and £0.5 million (2013: £0.1 million) respectively.

*1.8.2 Fair value of share based payments*

The fair value of the share awards is calculated using statistical models. The inputs to these models require management judgement to estimate the probability and timings of events taking place in the future. The significant inputs used in the models include the exercise price, share price, expected volatility, expected dividend yield, expected life and the risk free rate. The share based payment recognised can be materially affected by these assumptions and the key drivers of changes in value are timing probability and value of Virgin Money Holdings (UK) plc on listing.

*1.8.3 Impairment of loans and receivables*

Individual impairment losses on secured loans and advances are calculated based on an individual valuation of the underlying asset. Collective impairment losses on loans and advances are calculated using a statistical model.

The key assumptions used in the model are the probability of default; the probability of this default resulting in possession and/or write off; and the subsequent loss incurred. These key assumptions are monitored regularly to ensure the impairment allowance is entirely reflective of the current portfolio.

The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes. For mortgage loan receivables to the extent that:

- the loss given default differs by +/- 10%, for example if the loss given default is 10% then it is increased to 11%, the impairment allowance would be an estimated £0.2 million (2013: £0.7 million) higher or £0.2 million (2013: £0.7 million) lower respectively;
- the level of house prices differs by +/- 10%, for example a property value of £100,000 is increased to £110,000, the impairment allowance would be an estimated

**Note 1: Basis of preparation (continued)**

£0.7 million (2013: £2.9 million) lower or £3.4 million (2013: £6.0 million) higher respectively; and

- the emergence period of 6 months differs by +/- 3 months, the impairment allowance would be an estimated £0.1 million (2013: £0.2 million) higher or £0.1 million (2013: £0.2 million) lower respectively.

For credit card receivables, to the extent that the loss given default differs by +/- 10%, the impairment allowance would be an estimated £2.7 million (2013: £4.4 million) higher or £2.7 million (2013: £4.4 million) lower respectively, and to the extent the emergence period of 6 months differs by +/-3 months, the impairment allowance would be an estimated £2.0 million (2013: £2.9 million) higher or £2.0 million (2013: £2.9 million) lower respectively.

*1.8.4 Tax uncertainty*

The determination of the Company's provision for income taxation, deferred taxation assets and liabilities and potential taxation liabilities involves significant estimates and judgements on certain matters, for which the ultimate outcome may be uncertain. The current and deferred income taxation assets and liabilities are adjusted for any difference between the final outcome and the amount provided for in the period when the matter is resolved. The Company recognises potential taxation liabilities based on all available evidence and, where appropriate, in the light of external advice.

*1.8.5 Capitalisation and impairment of intangibles*

Intangibles are initially recognised when they are separable or arise from contractual or other legal rights, the cost can be measured reliably and, in the case of intangible assets not acquired in a business combination, where it is probable that future economic benefits attributable to the assets will flow from their use. Management review and monitor the capitalisation of significant project development costs on a regular basis to ensure that they meet the recognition criteria for capitalisation of an intangible asset and to ensure the costs are directly attributable to the individual projects where an asset is under construction. A review of capitalisation of intangibles has been undertaken to ensure these conditions have been met.

A review of intangible assets which are not yet in use for indications of impairment is undertaken at each reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. Value in use is calculated by discounting the future cash flows (both costs to complete and benefits post completion) generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised. Through their assessment of intangible assets and review for impairment indicators Management have not identified any assets that have an impairment therefore a £nil impairment charge has been recognised (2013: £35.2 million).

*1.8.6 Deferred tax*

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is

**Note 1: Basis of preparation (continued)**

based mainly on a determination of whether the relevant entity will generate sufficient profits within 5 years to realise the deferred tax assets.

This is reviewed at each reporting date by the Directors with a detailed exercise conducted to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise and the deferred tax assets will reverse. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and which are expected to apply when the related deferred tax assets are realised or the deferred tax liabilities are settled.

The judgement required in the assessment of whether to recognise deferred tax assets is set out in policy 1.7.18. Based on their interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards, the Directors conclude that a net deferred tax asset of £46.0 million (2013: £62.9 million) should be recognised at the balance sheet date.

1.8.7 *Provisions*

Due to the nature of provisions, their determination is based upon estimates and judgements concerning the future. Provisions are based on the best information available at the reporting date, including independent expert advice.

1.8.8 *Contingent liabilities*

In the normal course of its business, the Company may be subject to matters of litigation or dispute. While there can be no assurances, at this time the Directors believe, based on the information currently available to them, that it is not probable that the ultimate outcome of any of these matters will have a material adverse effect on the financial condition of the Company.

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

1.8.9 *Fair value of financial assets and liabilities*

Management must use judgement and estimates calculating fair value where not all necessary inputs are observable or where factors specific to the Company's holdings need to be considered. The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions. For example, if Management were to use a tightening in the credit spread of ten basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £20.0 million (2013: £18.1 million).

The following estimates and judgements were removed from those judgements which are significant to the Company as they are no longer applicable or no longer significant to the financial statements for the year ended 31 December 2014: acquisitions and disposals and impairment of tangible fixed assets.

**Note 2: Net interest income**

Net interest income comprises:

| | 2014 £m | 2013[1] £m |
|---|---|---|
| Interest and similar income: | | |
| Loans and advances to customers – secured | **658.4** | 637.4 |
| Loans and advances to customers – unsecured | **89.8** | 122.6 |
| Loans and advances to banks | **0.3** | 0.5 |
| Debt securities held as loans and receivables | **21.3** | 34.6 |
| **Interest receivable on loans and receivables** | **769.8** | **795.1** |
| Available-for sale financial assets | **11.5** | 12.2 |
| Cash and balances with central banks | **5.9** | 7.4 |
| Securitisation subordinated loan | **5.0** | 7.1 |
| Other interest | **3.2** | 4.0 |
| **Total interest and similar income** | **795.4** | **825.8** |
| Interest and similar expense: | | |
| Deposits from banks including liabilities under sale and repurchase agreements | **(3.3)** | (0.2) |
| Customer deposits | **(370.4)** | (431.3) |
| Securitisation special purpose vehicles | **(46.6)** | (74.4) |
| Other | **(6.7)** | (6.5) |
| **Total interest and similar expense** | **(427.0)** | **(512.4)** |
| **Net interest income** | **368.4** | **313.4** |

[1] Restated (refer notes 1 and 36).

Interest accrued on individually impaired assets was £6.8 million (2013: £8.1 million).

Included within interest income in 2013 is an amount of £21.8 million which related to the acceleration of the discount on the acquisition of the credit card book. This discount represented the difference between the price paid over the fair value at acquisition. The full discount was unwound in 2013 in full based on the repayment profiles.

### Note 3: Net fee and commission income

Net fee and commission income comprises:

| | **2014 £m** | 2013[1] £m |
|---|---|---|
| **Fee and commission income:** | | |
| On loans and advances to customers – secured | **4.3** | 3.5 |
| On loans and advances to customers – unsecured | **24.6** | 27.8 |
| Other fee and commission income | **0.8** | 1.5 |
| **Total fee and commission income** | **29.7** | **32.8** |
| **Fee and commission expense:** | | |
| Other fee and commission expense | **—** | (0.2) |
| **Total fee and commission expense** | **—** | **(0.2)** |
| **Net fee and commission income** | **29.7** | **32.6** |

[1] Restated (refer notes 1 and 36).

Fee and commission expense includes bank servicing costs and bank charges.

### Note 4: Other operating income

Other operating income comprises:

| | **2014 £m** | 2013[1] £m |
|---|---|---|
| Credit card income | **0.6** | 2.9 |
| Investment and protection income | **—** | 1.2 |
| Gain on sale of available-for-sale assets (note 13) | **2.3** | 2.9 |
| Other | **2.4** | 0.2 |
| **Total other operating income** | **5.3** | **7.2** |

[1] Restated (refer notes 1 and 36).

Total other operating income is derived in the United Kingdom and relates to trade with third parties and continuing operations.

Investment and protection income relates to compensation income received or receivable from one of our general insurance partners.

# Notes to the financial statements

**Note 5: Total operating expenses**

Total operating expenses comprise:

| | Note | **2014 £m** | 2013[1] £m |
|---|---|---|---|
| Staff costs: | | | |
| Salaries | | **125.6** | 100.0 |
| Social security costs | | **14.3** | 10.6 |
| Other pension costs | | **9.6** | 8.0 |
| Employee share option schemes | 6 | **13.5** | 0.4 |
| | | **163.0** | 119.0 |
| Premises and equipment: | | | |
| Hire of equipment | | **4.8** | 5.4 |
| Rent and rates | | **7.2** | 5.0 |
| | | **12.0** | 10.4 |
| Other expenses: | | | |
| Marketing costs | | **15.7** | 8.9 |
| FSCS levy | | **16.6** | 13.5 |
| Professional fees | | **8.3** | 12.1 |
| Other | | **92.2** | 111.7 |
| | | **132.8** | 146.2 |
| Depreciation and amortisation: | | | |
| Depreciation of tangible fixed assets | | **6.4** | 5.1 |
| Amortisation of intangible assets | | **5.1** | 2.7 |
| | | **11.5** | 7.8 |
| Impairment: | | | |
| Tangible fixed assets | | **—** | 0.7 |
| Intangible assets | | **—** | 35.2 |
| | | **—** | 35.9 |
| **Total operating expenses** | | **319.3** | **319.3** |

[1] Restated (refer notes 1 and 36).

Deferred bonus amounts included within staff costs

In 2013 the Company established a Phantom Scheme which was accounted for as a long-term employee benefit. The charge for deferred bonus amounts of £4.9 million relating to the Phantom Scheme, and other legacy long-term incentive plans which are now closed, were included within staff costs.

On 23 September 2014 the Remuneration Committee agreed that existing awards under the Phantom Scheme for 36 senior employees would be converted to awards over Virgin Money Holdings (UK) plc Ordinary Shares on listing, with no acceleration of vesting. This has resulted in a change in accounting treatment of the Phantom Scheme such that it is now accounted for as an equity settled share based payment rather than as a long-term employee benefit (refer note 6).

**Note 5: Total operating expenses (continued)**

Average headcount

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

| | 2014 | 2013 |
|---|---|---|
| Full time | **2,244** | 2,040 |
| Part time | **660** | 588 |
| **Total** | **2,904** | **2,628** |

At 31 December 2014, the total number of full time equivalent employees is 2,758 (2013: 2,637).

Retirement benefit obligations

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

The Company made contributions of £9.6 million (2013: £8.0 million) during the year. There were no unpaid contributions outstanding at the year end (2013: £nil).

Fees payable to the auditor

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

| | 2014 £m | 2013 £m |
|---|---|---|
| Fees payable for the audit of the Company's current year annual report and accounts | **0.4** | 0.4 |
| **Total fees payable to the auditor by the Company** | **0.4** | **0.4** |

Fees paid to the Company's auditor, KPMG LLP, for services other than the statutory audit of the Company are not disclosed in these accounts. Instead they are required to be disclosed in the accounts of Virgin Money Holdings (UK) plc, the Company's parent, on a consolidated basis.

**Note 6: Share based payments**

Share based payment charges comprise:

| | 2014 £m | 2013 £m |
|---|---|---|
| Equity settled | **12.9** | 0.4 |
| Cash settled | **0.6** | — |
| **Total share based payment charge** | **13.5** | **0.4** |

**Note 6: Share based payments (continued)**

The listing of the Company crystallised the vesting of a number of share schemes. Of the total share based payment charge of £13.5 million in 2014, £10.7 million of this was attributable to awards which vested on listing. A breakdown of this is below.

| Vested on listing | 2014 £m |
|---|---|
| IPO incentive plan (including modifications) | **6.8** |
| Employee share award plan | **1.8** |
| Growth shares | **0.7** |
| Modification to phantom share award | **0.7** |
| Other equity and cash settled awards | **0.7** |
| **Total of awards which vested on listing** | **10.7** |

The scheme details are summarised below.

**Equity settled schemes**

| | Award plan | Eligible employees | Nature of award | Vesting conditions[1] | Issue dates[2] |
|---|---|---|---|---|---|
| (A) | IPO incentive plan 2013 | Selected senior employees | Conditional share award | Continuing employment or leavers in certain circumstances and achievement of performance conditions | 2013 |
| (B) | Employee share award plan | Staff below executive level | Conditional share award | Continuing employment or leavers in certain circumstances and achievement of performance conditions | 2013 |
| (C) | Phantom share award | Selected senior employees | Deferred bonus—conditional share award | Continuing employment or leavers in certain circumstances | 2012 & 2013 |
| (D) | Growth shares | Selected senior employees | Offer to subscribe for a restricted class of shares | Continuing employment or leavers in certain circumstances and achievement of performance conditions | 2012 & 2014 |
| (E) | Share award plan | Two senior employees | Conditional share award | Continuing employment or leavers in certain circumstances | 2013 |
| (F) | Chairman's interest in share options | Chairman | Award of share options | Continuing employment or leavers in certain circumstances | 2011 |
| (G) | Long term incentive plan (LTIP) | Selected senior employees | Conditional share award | Continuing employment or leavers in certain circumstances and achievement of performance conditions | 2014 |
| (H) | IPO share award 2014 | All employees excluding the Group's Executive Committee | Conditional share award | Continuing employment or leavers in certain circumstances | 2014 |
| (I) | Deferred bonus share plan[3] | Selected senior employees | Deferred bonus—conditional share award | Continuing employment or leavers in certain circumstances | 2014 |

[1] All awards have vesting conditions.
[2] Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years.
[3] The deferred bonus share plan is the scheme in operation in 2014 for bonuses which are to be settled in shares, in respect of employee performances in 2014.

**Note 6: Share based payments (continued)**

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

(A) IPO incentive plan 2013

The IPO incentive plan was introduced in December 2013 for selected senior employees. Participants were entitled to receive shares in the event of a listing of Virgin Money Holdings (UK) plc. The award was a pre-determined percentage of the listing value of Virgin Money Holdings (UK) plc, which was then converted to a number of Ordinary Shares in Virgin Money Holdings (UK) plc based on the listing price.

The fair value of the IPO incentive plan of £8.0 million (2013: £nil) was determined at grant date using a binomial valuation model. During 2014 £5.3 million (2013: £nil) was charged to the income statement.

During 2014 modifications were made to the scheme including removal of the minimum listing market value.

The combined impact of the modifications was an increase in the fair value of the awards granted of £3.0 million, which will be recorded in profit or loss over the vesting period through to 2017. At 31 December 2014 £1.5 million (2013: £nil) has been charged to the income statement.

The significant inputs used to estimate the fair value of the scheme and subsequent modifications included the probability, value and expected timing of the listing of Virgin Money Holdings (UK) plc. The valuation model included other estimates such as volatility, risk-free rate and discount factors. The risk-free rate was based on the UK Government bond yield and expected volatility was determined using observed market benchmarks.

(B) Employee share award plan

The employee share award plan was established for employees below executive level to share in the future success and growth of the Group by granting an award of 43 shares to each relevant employee. Under the scheme rules the vesting date was the earlier of (i) Virgin Money Holdings (UK) plc undertaking a listing or share sale (as defined in the Virgin Money Holdings (UK) plc's Articles of Association at the time) or (ii) at such other time as determined at the discretion of the Remuneration Committee.

The award vested on listing.

(C) Phantom share award

In late 2012 a notional (phantom) share award for senior individuals was established. The award is designed to comply with PRA requirements for deferral and clawback on treatment of variable remuneration. In 2012 this was accounted for as a cash settled share based payment. This scheme was amended during 2013 by the Remuneration Committee so that the award was based on Tangible Net Asset Value (TNAV) rather than share price over the vesting period. TNAV is calculated as the total assets of the Group less any intangible assets and liabilities. This amendment resulted in a change in accounting treatment of the phantom share award such that in 2013 it was accounted for as a long-term employee benefit rather than a cash settled share based payment (refer note 5).

**Note 6: Share based payments (continued)**

During 2014 the Remuneration Committee approved that existing awards under the phantom share scheme would be converted into Ordinary Share awards on listing of Virgin Money Holdings (UK) plc, with no acceleration of vesting.

This has resulted in a change in accounting treatment of the phantom share award to an equity settled share based payment therefore the Company has reclassified a liability of £4.2 million to equity. The fair value of the converted award was recalculated and will be recognised over the remaining vesting period within profit or loss through to 2018. The financial impact for the period to 31 December 2014 was £0.4 million, which has been recognised within the equity settled share based payment charge.

As part of the modification, the Remuneration Committee approved that an additional cash payment would be made to participants in relation to the 2013 deferred bonus. This was paid in December 2014. The financial impact for the year to 31 December 2014 was £0.3 million which is included within the cash settled share based payments.

The fair value of the modifications was calculated using a Black Scholes model as at the modification date. The significant inputs used to estimate the fair value included share price of Virgin Money Holdings (UK) plc, expected volatility of Virgin Money Holdings (UK) plc's share price, dividend yield of Virgin Money Holdings (UK) plc and the risk free rate. The risk free rate was based on the UK Government bond yield. Expected volatility was determined using observed market benchmarks.

(D) Growth shares

Offers to acquire Growth shares (a restricted class of Virgin Money Holdings (UK) plc shares) were extended to selected senior executives in 2012 (A Ordinary Shares) and 2014 (B Ordinary Shares).

During 2014 the A and B Ordinary Shares were converted into a combination of Ordinary Shares and Deferred Shares in Virgin Money Holdings (UK) plc. The conversion was based on the calculation and hurdle rate specified in the Articles of Association of Virgin Money Holdings (UK) plc. Following conversion of A and B Ordinary Shares this scheme was closed.

(E) Share award plan

Under the scheme the participants received shares in Virgin Money Holdings (UK) plc in March 2014 and will receive shares on vesting dates in 2015 and 2016. No awards were granted in 2014 under this scheme.

(F) Chairman's interest in share options

During 2011 an equity based option scheme was set up for the Chairman. Under the scheme the participant had an option over 65,824 Virgin Money Holdings (UK) plc Ordinary Shares (converted to 658,240 on 18 November 2014). The option vested in three tranches during 2012, 2013 and 2014.

During 2014, 32,912 share options were exercised for a weighted-average exercise price of £2.15. No options were exercised in 2013.

**Note 6: Share based payments (continued)**

At 31 December 2014 the weighted-average exercise price for options outstanding was £2.15 (2013: £21.49 prior to share reorganisation). The options outstanding will expire in ten years from the date of listing if not exercised.

(G) Long term incentive plan (LTIP)

The LTIP was approved by the Remuneration Committee during 2014. Awards are made within limits set by the rules of the plan. The maximum number of Ordinary Shares in Virgin Money Holdings (UK) plc that can be awarded equates to 120% of total annual remuneration under normal circumstances.

A one-off award was granted in 2014 to a senior employee on recruitment. The award contained no service or performance conditions therefore vested immediately on the grant date. The number of shares in Virgin Money Holdings (UK) plc granted was 105,448 with a fair value of £0.3 million. The fair value of the award was calculated based on the number of shares awarded and the Virgin Money Holdings (UK) plc's share price at grant date of 284.75p.

(H) IPO share award 2014

On listing the Group granted all employees below executive level a one-off share award. A small number of senior employees received an award over Ordinary Shares in Virgin Money Holdings (UK) plc of either 10% or 20% of salary. All other employees received an award over Ordinary Shares in Virgin Money Holdings (UK) plc with a value of £1,000. The awards will normally vest in full on the first anniversary of the listing of Virgin Money Holdings (UK) plc, provided that the participant is still employed within the Group at that time. Certain awards granted to senior employees will be subject to different vesting schedules, and holding periods, to comply with the PRA Remuneration Code. 1,773,880 shares were granted with an estimated fair value of £5.0 million. At 31 December 2014, £0.4 million (2013: £nil) has been charged to the income statement in respect of this scheme.

The fair value was determined using a Black Scholes valuation model. The significant inputs are summarised below:

| | **2014** |
|---|---|
| Share price of Virgin Money Holdings (UK) plc | **283p** |
| Exercise price | **0p** |
| Expected volatility of Virgin Money Holdings (UK) plc's share price | **20%**[1] |
| Expected dividend yield of Virgin Money Holdings (UK) plc | **1.28% / 1.14%**[2] |
| Expected life | **1 year / 1.8 years**[2] |
| Risk-free interest rate | **0.6%**[3] |

[1] As historic data is not available for Virgin Money Holdings (UK) plc expected volatility was determined using observed market benchmarks.
[2] For awards granted to senior employees that are subject to the PRA remuneration code, an average expected dividend yield for Virgin Money Holdings (UK) plc and average expected life has been calculated for the full vesting period.
[3] The risk-free rate is based on the UK Government bond yield.

**Note 6: Share based payments (continued)**

(I) Deferred bonus share plan

The deferred bonus share plan was approved by the Remuneration Committee during 2014 and is operated in conjunction with the Group's short-term incentive plan for Executive Directors and other senior managers of the Group.

Share awards for the deferred element of 2014 bonuses have not yet been granted. Share awards under the scheme for the deferred element of 2014 bonuses will be granted under this scheme in 2015.

A one-off award was granted under the scheme in 2014 to a senior employee on recruitment. The award has service conditions and the participant will receive shares on vesting dates in 2015, 2016, 2017 and 2018. The number of Virgin Money Holdings (UK) plc shares originally granted was 14,918 shares with an estimated fair value at grant of £0.1 million.

The fair value was determined using a Black Scholes valuation model. The significant inputs are summarised below:

| | **2014** |
|---|---|
| Share price of Virgin Money Holdings (UK) plc | **285p** |
| Exercise price | **0p** |
| Expected volatility of Virgin Money Holdings (UK) plc's share price | **20%**[1] |
| Expected dividend yield of Virgin Money Holdings (UK) plc | **0.96%**[2] |
| Expected life | **1.3 years**[2] |
| Risk-free interest rate | **0.6%**[3] |

[1] As historic data is not available for Virgin Money Holdings (UK) plc, expected volatility was determined using observed market benchmarks.
[2] An average expected dividend yield of Virgin Money Holdings (UK) plc and expected life has been calculated for the full vesting period.
[3] The risk-free rate is based on the UK Government Bond Yield.

Cash settled schemes

A cash payment of £1.4 million was made on listing Virgin Money Holdings (UK) plc in respect of a cash settled share based payment scheme which vested in 2011 resulting in a charge of £0.3 million to the Income Statement in 2014.

The terms of the phantom scheme were modified and as a result, a cash payment of £0.3 million was made in December 2014. Refer to (C) within the equity settled schemes section for details.

**Note 6: Share based payments (continued)**

Movement in share options and conditional shares

Analysis of the movement in share options and conditional shares for the Group's existing schemes is set out below:

| | Virgin Money Holdings (UK) plc Ordinary Shares | | | | |
|---|---|---|---|---|---|
| | **Chairman's interest in share options[1]** | **Employee share award plan** | **Share award plan[1]** | **Phantom share award[1]** | **IPO share award[1]** |
| Shares in existence at 1 January 2014 | **65,824** | **104,232** | **39,014** | **—** | **—** |
| Modification to phantom share award | **—** | **—** | **—** | **312,090** | **—** |
| Impact of share reorganisation by Virgin Money Holdings (UK) plc[4] | **592,416** | **871,911** | **294,984** | **2,808,810** | **—** |
| Granted in year | **—** | **—** | **—** | **—** | **1,773,880** |
| Exercised or vested in year | **(32,912)** | **(968,790)** | **(6,238)** | **—** | **—** |
| Less: forfeited in year | **—** | **(7,353)** | **—** | **—** | **—** |
| **Outstanding at 31 December 2014** | **625,328** | **—** | **327,760** | **3,120,900** | **1,773,880** |
| Of which exercisable | **625,328** | **—** | **—** | **—** | **—** |

| | Virgin Money Holdings (UK) plc Ordinary Shares | | | Virgin Money Holdings (UK) plc A and B Ordinary Shares |
|---|---|---|---|---|
| | **Long term incentive plan** | **Deferred bonus plan[1]** | **IPO incentive plan 2013[3]** | **Growth shares[2]** |
| Shares in existence at 1 January 2014 | **—** | **—** | **—** | **1,123,407** |
| Conversion of A and B Ordinary Shares | **—** | **—** | **—** | **(1,123,407)** |
| Crystalisation of IPO incentive plan shares | **—** | **—** | **1,661,631** | **—** |
| Granted in year | **105,448** | **14,918** | **—** | **—** |
| Exercised or vested in year | **(105,448)** | **—** | **(996,973)** | **—** |
| **Outstanding at 31 December 2014** | **—** | **14,918** | **664,658** | **—** |
| Of which exercisable | **—** | **—** | | **—** |
| | **—** | **—** | **—** | **—** |

[1] Awards have vesting conditions.
[2] Growth shares were A and B Ordinary Shares in Virgin Money Holdings (UK) plc. The return on these shares on listing was calculated as set out in the Virgin Money Holdings (UK) plc's Articles of Association. A Ordinary Shares were converted into 38,055 Ordinary Shares and 1,064,927 Deferred Shares. B Ordinary Shares were converted into 9,192 Ordinary Shares and 92,936 Deferred Shares. The Deferred Share created on the conversion of the A and B Ordinary Shares were then cancelled by Virgin Money Holdings (UK) plc.
[3] The IPO incentive plan 2013 was awarded as a percentage of the listing value of Virgin Money Holdings (UK) plc, which is then converted to a number of shares in Virgin Money Holdings (UK) plc based on the listing price. On listing 1,661,631 Ordinary Shares in Virgin Money Holdings (UK) plc were awarded.
[4] Immediately prior to listing of Virgin Money Holdings (UK) plc, there was a reorganisation of share capital which is detailed within the Annual Report and Accounts of Virgin Money Holdings (UK) plc for the year ended 31 December 2014. The number of equity instruments previously granted under employee share schemes increased as a result of the share reorganisation by Virgin Money Holdings (UK) plc.

**Note 6: Share based payments (continued)**

| | Virgin Money Holdings (UK) plc Ordinary Shares | | | Virgin Money Holdings (UK) plc A and B Ordinary Shares |
|---|---|---|---|---|
| | Chairman's interest in share options[1] | Employee share award plan[1] | Share award plan[1] | Growth shares[12] |
| Shares in existence at 1 January 2013 | 65,824 | — | — | 1,062,130 |
| Granted in year[3] | — | 106,898 | 39,014 | 102,128 |
| Less: forfeited in year | — | (2,666) | — | (40,851) |
| **Outstanding at 31 December 2013** | **65,824** | **104,232** | **39,014** | **1,123,407** |
| Of which exercisable | 43,833 | — | — | — |

[1] Awards have vesting conditions.
[2] Growth shares are A and B Ordinary Shares in Virgin Money Holdings (UK) plc. The return on these shares in the event of an exit event is calculated as set out in the Virgin Money Holdings (UK) plc's Articles of Association.
[3] The IPO incentive plan 2013 was awarded as a percentage of the listing value of Virgin Money Holdings (UK) plc, which is then converted to a number of shares in Virgin Money Holdings (UK) plc based on the listing price. It is not an award over a set number of shares; as such no shares are shown in the table above for this.

**Note 7: Allowance for impairment losses on loans and receivables**

| | **On advances secured on residential property £m** | **On advances secured on residential buy-to-let property £m** | **On unsecured loans £m** | **Total £m** |
|---|---|---|---|---|
| At 1 January 2013 | 7.2 | 0.5 | 0.1 | 7.8 |
| Advances written off | (1.7) | (0.6) | (21.6) | (23.9) |
| Charge to the income statement net of recoveries | 1.4 | 0.7 | 48.6 | 50.7 |
| At 31 December 2013 | **6.9** | **0.6** | **27.1** | **34.6** |
| Advances written off | **(1.0)** | **(0.1)** | **(9.8)** | **(10.9)** |
| Debt sale recovery | **—** | **—** | **(8.9)** | **(8.9)** |
| Charge to the income statement net of recoveries | **0.3** | **0.9** | **14.6** | **15.8** |
| **As at 31 December 2014** | **6.2** | **1.4** | **23.0** | **30.6** |

Of the total allowance in respect of loans and advances to customers, £27.6 million (2013: £32.9 million) was assessed on a collective basis.

On 30 September 2014 the Company entered into an agreement for the sale of credit card receivables which had previously been written-off. This subsequently completed on 31 October 2014 with net proceeds of £8.9 million. The full amount of the proceeds has been recognised as a gain and included as recoveries in the table above.

**Note 8: Taxation**

(A) Analysis of the tax (charge)/credit for the year

| | 2014 £m | 2013[1] £m |
|---|---|---|
| **UK corporation tax** | | |
| Group relief receipt | **—** | 0.5 |
| Credit attributable to available-for-sale reserve | **1.3** | — |
| Adjustments in respect of prior years | **(0.3)** | 0.2 |
| Current tax credit | **1.0** | **0.7** |
| **Deferred tax (refer note 20)** | | |
| Origination and reversal of temporary differences | **(12.3)** | 6.2 |
| Adjustments in respect of prior years | **(6.0)** | 3.5 |
| Reduction in UK corporation tax rate | **0.1** | (8.7) |
| FSCS levy adjustment | **—** | (1.3) |
| Deferred tax charge in the income statement | **(18.2)** | **(0.3)** |
| **Tax (charge) / credit** | **(17.2)** | **0.4** |

[1] Restated (refer notes 1 and 36).

Analysis of tax charge recognised in Other Comprehensive Income:

| | 2014 £m | 2013[1] £m |
|---|---|---|
| Current tax | | |
| Available-for-sale financial assets | **(1.3)** | (0.5) |
| Deferred tax | | |
| Cash flow hedge | **0.3** | (0.3) |
| **Total charge** | **(1.0)** | **(0.8)** |

[1] Restated (refer notes 1 and 36).

(B) Factors affecting the tax (charge)/credit for the year

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

| | 2014 £m | 2013[1] £m |
|---|---|---|
| **Profit before tax** | **52.9** | 275.9 |
| Tax charge at effective corporation tax rate of 21.5% (2013: 23.25%) | **(11.4)** | (64.1) |
| Factors affecting (charge)/credit: | | |
| Disallowed items | **(0.5)** | (0.9) |
| Dividends received not taxable | **—** | 25.4 |
| Group relief not paid for | **0.9** | — |
| UK corporation tax rate change | **0.1** | (8.7) |
| Adjustments in respect of previous years | **(6.3)** | 3.7 |
| Gains covered by the substantial shareholding exemption | **—** | 45.0 |
| **Total tax (charge) / credit** | **(17.2)** | **0.4** |

[1] Restated (refer notes 1 and 36).

**Note 8: Taxation (continued)**

The Company has been engaged in discussion with HM Revenue and Customs (HMRC) regarding the tax treatment of certain commercial funding transactions entered into by Virgin Money Cards Limited (VMCL), during 2009. VMCL was a subsidiary of the Company until its sale on 18 January 2013. It is no longer a subsidiary of the Company and has now been renamed Sapphire Cards Limited.

A Sapphire Cards Limited corporation tax liability of £2.3 million, a reduction in the Company deferred tax assets of £5.9 million and a credit of £1.4 million associated with group relief have been recognised in relation to the settlement of the HMRC enquiry for periods when Sapphire Cards Limited was a subsidiary of the Company. These amounts are reflected within the 2014 adjustments in respect of prior years.

In determining the value of the tax liability at 31 December 2014 resulting from the settlement of the HMRC enquiry, it is anticipated that Sapphire Cards Limited will benefit from the surrender of additional tax losses of up to £62.9 million from the Virgin Group in the years 2009 to 2011. Sapphire Cards Limited will make an expected payment in the region of £15.3 million for the losses surrendered by the Virgin Group with payment being funded through anticipated refunds of corporation tax previously paid by Sapphire Cards Limited.

The Finance Act 2013 was substantively enacted on 2 July 2013. This reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015.

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

| | Held at amortised cost £m | Fair value through profit or loss £m | Loans and receivables £m | Available-for-sale securities £m | Derivatives not designated as hedging instruments £m | Derivatives designated as hedging instruments: Fair value hedges £m | Derivatives designated as hedging instruments: Cash flow hedges £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **2014** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash and balances at central banks | — | — | 851.3 | — | — | — | — | 851.3 |
| Derivative financial instruments | — | — | — | — | 102.7 | 75.3 | — | 178.0 |
| Loans and receivables: | | | | | | | | |
| Loans and advances to banks | — | — | 136.4 | — | — | — | — | 136.4 |
| Loans and advances to customers | — | — | 23,347.9 | — | — | — | — | 23,347.9 |
| Debt securities | — | — | 1,407.4 | — | — | — | — | 1,407.4 |
| Available-for-sale financial assets | — | — | — | 1,539.6 | — | — | — | 1,539.6 |
| Other assets | — | — | 7.7 | — | — | — | — | 7.7 |
| **Total financial assets** | — | — | 25,750.7 | 1,539.6 | 102.7 | 75.3 | — | 27,468.3 |
| Non financial assets | | | | | | | | 226.5 |
| **Total assets** | | | | | | | | 27,694.8 |
| **Financial liabilities** | | | | | | | | |
| Deposits from banks | 845.5 | — | — | — | — | — | — | 845.5 |
| Customer deposits | 22,368.9 | — | — | — | — | — | — | 22,368.9 |
| Derivative financial instruments | — | — | — | — | 24.2 | 203.7 | — | 227.9 |
| Amounts due to securitisation special purpose vehicles | 317.5 | 2,449.4 | — | — | — | — | — | 2,766.9 |
| Other liabilities | 134.2 | — | — | — | — | — | — | 134.2 |
| **Total financial liabilities** | 23,666.1 | 2,449.4 | — | — | 24.2 | 203.7 | — | 26,343.4 |
| Non financial liabilities | | | | | | | | 125.8 |
| **Total liabilities** | | | | | | | | 26,469.2 |
| Equity | | | | | | | | 1,225.6 |
| **Total liabilities and equity** | | | | | | | | 27,694.8 |

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

| | Held at amortised cost £m | Fair value through profit or loss £m | Loans and receivables £m | Available-for-sale securities £m | Derivatives not designated as hedging instruments £m | Derivatives designated as hedging instruments: Fair value hedges £m | Derivatives designated as hedging instruments: Cash flow hedges £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **2013** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash and balances at central banks | — | — | 1,423.5 | — | — | — | — | 1,423.5 |
| Derivative financial instruments | — | — | — | — | 77.0 | 170.2 | 4.8 | 252.0 |
| Loans and receivables: | | | | | | | | |
| Loans and advances to banks | — | — | 91.8 | — | — | — | — | 91.8 |
| Loans and advances to customers | — | — | 20,598.9 | — | — | — | — | 20,598.9 |
| Debt securities | — | — | 1,602.6 | — | — | — | — | 1,602.6 |
| Available-for-sale financial assets | — | — | — | 1,579.3 | — | — | — | 1,579.3 |
| Other assets | — | — | 7.7 | — | — | — | — | 7.7 |
| **Total financial assets** | **—** | **—** | **23,724.5** | **1,579.3** | **77.0** | **170.2** | **4.8** | **25,555.8** |
| Non financial assets | | | | | | | | 192.7 |
| **Total assets** | | | | | | | | **25,748.5** |
| **Financial liabilities** | | | | | | | | |
| Deposits from banks | 382.2 | — | — | — | — | — | — | 382.2 |
| Customer deposits | 21,127.2 | — | — | — | — | — | — | 21,127.2 |
| Derivative financial instruments | — | — | — | — | 16.1 | 126.7 | 2.4 | 145.2 |
| Amounts due to securitisation special purpose vehicles | 486.2 | 2,192.4 | — | — | — | — | — | 2,678.6 |
| Other liabilities | 157.8 | — | — | — | — | — | — | 157.8 |
| **Total financial liabilities** | **22,153.4** | **2,192.4** | **—** | **—** | **16.1** | **126.7** | **2.4** | **24,491.0** |
| Non financial liabilities | | | | | | | | 88.8 |
| **Total liabilities** | | | | | | | | **24,579.8** |
| Equity | | | | | | | | 1,168.7 |
| **Total liabilities and equity** | | | | | | | | **25,748.5** |

**Note 10: Loans and advances to banks**

Loans and advances to banks comprise variable rate deposits of £136.4 million (2013: £91.8 million).

**Note 11: Loans and advances to customers**

Loans and advances comprise:

| | 2014 £m | 2013 £m |
|---|---|---|
| Advances secured on residential property not subject to securitisation | **15,620.5** | 14,299.0 |
| Advances secured on residential property subject to securitisation | **3,125.8** | 2,885.7 |
| | **18,746.3** | 17,184.7 |
| Residential buy-to-let loans not subject to securitisation | **3,134.3** | 2,368.1 |
| **Total loans and advances to customers secured on residential property** | **21,880.6** | **19,552.8** |
| Unsecured receivables not subject to securitisation | **1,121.3** | 808.8 |
| Amounts due from group companies | **249.8** | 252.6 |
| **Total loans and advances to customers before allowance for impairment losses** | **23,251.7** | **20,614.2** |
| Impairment allowance (refer note 7) | **(30.6)** | (34.6) |
| **Total loans and advances to customers excluding portfolio hedging** | **23,221.1** | **20,579.6** |
| Fair value of portfolio hedging | **126.8** | 19.3 |
| **Total loans and advances to customers** | **23,347.9** | **20,598.9** |
| **Loans to customers by rate** | | |
| Fixed rate | **17,149.9** | 14,257.7 |
| Variable rate | **6,198.0** | 6,341.2 |
| **Total** | **23,347.9** | **20,598.9** |

Included within loans and advances to customers are credit card receivables. The Company acquired Virgin Money branded credit cards from MBNA on 18 January 2013. Subsequently on 30 November 2014, the Company purchased a further portfolio of £359.3 million of Virgin Money branded customer balances from MBNA. At 31 December 2014 £22.9 million (31 December 2013: £27.0 million) of the impairment allowance relates to impairment on amounts outstanding on credit cards. Details of the credit card portfolio acquisitions can be found in note 17.

The fair value of portfolio hedging represents an accounting adjustment which offsets the fair value movement on the related derivatives. Such relationships are established to protect the Company from interest rate risk on fixed rate products (refer note 14).

For collateral held in respect of the values included in the table above, please refer to note 15.

Securitisation

Securitisation is a means used by the Company to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These

**Note 11: Loans and advances to customers (continued)**

advances have been transferred at their carrying value to SPVs and have been funded through the issue of amortising mortgage backed securities to investors with a proportion retained by the Company. The transfers do not meet the criteria for asset derecognition in IAS 39 Financial Instruments: Recognition and Measurement as the Company has retained the risks and rewards of the assets.

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. Where relevant, the table also 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. There were no transactions in the year where the Company transferred financial assets that should have been derecognised in their entirety.

| | **2014 Carrying value £m** | **Fair value £m** | 2013 Carrying value £m | Fair value £m |
|---|---|---|---|---|
| Transferred assets | **3,125.8** | **3,197.4** | 2,885.7 | 2,994.7 |
| Associated liabilities | **2,766.9** | **2,775.0** | 2,678.6 | 2,693.4 |

**Note 12: Debt securities classified as loans and receivables**

Debt securities classified as loans and receivables comprise:

| | **2014 Carrying value £m** | **Fair value £m** | 2013 Carrying value £m | Fair value £m |
|---|---|---|---|---|
| Debt securities | **1,407.4** | **1,382.4** | 1,602.6 | 1,573.8 |

Debt securities classified as loans and receivables under IAS 39 'Financial Instruments: Recognition and Measurement' were all listed and variable rate.

All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

**Note 13: Available-for-sale financial assets**

Available-for-sale financial assets comprise:

| | **2014 £m** | 2013 £m |
|---|---|---|
| At fair value | | |
| Listed | **1,539.6** | 1,497.2 |
| Unlisted | **—** | 82.1 |
| **Total** | **1,539.6** | **1,579.3** |
| Fixed rate | **1,307.4** | 1,288.7 |
| Variable rate | **232.2** | 290.6 |
| **Total** | **1,539.6** | **1,579.3** |

Gains on sale of available-for-sale financial assets amounted to £2.3 million (2013:£2.9 million).

Further analysis of the composition of available-for-sale financial assets is set out in note 30.

| | **2014 £m** | 2013 £m |
|---|---|---|
| At 1 January | **1,579.3** | 1,255.8 |
| Additions | **567.6** | 746.3 |
| Disposals (sales and redemptions) | **(689.1)** | (362.5) |
| Exchange differences | **(1.4)** | 0.4 |
| Net gains on changes in fair value | **83.2** | (60.7) |
| **At 31 December** | **1,539.6** | **1,579.3** |

All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

For amounts included above which are subject to repurchase agreements refer to note 15.

# Notes to the financial statements

### Note 14: Derivative financial instruments

| | 2014 Contract/ notional amount £m | 2014 Asset fair value £m | 2014 Liability fair value £m | 2013 Contract/ notional amount £m | 2013 Asset fair value £m | 2013 Liability fair value £m |
|---|---|---|---|---|---|---|
| **Derivatives in accounting hedge relationships** | | | | | | |
| Derivatives designated as fair value hedges: | | | | | | |
| Interest rate swaps | **22,160.5** | **74.4** | **(203.7)** | 21,191.6 | 170.2 | (126.6) |
| Cross currency interest rate swaps | **21.8** | **0.9** | **—** | 21.8 | — | (0.1) |
| | **22,182.3** | **75.3** | **(203.7)** | 21,213.4 | 170.2 | (126.7) |
| Derivatives designated as cashflow hedges: | | | | | | |
| Interest rate swaps | **—** | **—** | **—** | 732.5 | 4.8 | (2.4) |
| **Total derivative assets/ liabilities—in accounting hedge relationships** | **22,182.3** | **75.3** | **(203.7)** | **21,945.9** | **175.0** | **(129.1)** |
| **Derivatives in economic hedging relationships but not in accounting hedge relationships** | | | | | | |
| Interest rate contracts: | | | | | | |
| Interest rate swaps | **9,833.3** | **102.7** | **(24.2)** | 15,633.8 | 77.0 | (16.1) |
| **Total derivative assets/ liabilities—in economic hedging relationship but not in accounting hedge relationships** | **9,833.3** | **102.7** | **(24.2)** | **15,633.8** | **77.0** | **(16.1)** |
| **Total recognised derivative assets/ (liabilities)** | **32,015.6** | **178.0** | **(227.9)** | **37,579.7** | **252.0** | **(145.2)** |

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

Hedged cash flows

For designated cash flow hedges the following table shows when the Company's hedged cash flows are expected to occur and when they will impact income.

| | **2014 £m** | 2013 £m |
|---|---|---|
| Within one year | **—** | (0.7) |
| In one to five years | **—** | 2.0 |
| **Total** | **—** | **1.3** |

## Note 14: Derivative financial instruments (continued)

Fair value losses on financial instruments

| | **2014 £m** | 2013 £m |
|---|---|---|
| Derivatives designated as fair value hedges | **(156.3)** | 156.9 |
| Fair value movement attributable to hedged risk | **155.1** | (167.5) |
| Loss from fair value hedges[1] | **(1.2)** | (10.6) |
| Gain/(loss) from cash flow hedges | **0.9** | (5.1) |
| Loss from hedge accounting | **(0.3)** | (15.7) |
| Fair value losses from other derivatives[2] | **(0.5)** | (40.2) |
| Fair value (losses)/gains from other financial instruments | **(19.1)** | 45.7 |
| **Fair value losses on financial instruments** | **(19.9)** | **(10.2)** |

[1] Gains or losses from fair value hedges can arise where there is an IFRS hedge accounting relationship in place and either:
– the fair value of the derivative was not exactly offset by the change in fair value attributable to the hedged risk; or
– the derivative was designated in or dedesignated from the IFRS hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.
[2] Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.
[3] Other financial instruments relate to amounts due to securitisation special purpose vehicles which are classified as financial liabilities at fair value through profit or loss.

## Note 15: Collateral pledged and received

The Company receives and accepts collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives;
- sales and repurchase and reverse sale and repurchase agreements; and
- securities lending and borrowing.

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

At 31 December 2014 cash collateral of £120.0 million (2013: £68.5 million) had been pledged by the Company and £10.2 million (2013: £78.7 million) has been received as cash collateral by the Company.

At 31 December 2014 financial assets of £467.3 million (2013: £328.3 million) are pledged as collateral in respect of sale and repurchase transactions under terms that are usual and customary for such activities.

The value of collateral pledged in respect of repurchase transactions that was transferred, accounted for as secured borrowings, where the transferee is permitted by contract or custom to repledge collateral was £450.2 million (2013: £328.3 million).

**Note 16: Investments in subsidiary undertakings**

The following are subsidiaries of the Company:

| Name | Class of share | Holding |
|---|---|---|
| **Direct holdings** | | |
| Northern Rock (Guernsey) Limited | Ordinary | 100% |
| Virgin Card Limited[1] | Ordinary | 100% |
| Northern Rock Limited[1] | Ordinary | 100% |

[1] Indicates dormant company

Northern Rock (Guernsey) Limited was dissolved on 2 January 2015. During the year ended 31 December 2014, a distribution of £4.5 million was made to the Company by Northern Rock (Guernsey) Limited.

On 18 January 2013, the Company sold 100% of the ordinary share capital of Virgin Money Cards Limited (name changed to Sapphire Cards Limited on 18 January 2013 immediately prior to disposal) to MBNA Europe Bank Limited (''MBNA'') for an overall gain of £193.8 million. The principal activities of Virgin Money Cards Limited were the marketing and direct distribution of Virgin Money branded personal credit cards issued by and under a partnership agreement with MBNA. Prior to the sale, all assets, liabilities and contracts not connected with the MBNA partnership agreement were transferred to the Company. Refer to note 17 for further details.

The movement in investments in subsidiary undertakings is reconciled as follows:

| | **2014 £m** | 2013 £m |
|---|---|---|
| **Cost or valuation** | | |
| At the beginning of the period | — | 9.6 |
| Sale of Virgin Money Cards Limited | — | (9.6) |
| **At the end of the period** | **—** | **—** |

The following companies are Special Purpose Vehicles (SPV) established in connection with the Company's securitisation programme. The principal place of business of each SPV is the UK. Judgement has been used to determine whether the Company has control over these entities and should account for them as subsidiaries. Although the Company has no direct or indirect ownership interest in these companies, they are accounted for as subsidiaries, because they are

**Note 16: Investments in subsidiary undertakings (continued)**

principally engaged in providing a source of long-term funding to the Company. This means the Company has the rights to all benefits from the activities of the SPVs.

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

[1] In liquidation
[2] Company dissolved on 27 January 2015

**Note 17: Acquisitions and disposals**

Credit card purchase and disposal of Virgin Money Cards Limited (2013)

The 2013 acquisition of £1.0 billion of the Virgin Money branded credit cards from MBNA Europe Bank Limited (MBNA) has been accounted for as a business combination in accordance with the applicable accounting standards which require the recognition of the identifiable assets acquired and liabilities assumed at their acquisition date fair values.

Material features of the transaction are as follows:

On 18 January 2013 the Company sold 100% of the ordinary share capital of Virgin Money Cards Limited (name changed to Sapphire Cards Limited on 18 January 2013 immediately prior to disposal) to MBNA for an overall gain of £193.8 million. The principal activities of Virgin Money Cards Limited were the marketing and direct distribution of Virgin Money branded personal credit cards issued by and under a partnership agreement with MBNA. Prior to the sale, all assets, liabilities and contracts not connected with the MBNA partnership agreement were transferred to the Company. This terminated all pre-existing relationships in relation to the Virgin Money branded cards.

On the same day the Company entered into a transaction to acquire approximately one third of the Virgin Money branded personal credit card book issued by MBNA, for a purchase consideration of £1,019.6 million which was paid in cash. The assets were previously managed jointly by MBNA and Virgin Money Cards Limited under a partnership agreement. The initial fair value of the assets acquired is estimated to be £1,019.6 million with the credit card book being the only assets acquired. The gross contractual amounts due for the credit card book acquired were £1,042.7 million and the initial estimate of contractual cash flows that were not expected to be collected equate to the difference in this value to the fair value. The associated acquisition costs of £6.3 million were charged to the income statement in 2012. The remaining

**Note 17: Acquisitions and disposals (continued)**

two thirds of the portfolio managed under the partnership agreement are now wholly owned by MBNA. These assets were rebranded during 2013. £5.0 million of the gain on sale of Virgin Money Cards Limited was deferred and was recognised in income in 2013.

In the period from 18 January 2013 to 31 December 2013 the acquired credit card portfolio contributed net interest income of £122.6 million. If the acquisition had occurred on 1 January 2013 Management estimates that consolidated net interest income would not have been materially different to that recorded for the period 18 January 2013 to 31 December 2013. In determining these amounts, Management have used weighted-average cost of funding to determine interest expense and assumed that all fair value adjustments would have been the same if the acquisition had occurred on 1 January 2013.

Purchase of credit card portfolio (2014)

From the point of acquisition of the credit card book from MBNA on 18 January 2013, until 30 November 2014, MBNA agreed to underwrite and administer new Virgin Money branded credit cards on a commission basis. On 30 November 2014 the Company completed an agreement to purchase the assets originated during this period. The portfolio was purchased for a consideration of £362.7 million. The fair value of the assets purchased was £354.5 million (a premium of £8.2 million). This included credit cards that had previously been charged-off. The premium will be unwound over the life of the purchased assets.

Management has determined the acquisition is an asset purchase as the assets were purchased without staff contracts or processes or other aspects of the business being transferred to them.

Purchase of customer loans from Church House Trust Limited (2014)

On 30 September 2014, the Company purchased £4.3 million customer loans from Church House Trust Limited, a fellow subsidiary of the Group at that time.

**Note 18: Intangible assets**

Intangible assets comprise:

| | Software £m | Core banking platform £m | Total £m |
|---|---|---|---|
| **Cost:** | | | |
| Cost at 1 January 2013 | 53.0 | — | 53.0 |
| Additions | 25.9 | 6.9 | 32.8 |
| **Cost at 31 December 2013** | **78.9** | **6.9** | **85.8** |
| **Additions[1]** | **14.0** | **13.0** | **27.0** |
| **Cost at 31 December 2014** | **92.9** | **19.9** | **112.8** |
| **Accumulated amortisation:** | | | |
| Accumulated amortisation at 1 January 2013 | 24.8 | — | 24.8 |
| Charge for the year | 2.7 | — | 2.7 |
| Impairment | 35.2 | — | 35.2 |
| **Accumulated amortisation at 31 December 2013** | **62.7** | **—** | **62.7** |
| **Charge for the year** | **5.1** | **—** | **5.1** |
| **Accumulated amortisation at 31 December 2014** | **67.8** | **—** | **67.8** |
| **Balance sheet amount at 31 December 2014** | **25.1** | **19.9** | **45.0** |
| Balance sheet amount at 31 December 2013 | 16.2 | 6.9 | 23.1 |

[1] Additions during the year relate to software and core banking platform intangible assets. This includes the construction of assets which support the development of the Company's credit card capability in partnership with Total System Services, Inc. and the development of the Company's digital banking channel.

**Note 19: Tangible fixed assets**

Tangible fixed assets comprise:

| | Land and buildings £m | Plant, equipment, fixtures, fittings and vehicles £m | Total £m |
|---|---|---|---|
| **Cost:** | | | |
| Cost at 1 January 2013 | 54.3 | 38.7 | 93.0 |
| Additions | 1.0 | 1.0 | 2.0 |
| Disposals | — | (0.2) | (0.2) |
| **Cost at 31 December 2013** | **55.3** | **39.5** | **94.8** |
| **Additions** | **4.2** | **6.4** | **10.6** |
| **Disposals** | **(1.2)** | **(0.1)** | **(1.3)** |
| **Cost at 31 December 2014** | **58.3** | **45.8** | **104.1** |
| **Accumulated depreciation and impairment:** | | | |
| Accumulated depreciation and impairment at 1 January 2013 | 2.2 | 18.3 | 20.5 |
| Depreciation charge for the year | 1.2 | 3.9 | 5.1 |
| Disposals | — | (0.2) | (0.2) |
| Write-offs | 0.3 | 0.4 | 0.7 |
| **Accumulated depreciation and impairment at 31 December 2013** | **3.7** | **22.4** | **26.1** |
| **Depreciation charge for the year** | **1.5** | **4.9** | **6.4** |
| **Disposals** | **(0.3)** | **(0.1)** | **(0.4)** |
| **Write-offs** | **—** | **—** | **—** |
| **At 31 December 2014** | **4.9** | **27.2** | **32.1** |
| **Balance sheet amount at 31 December 2014** | **53.4** | **18.6** | **72.0** |
| Balance sheet amount at 31 December 2013 | 51.6 | 17.1 | 68.7 |

**Note 20: Deferred tax asset**

Deferred tax assets and liabilities comprise:

| | 2014 £m | 2013[1] £m |
|---|---|---|
| Deferred tax assets: | | |
| Accelerated capital allowances | **5.6** | 6.8 |
| Cash flow hedge reserve | **—** | (0.3) |
| Tax losses carried forward | **40.3** | 62.0 |
| FSCS adjustment | **—** | (3.9) |
| Change in accounting basis on adoption of IFRS | **(3.2)** | (2.7) |
| Other temporary differences | **3.3** | 1.0 |
| **Total deferred tax assets** | **46.0** | **62.9** |

[1] Restated (refer notes 1 and 36).

# Notes to the financial statements

**Note 20: Deferred tax asset (continued)**

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

| | **2014 £m** | 2013[1] £m |
|---|---|---|
| At 1 January | **62.9[1]** | 64.0 |
| Accelerated capital allowances | **(1.2)** | (1.2) |
| Tax losses carried forward | **(21.7)** | 2.7 |
| Other temporary differences | **4.7** | (1.8) |
| | **(18.2)** | (0.3) |
| Deferred tax balance transferred in | **1.0** | — |
| Amounts credited/(charged) to equity: | | |
| Available-for-sale financial assets | **—** | (0.5) |
| Cash flow hedges | **0.3** | (0.3) |
| | **0.3** | (0.8) |
| **At 31 December** | **46.0** | **62.9** |

[1] Restated (refer notes 1 and 36).

**Note 21: Other assets**

Other assets comprise:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Trade debtors | **6.5** | 8.1 |
| Prepayments and accrued income | **19.1** | 19.7 |
| Amounts owed from related parties | **18.5** | 7.3 |
| Other | **27.1** | 10.6 |
| **Total other assets** | **71.2** | **45.7** |

The Company's exposure to credit risk and impairment losses related to trade and other receivables is shown in note 30.

**Note 22: Deposits from banks**

Deposits from banks comprise:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Fixed rate deposits | **285.4** | 153.6 |
| Variable rate deposits | **560.1** | 228.6 |
| **Total deposits from banks** | **845.5** | **382.2** |

Fixed and variable rate deposits include repo funding; a form of secured borrowing for a fixed period, where investment securities are sold to a third party with an agreement to buy them back on a set date for a set price. These transactions are treated as secured borrowing as none of the risks and rewards of ownership ever pass to the buyer. Fixed and variable rate deposits include repo funding and collateral deposits. At 31 December 2014 the amount of repo funding was £835.3 million (2013: £303.5 million).

**Note 23: Customer deposits**

Customer deposits comprise:

| | 2014 £m | 2013 £m |
|---|---|---|
| Fixed rate deposits | **9,725.0** | 8,031.2 |
| Variable rate deposits | **12,643.9** | 13,096.0 |
| **Total customer deposits** | **22,368.9** | **21,127.2** |

**Note 24: Provisions**

The movement in the provision was as follows:

| | FSCS £m | Other £m | Total £m |
|---|---|---|---|
| At 1 January 2014 | **7.2**[1] | **0.3** | **7.5** |
| Provisions applied | **(15.1)** | **(0.2)** | **(15.3)** |
| Charge for the year | **16.6** | **0.3** | **16.9** |
| **At 31 December 2014** | **8.7** | **0.4** | **9.1** |

[1] Restated (refer notes 1 and 36).

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund the compensation costs associated with institutions that failed in 2008 and will receive the receipts from asset sales, surplus cash flows and other recoveries from these institutions in the future. The FSCS meets its obligations by raising management expense and compensation levies. These include amounts to cover the interest on its borrowings and on-going management expenses. Each deposit taking institution contributes in proportion to its share of total protected deposits.

IFRIC 21 'Levies' was adopted during 2014 and addresses the accounting for a liability to pay a levy as described in note 1. This required a prior period restatement. The opening FSCS provision for 2014 decreased by £18.3 million to £7.2 million (refer note 36).

Other

Other provisions include amounts provided in relation to the European Working Time Directive ruling in respect of the calculation of statutory holiday pay of £0.2 million (2013: £nil) and National Insurance Contributions due in relation to preferential interest rates on loans provided to staff of £0.2 million (2013: £nil).

**Note 25: Other liabilities**

Other liabilities comprise:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Trade creditors | **26.1** | 21.9 |
| Deferred income | **4.7** | 6.8 |
| Amounts owed to subsidiary undertakings | **11.1** | 12.1 |
| Other creditors and accruals | **209.0** | 198.3 |
| **Total other liabilities** | **250.9** | **239.1** |

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

Accrued interest included within 'Other creditors and accruals' primarily represents interest which has accrued on retail funds and deposits.

The Company's exposure to liquidity risk related to trade and other payables is disclosed in note 30.

**Note 26: Share capital**

Share capital comprises:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Share capital (allotted, called up and fully paid)[1] | **1,400.0** | 1,400.0 |
| **At 31 December** | **1,400.0** | **1,400.0** |

[1] Total Ordinary Shares by number 1,400 million with a nominal value of £1, amounting to £1,400 million.

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

No dividends were paid in 2014 or 2013.

**Note 27: Other reserves**

Other reserves comprise:

| Available-for-sale reserve | 2014 £m | 2013 £m |
|---|---|---|
| At 1 January | **0.2** | (1.4) |
| Net gains from changes in fair value | **86.9** | (51.6) |
| Net gains on disposal transferred to net income | **(5.4)** | (3.5) |
| Amounts transferred to net income due to hedge accounting | **(74.8)** | 57.0 |
| Amortisation of fair value differences in respect of securities transferred to loans and receivables | **—** | 0.2 |
| Deferred tax | **(1.3)** | (0.5) |
| **At 31 December** | **5.6** | **0.2** |

| Cash flow hedge reserve | 2014 £m | 2013 £m |
|---|---|---|
| At 1 January | **1.3** | (10.2) |
| Amounts recognised in equity | **(0.5)** | 7.0 |
| Amounts transferred to interest payable | **(1.1)** | 4.8 |
| Deferred tax | **0.3** | (0.3) |
| **At 31 December** | **—** | **1.3** |

**Note 28: Contingent liabilities and commitments**

**Contingent liabilities**

The Company is not aware of any significant contingent liabilities as at 31 December 2014. At 31 December 2013, there were contingent liabilities of £9.0 million in relation to taxation which was settled in 2014. Refer to note 8.

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

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

**Note 28: Contingent liabilities and commitments (continued)**

**Loan commitments**

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

| | **2014 £m** | 2013 £m |
|---|---|---|
| Not later than 1 year | **3,100.4** | 2,784.0 |
| Later than one year and not later than 5 years | **—** | — |
| Later than 5 years | **593.8** | 720.1 |
| **Total loan commitments** | **3,694.2** | **3,504.1** |

**Operating lease commitments – land and buildings**

Minimum future lease payments under non-cancellable operating leases.

| | **2014 £m** | 2013 £m |
|---|---|---|
| Not later than 1 year | **5.5** | 5.4 |
| Later than one year and not later than 5 years | **18.4** | 17.0 |
| Later than 5 years | **19.8** | 18.9 |
| **Total operating lease commitments – land and buildings** | **43.7** | **41.3** |

**Operating lease commitments – other operating leases**

Minimum future lease payments under non-cancellable operating leases.

| | **2014 £m** | 2013 £m |
|---|---|---|
| Not later than 1 year | **4.6** | 4.8 |
| Later than one year and not later than 5 years | **13.8** | 18.4 |
| Later than 5 years | **—** | — |
| **Total operating lease commitments – other operating leases** | **18.4** | **23.2** |

**Capital commitments**

Capital commitments for the acquisition of buildings and equipment.

| | **2014 £m** | 2013 £m |
|---|---|---|
| Not later than 1 year | **5.6** | 4.3 |
| Later than one year and not later than 5 years | **—** | — |
| Later than 5 years | **—** | — |
| **Total capital commitments** | **5.6** | **4.3** |

**Note 29: Fair value of financial assets and liabilities**

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

The following table summarises the fair values of those financial assets and liabilities not presented on the Company's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy 1.7.8 sets out the key principles for estimating the fair values of the financial instruments.

| | Level 1 £m | Level 2 £m | Level 3 £m | Total fair value £m | Total carrying value £m |
|---|---|---|---|---|---|
| **2014** | | | | | |
| Cash and balances with central banks | **—** | **851.3** | **—** | **851.3** | **851.3** |
| Loans and advances to banks | **—** | **136.4** | **—** | **136.4** | **136.4** |
| Loans and advances to customers | **—** | **249.8** | **23,197.3** | **23,447.1** | **23,347.9** |
| Debt securities held as loans and receivables | **10.0** | **1,372.4** | **—** | **1,382.4** | **1,407.4** |
| Other assets | **—** | **7.7** | **—** | **7.7** | **7.7** |
| **Total financial assets** | **10.0** | **2,617.6** | **23,197.3** | **25,824.9** | **25,750.7** |
| Deposits from banks | **—** | **845.5** | **—** | **845.5** | **845.5** |
| Customer deposits | **—** | **22,424.3** | **—** | **22,424.3** | **22,368.9** |
| Amounts due to securitisation special purpose vehicles | **—** | **—** | **325.7** | **325.7** | **317.5** |
| Other liabilities | **—** | **134.2** | **—** | **134.2** | **134.2** |
| **Total financial liabilities** | **—** | **23,404.0** | **325.7** | **23,729.7** | **23,666.1** |

| | Level 1 £m | Level 2 £m | Level 3 £m | Total fair value £m | Total carrying value £m |
|---|---|---|---|---|---|
| **2013** | | | | | |
| Cash and balances with central banks | — | 1,423.5 | — | 1,423.5 | 1,423.5 |
| Loans and advances to banks | — | 91.8 | — | 91.8 | 91.8 |
| Loans and advances to customers | — | 252.6 | 20,586.8 | 20,839.4 | 20,598.9 |
| Debt securities held as loans and receivables | 9.8 | 1,564.0 | — | 1,573.8 | 1,602.6 |
| Other assets | — | 7.7 | — | 7.7 | 7.7 |
| **Total financial assets at fair value** | **9.8** | **3,339.6** | **20,586.8** | **23,936.2** | **23,724.5** |
| Deposits from banks | — | 382.2 | — | 382.2 | 382.2 |
| Customer deposits | — | 21,211.7 | — | 21,211.7 | 21,127.2 |
| Amounts due to securitisation special purpose vehicles | — | 501.0 | — | 501.0 | 486.2 |
| Other liabilities | — | 157.8 | — | 157.8 | 157.8 |
| **Total financial liabilities at fair value** | **—** | **22,252.7** | **—** | **22,252.7** | **22,153.4** |

**Note 29: Fair value of financial assets and liabilities (continued)**

Fair value hierarchy

The table on page 72 summarises the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

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

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

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

Valuation methods for calculations of fair values in the table on page 72 are set out below:

Cash and balances with central banks

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

Loans and advances to banks

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

Loans and advances to customers

The Company provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Company. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Company's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Company has an exposure to this difference in value. However, were the Company to dispose of a portfolio of mortgages, it would be likely the fair value would be lower than disclosed, as there is currently no active market for the sale of mortgage books. The fair value of a loan takes into account credit risk at the balance sheet date. Loans and advances to customers are categorised as level 3 as unobservable prepayment rates are applied.

Debt securities held as loans and receivables

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

**Note 29: Fair value of financial assets and liabilities (continued)**

Other assets and other liabilities

Fair value is deemed to approximate to the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Company for deposits of similar remaining maturities. Customer deposits have been reclassified as level 2 from level 3 as the material inputs are observable. The 2013 table has been amended to reflect this change.

Amounts due to securitisation special purpose vehicles

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

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

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy 1.7.8 sets out the key principles for estimating the fair values of financial instruments.

| **2014** | **Level 1 £m** | **Level 2 £m** | **Level 3 £m** | **Total £m** |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial instruments | **—** | **100.1** | **77.9** | **178.0** |
| Available-for-sale financial assets | **1,539.6** | **—** | **—** | **1,539.6** |
| **Financial liabilities** | | | | |
| Derivative financial instruments | **—** | **227.9** | **—** | **227.9** |
| Amounts due to securitisation special purpose vehicles[1] | **—** | **—** | **2,449.4** | **2,449.4** |

| 2013 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial instruments | — | 187.2 | 64.8 | **252.0** |
| Available-for-sale financial assets | 1,497.2 | 82.1 | — | **1,579.3** |
| **Financial liabilities** | | | | |
| Derivative financial instruments | — | 145.2 | — | **145.2** |
| Amounts due to securitisation special purpose vehicles[1] | — | — | 2,192.4 | **2,192.4** |

[1] The contractual amount due to securitisation special purpose vehicles was £2,386.1 million (2013: £2,148.1)

**Note 29: Fair value of financial assets and liabilities (continued)**

Level 1 Valuations

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

Level 2 Valuations

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

The fair value of level 2 available-for-sale financial assets are calculated using valuation techniques including discounted cash flow models.

Level 3 Valuations

(i) Reconciliation

The following shows a reconciliation of level 3 fair value measurements from the beginning to the end of the period:

| **2014** | **Financial assets derivative financial instruments £m** | **Financial liabilities amounts due to securitisation special purpose vehicles £m** |
|---|---|---|
| **Balance at 1 January** | **64.8** | **(2,192.4)** |
| Total gains or losses: | | |
| In profit or loss | **47.5** | **(19.1)** |
| Transactions with group undertakings | **—** | **(1,388.9)** |
| Settlements | **(34.4)** | **1,151.0** |
| **Balance at 31 December** | **77.9** | **(2,449.4)** |

| **2014** | **Financial assets derivative financial instruments £m** | **Financial liabilities amounts due to securitisation special purpose vehicles £m** |
|---|---|---|
| Total gains and losses recognised in profit or loss: | | |
| Fair value movements | **10.9** | **(19.1)** |
| Net interest income | **36.6** | **—** |

**Note 29: Fair value of financial assets and liabilities (continued)**

| 2013 | Financial assets derivative financial instruments £m | Financial liabilities amounts due to securitisation special purpose vehicles £m |
|---|---|---|
| Balance at 1 January | 120.5 | (3,829.3) |
| Total gains or losses: | | |
| In profit or loss | (8.8) | 45.7 |
| Transactions with group undertakings | — | — |
| Settlements | (46.9) | 1,591.2 |
| **Balance at 31 December** | **64.8** | **(2,192.4)** |

| 2013 | Financial assets derivative financial instruments £m | Financial liabilities amounts due to securitisation special purpose vehicles £m |
|---|---|---|
| Total gains and losses recognised in profit or loss: | | |
| Fair value movements | (54.8) | 45.7 |
| Net interest income | 46.0 | — |

(ii) Unobservable inputs used in measuring fair value

The table below sets out information about significant unobservable inputs used at 31 December 2014 in measuring financial instruments categorised as level 3.

| Type of financial instrument | Fair value at 31 December 2014 £m | Value technique | Significant unobservable input | Range of estimates for unobservable input | Fair value measurement to unobservable inputs |
|---|---|---|---|---|---|
| Derivative financial instruments | 77.9 | Discounted cash flow | Expected prepayment rate of underlying mortgages | 25%-36% | Significant increases and decreases in expected prepayment rates of underlying mortgages will cause the fair value of derivative financial instruments to move favourably and unfavourably depending upon the timing of the cash flows |
| Amounts due to securitisation special purpose vehicles | (2,449.4) | Discounted cash flow | Expected prepayment rate of underlying mortgages | 25%-36% | Significant increases and decreases in expected prepayment rates of underlying mortgages will cause the fair value of amounts due to securitisation special purpose vehicles to move favourably and unfavourably depending upon the timing of the cash flows |

**Note 29: Fair value of financial assets and liabilities (continued)**

Expected prepayment rates of underlying mortgages are derived from historical prepayment trends, adjusted to reflect current expected prepayment behaviours.

(iii) The effect of unobservable inputs on fair value measurement

Although the Company believes that its estimates of fair values are appropriate, the use of different methodologies or assumptions could lead to different measurements of fair value. For fair value measurements in level 3, changing the expected prepayment rate to reasonably possible alternative rates would have the following impacts:

| **2014** | **Impact on profit or loss** | |
|---|---|---|
| | **25% increase in expected prepayment rate £m** | **25% decrease in expected prepayment rate £m** |
| **Derivative financial instruments** | **(2.2)** | **2.3** |
| **Amounts due to securitisation special purpose vehicles** | **2.3** | **(2.5)** |
| | **0.1** | **(0.2)** |

| 2013 | Impact on profit or loss | |
|---|---|---|
| | 25% increase in expected prepayment rate £m | 25% decrease in expected prepayment rate £m |
| Derivative financial instruments | (1.1) | 0.5 |
| Amounts due to securitisation special purpose vehicles | 0.5 | 0.2 |
| | **(0.6)** | **0.7** |

The favourable and unfavourable impacts of using reasonably possible expected prepayment rates for the valuation of derivative financial instruments and amounts due to securitisation special purpose entities have been recalculated by using unobservable expected prepayment rates 25% higher and lower than those used in the fair value calculation. Key inputs and assumptions used in the models at 31 December 2014 include an expected prepayment rate of 25% to 36% (2013: 23% to 44%), with reasonably possible alternative expected prepayments average rates in the range of 19% to 40% (2013: 18% to 49%).

**Note 30: Financial risk management**

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

**(1) Market risk**

The Company uses various market risk measures for risk reporting and setting risk appetite limits and triggers. These measures include Capital at Risk and Earnings at Risk.

**Note 30: Financial risk management (continued)**

A. Interest rate risk

Interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate movements and bear rates which may be varied at the Company's discretion. There is a significant proportion of deposits with contractually fixed rates for their term to maturity.

Many assets are sensitive to interest rate movements. There is a small volume of managed rate assets such as variable rate mortgages which may be considered as a partial offset to the interest rate risk arising from the managed rate liabilities. A significant proportion of the Company's mortgage assets bear interest rates which are contractually fixed for periods of up to five years or longer.

The Company establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Company is exposed to fair value interest rate risk on fixed rate customer loans, fixed rate customer deposits and to cash flow interest rate risk on variable rate loans and deposits.

At 31 December 2014 the aggregate notional principal of interest rate swaps designated as fair value hedges was £22,182.3 million (2013: £21,213.4 million) with a net fair value liability of £128.4 million (2013: asset of £43.5 million). The losses on the hedging instruments and the gains on the hedged items are shown in note 14.

In addition the Company has cash flow hedges which are primarily used to hedge retail pipeline lending. Note 14 shows when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2014 was £nil (2013: £732.5 million) with a net fair value liability of £nil (2013: asset of £2.4 million). Ineffectiveness recognised in the income statement that arises from cash flow hedges is shown in note 14.

**Note 30: Financial risk management (continued)**

The following tables give an analysis of the repricing periods of assets and liabilities on the balance sheet. Mismatches in the repricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in Capital at Risk and Earnings at Risk.

| 2014 Interest rate repricing mismatch of assets and liabilities[1] | Within 3 months £m | After 3 months and within 6 months £m | After 6 months and within 1 year £m | After 1 year and within 5 years £m | After 5 years £m | Non interest bearing instruments £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | 803.7 | — | — | — | — | 47.6 | 851.3 |
| Loans and receivables: | | | | | | | |
| Loans and advances to banks | 133.3 | — | — | — | — | 3.1 | 136.4 |
| Loans and advances to customers | 6,946.0 | 1,247.2 | 2,522.1 | 12,004.4 | 324.1 | 304.1 | 23,347.9 |
| Debt securities | 1,324.1 | — | — | 83.3 | — | — | 1,407.4 |
| Available-for-sale financial assets | 230.1 | — | 41.7 | 311.7 | 841.8 | 114.3 | 1,539.6 |
| Other assets | — | 106.5 | — | — | — | 305.7 | 412.2 |
| **Total assets** | 9,437.2 | 1,353.7 | 2,563.8 | 12,399.4 | 1,165.9 | 774.8 | 27,694.8 |
| **Liabilities** | | | | | | | |
| Deposits from banks | 845.5 | — | — | — | — | — | 845.5 |
| Customer deposits | 14,381.1 | 1,108.4 | 1,827.4 | 5,025.0 | 2.0 | 25.0 | 22,368.9 |
| Amounts due to securitisation special purpose vehicles | 1,138.7 | 136.8 | 226.3 | 1,206.0 | 59.1 | — | 2,766.9 |
| Other liabilities | — | — | — | — | — | 487.9 | 487.9 |
| Equity | — | — | — | — | — | 1,225.6 | 1,225.6 |
| **Total liabilities and equity** | 16,365.3 | 1,245.2 | 2,053.7 | 6,231.0 | 61.1 | 1,738.5 | 27,694.8 |
| Notional values of derivatives affecting interest rate sensitivity | 6,093.1 | 282.7 | (291.4) | (4,593.3) | (1,488.7) | (2.4) | — |
| **Total interest rate sensitivity gap** | (835.0) | 391.2 | 218.7 | 1,575.1 | (383.9) | (966.1) | — |
| **Cumulative interest rate sensitivity gap** | (835.0) | (443.8) | (225.1) | 1,350.0 | 966.1 | — | — |

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

**Note 30: Financial risk management (continued)**

| 2013<br>Interest rate repricing mismatch of assets and liabilities | Within 3 months £m | After 3 months and within 6 months £m | After 6 months and within 1 year £m | After 1 year and within 5 years £m | After 5 years £m | Non interest bearing instruments £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | 1,380.1 | — | — | — | — | 43.4 | 1,423.5 |
| Loans and receivables: | | | | | | | |
| Loans and advances to banks | 90.5 | — | — | — | — | 1.3 | 91.8 |
| Loans and advances to customers | 7,077.3 | 1,334.4 | 2,038.6 | 9,848.4 | 248.2 | 52.0 | 20,598.9 |
| Debt securities | 1,602.6 | — | — | — | — | — | 1,602.6 |
| Available-for-sale financial assets | 308.1 | 8.0 | 148.6 | 378.4 | 729.6 | 6.6 | 1,579.3 |
| Other assets | — | — | — | — | — | 452.4 | 452.4 |
| **Total assets** | **10,458.6** | **1,342.4** | **2,187.2** | **10,226.8** | **977.8** | **555.7** | **25,748.5** |
| **Liabilities** | | | | | | | |
| Deposits from banks | 382.2 | — | — | — | — | — | 382.2 |
| Customer deposits | 14,000.7 | 1,081.2 | 1,854.1 | 3,996.0 | 3.7 | 191.5 | 21,127.2 |
| Amounts due to securitisation special purpose vehicles | 1,162.4 | 298.0 | 356.6 | 773.6 | 88.0 | — | 2,678.6 |
| Other liabilities | — | — | — | — | — | 391.8 | 391.8 |
| Equity | — | — | — | — | — | 1,168.7 | 1,168.7 |
| **Total liabilities and equity** | **15,545.3** | **1,379.2** | **2,210.7** | **4,769.6** | **91.7** | **1,752.0** | **25,748.5** |
| Notional values of derivatives affecting interest rate sensitivity | 5,678.0 | 207.5 | 487.4 | (5,467.4) | (904.5) | (1.0) | — |
| **Total interest rate sensitivity gap** | **591.3** | **170.7** | **463.9** | **(10.2)** | **(18.4)** | **(1,197.3)** | **—** |
| **Cumulative interest rate sensitivity gap** | **591.3** | **762.0** | **1,225.9** | **1,215.7** | **1,197.3** | **—** | **—** |

The interest rate repricing table shown above reflects the contractual repricing of assets and liabilities. The movement between 2014 and 2013 repricing gaps is primarily due to increased use of core customer deposits and shareholder funds as natural offsets to matching the interest rate profile of fixed rate assets, particularly in the term bucket one to five years.

B. Currency risk

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than sterling as a result of banking activities. This includes maintaining liquid assets and wholesale funding. The Company has minimal appetite for foreign exchange risk. The Company does allow the purchase of liquid assets denominated in both US dollars and Euros within a well controlled limit framework.

**Note 30: Financial risk management (continued)**

At 31 December 2014 the Company had negligible net foreign exchange risk positions after taking into account foreign currency derivatives. The exposure to changes in exchange rates is minimised by using cross-currency swaps and forward foreign exchange contracts.

| Assets and liabilities in foreign currency at sterling carrying values | 2014 | | 2013 |
|---|---|---|---|
| | **US$ in £m** | **€ in £m** | € in £m |
| **Assets** | | | |
| Loans and advances to banks | — | — | 0.1 |
| Available-for-sale financial assets | — | **19.4** | 20.7 |
| Other assets | **0.1** | — | — |
| **Total assets** | **0.1** | **19.4** | **20.8** |
| **Liabilities** | | | |
| Other liabilities | **0.1** | — | — |
| **Total liabilities** | **0.1** | — | — |
| Notional value of derivatives affecting currency exposures | — | **19.5** | 20.8 |
| **Net position** | — | **(0.1)** | — |

**(2) Credit risk**

Credit risk appetite is set by the Board and is described and reported through a suite of metrics derived from accounting and credit portfolio performance measures. The Company uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral and using master netting agreements to permit the offset of exposures.

Loans and advances to customers comprise:

| **Loans and advances to customers** | **2014 £m** | 2013 £m |
|---|---|---|
| Advances secured on residential property not subject to securitisation | **15,620.5** | 14,299.0 |
| Advances secured on residential property subject to securitisation | **3,125.8** | 2,885.7 |
| | **18,746.3** | **17,184.7** |
| Residential buy to let loans not subject to securitisation | **3,134.3** | 2,368.1 |
| **Total loans and advances secured on residential property** | **21,880.6** | **19,552.8** |
| Impairment allowance- secured | **(7.6)** | (7.5) |
| **Loans and advances- secured** | **21,873.0** | **19,545.3** |
| Credit cards not subject to securitisation | **1,121.1*** | 808.6 |
| Overdrafts not subject to securitisation | **0.2** | 0.2 |
| **Total unsecured receivables not subject to securitisation** | **1,121.3** | **808.8** |
| Impairment allowance – unsecured | **(23.0)** | (27.1) |
| **Loans and advances- unsecured** | **1,098.3** | **781.7** |
| Amounts due from group companies | **249.8** | 252.6 |
| **Total loans and advances to customers excluding fair value of portfolio hedging** | **23,221.1** | **20,579.6** |

* of which £5.9 million relates to the fair value of expected losses on acquired assets

**Note 30: Financial risk management (continued)**

A. Maximum credit exposure

The maximum credit risk exposure of the Company in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held, other credit enhancements or provisions for impairment.

The maximum credit risk exposure for off-balance sheet items relates to applications that have been approved and have not yet been drawn by the customer and undrawn loan commitments (pipeline). These commitments represent agreements to lend in the future and can be cancelled unconditionally, subject to notice requirements.

| **2014 Maximum exposure to credit risk by credit quality** | **Low risk £m** | **Medium risk £m** | **Higher risk £m** | **Total exposures £m** | **Low risk %** | **Medium risk %** | **Higher risk %** |
|---|---|---|---|---|---|---|---|
| **On-balance sheet** | | | | | | | |
| **Wholesale** | | | | | | | |
| Cash and balances at central banks | **851.3** | **—** | **—** | **851.3** | **100.0** | **—** | **—** |
| Debt securities held as loans and receivables | **989.4** | **—** | **418.0** | **1,407.4** | **70.3** | **—** | **29.7** |
| Available-for-sale financial assets | **1,539.6** | **—** | **—** | **1,539.6** | **100.0** | **—** | **—** |
| Loans and advances to banks | **136.4** | **—** | **—** | **136.4** | **100.0** | **—** | **—** |
| Derivative financial instruments | **178.0** | **—** | **—** | **178.0** | **100.0** | **—** | **—** |
| Loans and advances to customers – amounts due from group companies | **249.8** | **—** | **—** | **249.8** | **100.0** | **—** | **—** |
| **Retail** | | | | | | | |
| Gross loans and advances to customers – secured[1] | **19,623.4** | **1,573.4** | **683.8** | **21,880.6** | **89.7** | **7.2** | **3.1** |
| Gross loans and advances to customers – unsecured | **1,091.4** | **2.5** | **27.4** | **1,121.3** | **97.4** | **0.2** | **2.4** |
| **Total on-balance sheet** | **24,659.3** | **1,575.9** | **1,129.2** | **27,364.4** | **90.1** | **5.8** | **4.1** |
| **Off-balance sheet** | | | | | | | |
| Loan commitments (pipeline and undrawn commitments) | **3,694.2** | **—** | **—** | **3,694.2** | **100.0** | **—** | **—** |

[1] The Company has amended its definition for high, medium and low categories of gross loans and advances to customers for the secured portfolio. Details of the new definition can be found on pages 85-86. The 2013 numbers have been restated to reflect this change.

### Note 30: Financial risk management (continued)

| 2013 Maximum exposure to credit risk by credit quality | Low risk £m | Medium risk £m | Higher risk £m | Total exposures £m | Low risk % | Medium risk % | Higher risk % |
|---|---|---|---|---|---|---|---|
| **On-balance sheet** | | | | | | | |
| **Wholesale** | | | | | | | |
| Cash and balances at central banks | 1,423.5 | — | — | 1,423.5 | 100.0 | — | — |
| Debt securities held as loans and receivables | 1,267.9 | — | 334.7 | 1,602.6 | 79.1 | — | 20.9 |
| Available-for-sale financial assets | 1,579.3 | — | — | 1,579.3 | 100.0 | — | — |
| Loans and advances to banks | 91.8 | — | — | 91.8 | 100.0 | — | — |
| Derivative financial instruments | 252.0 | — | — | 252.0 | 100.0 | — | — |
| Loans and advances to customers – amounts due from group companies | 252.6 | — | — | 252.6 | 100.0 | — | — |
| **Retail** | | | | | | | |
| Gross loans and advances to customers – secured[1] | 17,517.8 | 1,300.6 | 734.4 | 19,552.8 | 89.5 | 6.7 | 3.8 |
| Gross loans and advances to customers – unsecured | 779.0 | 3.2 | 26.6 | 808.8 | 96.3 | 0.4 | 3.3 |
| **Total on-balance sheet** | **23,163.9** | **1,303.8** | **1,095.7** | **25,563.4** | **90.6** | **5.1** | **4.3** |
| **Off-balance sheet** | | | | | | | |
| Loan commitments (pipeline and undrawn commitments) | 3,504.1 | — | — | 3,504.1 | 100.0 | — | — |

[1] The Company has amended its definition for high, medium and low categories of gross loans and advances to customers for the secured portfolio. Details of the new definition can be found on pages 85-86. The 2013 numbers have been restated to reflect this change.

## B. Credit risk concentration

### Retail secured credit concentration

Mortgage lending is provided to individuals based in the UK. The mortgage portfolio is geographically diversified across the UK as shown below.

| **Geographical concentration** | **2014 £m** | **%** | 2013 £m | % |
|---|---|---|---|---|
| East Anglia | **517.5** | **2.4** | 456.4 | 2.3 |
| East Midlands | **1,070.8** | **4.9** | 916.8 | 4.7 |
| North | **918.6** | **4.2** | 877.0 | 4.5 |
| Yorkshire & Humberside | **1,231.2** | **5.6** | 1,099.8 | 5.6 |
| North West | **1,651.0** | **7.5** | 1,470.7 | 7.5 |
| West Midlands | **1,077.5** | **4.9** | 946.7 | 4.8 |
| South West | **1,695.2** | **7.7** | 1,534.8 | 7.9 |
| South East | **5,175.4** | **23.7** | 4,616.9 | 23.6 |
| Greater London | **6,033.0** | **27.6** | 5,300.3 | 27.1 |
| Wales | **546.6** | **2.5** | 502.7 | 2.6 |
| Scotland | **1,615.2** | **7.4** | 1,558.4 | 8.0 |
| Northern Ireland | **347.7** | **1.6** | 269.6 | 1.4 |
| Other | **0.9** | **—** | 2.7 | — |
| **Total** | **21,880.6** | **100.0** | **19,552.8** | **100.0** |

**Note 30: Financial risk management (continued)**

Retail secured credit concentrations by loan size

| **Retail secured credit concentrations by loan size** | **2014** £m | **%** | 2013 £m | % |
|---|---|---|---|---|
| 0-£100k | **4,719.6** | **21.5** | 4,392.5 | 22.5 |
| £100k-£250k | **10,017.2** | **45.8** | 8,967.8 | 45.9 |
| £250k-£500k | **4,848.0** | **22.2** | 4,131.2 | 21.1 |
| £500k-£1m | **2,066.7** | **9.4** | 1,825.5 | 9.3 |
| £1m-£2.5m | **210.0** | **1.0** | 216.9 | 1.1 |
| >£2.5m | **19.1** | **0.1** | 18.9 | 0.1 |
| **Total** | **21,880.6** | **100.0** | **19,552.8** | **100.0** |

Retail secured credit concentrations by loan type

| **2014 Retail secured credit concentrations by loan type** | **Residential mortgage loans £m** | **%** | **Buy-to-let mortgage loans £m** | **%** | **Total £m** | **%** |
|---|---|---|---|---|---|---|
| Capital repayment | **12,703.6** | **67.7** | **556.7** | **17.7** | **13,260.3** | **60.6** |
| Part and part | **1,418.9** | **7.6** | **23.9** | **0.8** | **1,442.8** | **6.6** |
| Interest only | **4,623.8** | **24.7** | **2,553.7** | **81.5** | **7,177.5** | **32.8** |
| **Total** | **18,746.3** | **100.0** | **3,134.3** | **100.0** | **21,880.6** | **100.0** |

| 2013 Retail secured credit concentrations by loan type | Residential mortgage loans £m | % | Buy-to-let mortgage loans £m | % | Total £m | % |
|---|---|---|---|---|---|---|
| Capital repayment | 10,383.6 | 60.4 | 393.7 | 16.6 | 10,777.3 | 55.1 |
| Part and part | 1,580.3 | 9.2 | 20.8 | 0.9 | 1,601.1 | 8.2 |
| Interest only | 5,220.8 | 30.4 | 1,953.6 | 82.5 | 7,174.4 | 36.7 |
| **Total** | **17,184.7** | **100.0** | **2,368.1** | **100.0** | **19,552.8** | **100.0** |

**Note 30: Financial risk management (continued)**

Loan to value (LTV)

The table below shows the profile of the retail secured portfolio in terms of Indexed LTV – current outstanding balance compared to the current property value.

| **Retail secured loan to value LTV (%) – indexed value at financial year end** | **2014** £m | **%** | 2013 £m | % |
|---|---|---|---|---|
| <50% | **7,157.3** | **32.7** | 4,614.8 | 23.6 |
| 50%-<60% | **5,624.4** | **25.7** | 3,886.4 | 19.9 |
| 60%-<70% | **4,971.3** | **22.7** | 5,711.6 | 29.2 |
| 70%-<80% | **2,858.9** | **13.1** | 3,601.3 | 18.4 |
| 80%-<90% | **1,068.9** | **4.9** | 1,547.0 | 7.9 |
| 90%-<100% | **183.1** | **0.8** | 141.1 | 0.7 |
| >100% | **16.7** | **0.1** | 50.6 | 0.3 |
| **Total** | **21,880.6** | **100.0** | **19,552.8** | **100.0** |

| | **2014** | 2013 |
|---|---|---|
| Average loan to value of stock – indexed[1] | **55.7** | 59.8 |
| Average loan to value of new business[1] | **66.9** | 65.4 |

[1] The average loan to value of stock and new business is balance weighted.

C. Credit quality of assets

Loans and receivables

Virgin Money defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures. These are based on the following criteria for the different credit risk exposure types.

Secured credit exposures are segmented according to the credit quality classification (detailed on page 86) and a point in time probability of default (PD). The point in time PD is an internal parameter used within our Advanced Internal Ratings Based (AIRB) capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where a borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan.

Exposures are categorised as:

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

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

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

Unsecured exposures are categorised as:

– higher risk where assets are past due;

**Note 30: Financial risk management (continued)**

- medium risk where assets are currently not past due and benefiting from a forbearance solution; and
- low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. All of Virgin Money's wholesale exposures are investment grade and therefore classified as low risk with the exception of debt securities reported as high risk, which relate to retained subordinated notes of Gosforth Funding Residential Mortgage-Backed Securities (RMBS) debt issuances sponsored by the Company.

No wholesale credit exposures are past due or impaired as at 31 December 2014 or 2013.

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

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

**Note 30: Financial risk management (continued)**

Less than 0.1% of the secured portfolio relates to expired term loan balances, with the average balance of these loans around £63,000 and an average LTV of 22%.

| **2014 Gross loans and advances to customers by credit quality** | **Secured Residential mortgage loans £m** | **%** | **Secured Residential buy-to-let mortgage loans £m** | **%** | **Unsecured Credit cards[2] £m** | **%** | **Unsecured Overdrafts £m** | **%** | **Total £m** | **%** |
|---|---|---|---|---|---|---|---|---|---|---|
| Neither past due nor impaired | **18,495.0** | **98.6** | **3,109.1** | **99.2** | **1,093.7** | **97.6** | **0.2** | **100.0** | **22,698.0** | **98.6** |
| – *of which in receipt of forbearance*[1] | *241.5* | *1.3* | *7.2* | *0.2* | *2.5* | *0.2* | — | — | *251.2* | *1.1* |
| Past due and not impaired | **182.5** | **1.0** | **17.6** | **0.6** | **—** | **—** | **—** | **—** | **200.1** | **0.9** |
| Impaired | **68.8** | **0.4** | **7.6** | **0.2** | **27.4** | **2.4** | **—** | **—** | **103.8** | **0.5** |
| **Total** | **18,746.3** | **100.0** | **3,134.3** | **100.0** | **1,121.1** | **100.0** | **0.2** | **100.0** | **23,001.9** | **100.0** |

[1] This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation.
[2] A fair value adjustment of £5.9m was made to the value of gross loans and advances in order to take account of expected losses incurred on purchased assets.

| 2013 Gross loans and advances to customers by credit quality | Secured Residential mortgage loans £m | % | Secured Residential buy-to-let mortgage loans £m | % | Unsecured Credit cards £m | % | Unsecured Overdrafts £m | % | Total £m | % |
|---|---|---|---|---|---|---|---|---|---|---|
| Neither past due nor impaired | 16,911.3 | 98.4 | 2,342.3 | 98.9 | 782.0 | 96.7 | 0.2 | 100.0 | 20,035.8 | 98.4 |
| – *of which in receipt of forbearance*[1,2] | *285.6* | *1.7* | *7.9* | *0.3* | *3.2* | *0.4* | — | — | *296.7* | *1.5* |
| Past due and not impaired | 170.8 | 1.0 | 17.4 | 0.7 | — | — | — | — | 188.2 | 0.9 |
| Impaired | 102.6 | 0.6 | 8.4 | 0.4 | 26.6 | 3.3 | — | — | 137.6 | 0.7 |
| **Total** | **17,184.7** | **100.0** | **2,368.1** | **100.0** | **808.6** | **100.0** | **0.2** | **100.0** | **20,361.6** | **100.0** |

[1] This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation.
[2] The Company has amended the approach to forbearance and impairment in line with FCA guidance as outlined on page 101. Loans in receipt of forbearance have been restated for 2013 comparatives to reflect the change in definition.

The criteria that the Company use to determine that there is objective evidence of an impairment loss are disclosed in Accounting policy 1.7.6. All loans where specific circumstances indicate that a loss is likely to be incurred, for example mortgage accounts which have entered possession or loans where fraud has been confirmed, are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

**Note 30: Financial risk management (continued)**

The table below shows the reconciliation of retail impairment losses during the year.

| **2014 Impairment provisions on loans and advances** | **Secured** | | **Unsecured** | | |
|---|---|---|---|---|---|
| | **On advances secured on residential property £m** | **On advances secured on residential buy-to-let property £m** | **Credit cards £m** | **Overdrafts £m** | **Total £m** |
| As at 1 January 2014 | **6.9** | **0.6** | **27.0** | **0.1** | **34.6** |
| Increase in allowances during the year net of recoveries reflected in the income statement | **0.3** | **0.9** | **14.6** | **—** | **15.8** |
| Amounts written off during the year | **(1.0)** | **(0.1)** | **(9.8)** | **—** | **(10.9)** |
| Debt sale recovery | **—** | **—** | **(8.9)** | **—** | **(8.9)** |
| **As at 31 December 2014** | **6.2** | **1.4** | **22.9** | **0.1** | **30.6** |

| 2013 Impairment provisions on loans and advances | Secured | | Unsecured | | |
|---|---|---|---|---|---|
| | On advances secured on residential property £m | On advances secured on residential buy-to-let property £m | Credit cards £m | Overdrafts £m | Total £m |
| As at 1 January 2013 | 7.2 | 0.5 | — | 0.1 | 7.8 |
| Increase in allowances during the year net of recoveries reflected in the income statement | 1.4 | 0.7 | 48.6 | — | 50.7 |
| Amounts written off during the year | (1.7) | (0.6) | (21.6) | — | (23.9) |
| **As at 31 December 2013** | **6.9** | **0.6** | **27.0** | **0.1** | **34.6** |

**Note 30: Financial risk management (continued)**

Loans and advances which are neither past due nor impaired

The table below shows the details of the credit quality of assets that are neither past due nor impaired, as shown in the gross secured loans and advances to customers by credit quality table on page 87.

| **2014 Credit quality for neither past due nor impaired loans[1]** | **Residential mortgage loans** | | **Residential buy-to-let mortgage loans** | | **Total** | |
|---|---|---|---|---|---|---|
| | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| PD by internal ratings | | | | | | |
| Low risk | **16,586.1** | **89.7** | **3,037.3** | **97.6** | **19,623.4** | **90.8** |
| Medium risk | **1,506.4** | **8.1** | **67.0** | **2.2** | **1,573.4** | **7.3** |
| Higher risk | **402.5** | **2.2** | **4.8** | **0.2** | **407.3** | **1.9** |
| **Total neither past due nor impaired** | **18,495.0** | **100.0** | **3,109.1** | **100.0** | **21,604.1** | **100.0** |

| 2013 Credit quality for neither past due nor impaired loans[1] | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| PD by internal ratings | | | | | | |
| Low risk | 15,232.6 | 90.0 | 2,285.2 | 97.5 | 17,517.8 | 90.9 |
| Medium risk | 1,245.4 | 7.4 | 55.2 | 2.4 | 1,300.6 | 6.8 |
| Higher risk | 433.3 | 2.6 | 1.9 | 0.1 | 435.2 | 2.3 |
| **Total neither past due nor impaired** | **16,911.3** | **100.0** | **2,342.3** | **100.0** | **19,253.6** | **100.0** |

[1] The Company has amended its definition for high, medium and low risk categories of gross loans and advances to customers for the secured portfolio. Details of the new definitions can be found on pages 85-86. The 2013 comparatives have been restated to reflect this change.
[2] The Company changed its approach to the categorisation of impairment during 2014. As a result of this change, the 2013 comparatives have been restated.

**Note 30: Financial risk management (continued)**

Loans and advances which are past due and not impaired

Mortgages past due and not impaired can also be analysed by overdue term as shown below. These assets represent 0.9% of secured balances (2013: 1.0%).

| **2014 Past due and not impaired loans[1]** | **Residential mortgage loans** | | **Residential buy-to-let mortgage loans** | | **Total** | |
|---|---|---|---|---|---|---|
| | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| Up to one month | **59.3** | **32.5** | **5.2** | **29.5** | **64.5** | **32.2** |
| One to three months | **72.0** | **39.5** | **8.2** | **46.6** | **80.2** | **40.1** |
| Three to six months | **29.6** | **16.2** | **2.6** | **14.8** | **32.2** | **16.1** |
| Over six months | **21.6** | **11.8** | **1.6** | **9.1** | **23.2** | **11.6** |
| **Total past due and not impaired** | **182.5** | **100.0** | **17.6** | **100.0** | **200.1** | **100.0** |

[1] Assets categorised as past due and not impaired are those where the expected recoverable amount exceeds the carrying amount.

| 2013 Past due and not impaired loans[1] | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| Up to one month | 55.7 | 32.6 | 3.9 | 22.4 | 59.6 | 31.7 |
| One to three months | 68.9 | 40.4 | 10.0 | 57.5 | 78.9 | 41.9 |
| Three to six months | 25.7 | 15.0 | 1.6 | 9.2 | 27.3 | 14.5 |
| Over six months | 20.5 | 12.0 | 1.9 | 10.9 | 22.4 | 11.9 |
| **Total past due and not impaired** | **170.8** | **100.0** | **17.4** | **100.0** | **188.2** | **100.0** |

[1] The Company changed its approach to the categorisation of impairment during 2014. As a result of this change, the 2013 comparatives have been restated.

**Note 30: Financial risk management (continued)**

The table below reconciles the movement throughout the year of all impaired secured and unsecured loans. The balance shown represents the entire financial asset rather than just the overdue elements.

| **2014 Reconciliation of impaired loans** | **Secured** | | **Unsecured** | |
|---|---|---|---|---|
| | **Residential mortgage loans £m** | **Residential buy-to-let mortgage loans £m** | **Credit cards £m** | **Total £m** |
| As at 1 January 2014 | **102.6** | **8.4** | **26.6** | **137.6** |
| Classified as impaired during the year | **121.6** | **14.5** | **77.0** | **213.1** |
| Transferred from impaired to unimpaired | **(136.3)** | **(13.7)** | **(39.4)** | **(189.4)** |
| Amounts written off | **(1.0)** | **(0.1)** | **(32.7)** | **(33.8)** |
| Repayments | **(18.1)** | **(1.5)** | **(4.1)** | **(23.7)** |
| **As at 31 December 2014** | **68.8** | **7.6** | **27.4** | **103.8** |

| 2013 Reconciliation of impaired loans[1] | Secured | | Unsecured | |
|---|---|---|---|---|
| | Residential mortgage loans £m | Residential buy-to-let mortgage loans £m | Credit cards £m | Total £m |
| As at 1 January 2013 | 150.0 | 13.0 | — | 163.0 |
| Classified as impaired during the year | 157.5 | 22.0 | 93.8 | 273.3 |
| Transferred from impaired to unimpaired | (186.1) | (25.6) | (36.8) | (248.5) |
| Amounts written off | (1.7) | (0.6) | (21.5) | (23.8) |
| Repayments | (17.1) | (0.4) | (8.9) | (26.4) |
| **As at 31 December 2013** | **102.6** | **8.4** | **26.6** | **137.6** |

[1] The Company changed its approach to the categorisation of impairment during 2014. As a result of this change, the 2013 comparatives have been restated.

**Note 30: Financial risk management (continued)**

Details of the Company's impaired assets and provisions are provided in the table below:

| **2014 Impaired assets and impairment provisions** | **Gross balances £m** | **Impaired balances £m** | **Impaired balances as a % of gross balances %** | **Impairment provisions £m** | **Impairment provisions as a % of impaired balances[1] %** |
|---|---|---|---|---|---|
| Residential mortgage loans | **18,746.3** | **68.8** | **0.4** | **6.2** | **9.0** |
| Residential buy-to-let mortgage loans | **3,134.3** | **7.6** | **0.2** | **1.4** | **18.4** |
| **Total secured** | **21,880.6** | **76.4** | **0.3** | **7.6** | **9.9** |
| Credit cards[2] | **1,121.1** | **27.4** | **2.4** | **22.9** | **83.6** |
| Overdrafts | **0.2** | **—** | **—** | **0.1** | **—** |
| **Total unsecured** | **1,121.3** | **27.4** | **2.4** | **23.0** | **83.9** |
| **Total** | **23,001.9** | **103.8** | **0.5** | **30.6** | **29.5** |

[1] The increase in the buy-to-let impairment provision as a percentage of impaired balances, from 2013 to 2014, has been driven by the reassessment of property values in a small number of cases.
[2] A fair value adjustment of £5.9m was made to the purchase price to take account of expected losses on these assets. These losses therefore do not appear as part of the impairment provision total as at December 2014, with only losses incurred after purchase being charged.

| 2013 Impaired assets and impairment provisions[1] | Gross balances £m | Impaired balances £m | Impaired balances as a % of gross balances % | Impairment provisions £m | Impairment provisions as a % of impaired balances % |
|---|---|---|---|---|---|
| Residential mortgage loans | 17,184.7 | 102.6 | 0.6 | 6.9 | 6.7 |
| Residential buy-to-let mortgage loans | 2,368.1 | 8.4 | 0.4 | 0.6 | 7.1 |
| **Total secured** | **19,552.8** | **111.0** | **0.6** | **7.5** | **6.8** |
| Credit cards | 808.6 | 26.6 | 3.3 | 27.0 | 101.5 |
| Overdrafts | 0.2 | — | — | 0.1 | — |
| **Total unsecured** | **808.8** | **26.6** | **3.3** | **27.1** | **101.9** |
| **Total** | **20,361.6** | **137.6** | **0.7** | **34.6** | **25.1** |

[1] The Company changed its approach to the categorisation of impairment during 2014. As a result of this change, the 2013 comparatives have been restated.

**Note 30: Financial risk management (continued)**

Impaired assets by overdue term

| **2014 Impaired assets by overdue term and possession status – secured** | **Residential mortgage loans** | | **Residential buy-to-let mortgage loans** | | **Total** | |
|---|---|---|---|---|---|---|
| | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| Up to one month | **44.0** | **63.9** | **4.0** | **52.7** | **48.0** | **62.8** |
| One to three months | **10.3** | **15.0** | **2.3** | **30.3** | **12.6** | **16.5** |
| Three to six months | **4.5** | **6.5** | **0.3** | **3.9** | **4.8** | **6.3** |
| Over six months | **9.0** | **13.1** | **0.7** | **9.2** | **9.7** | **12.7** |
| Possession | **1.0** | **1.5** | **0.3** | **3.9** | **1.3** | **1.7** |
| **Total impaired assets** | **68.8** | **100.0** | **7.6** | **100.0** | **76.4** | **100.0** |

| 2013 Impaired assets by overdue term and possession status – secured[1] | Residential mortgage loans | | Residential buy-to-let mortgage loans | | Total | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| Up to one month | 50.4 | 49.2 | 4.8 | 57.1 | 55.2 | 49.8 |
| In one to three months | 23.4 | 22.8 | 2.5 | 29.8 | 25.9 | 23.3 |
| In three to six months | 11.0 | 10.7 | 0.4 | 4.8 | 11.4 | 10.3 |
| Over six months | 15.0 | 14.6 | 0.7 | 8.3 | 15.7 | 14.1 |
| Possession | 2.8 | 2.7 | — | — | 2.8 | 2.5 |
| **Total impaired assets** | **102.6** | **100.0** | **8.4** | **100.0** | **111.0** | **100.0** |

[1] The Company changed its approach to the categorisation of impairment during 2014. As a result of this change, the 2013 comparatives have been restated.

**Note 30: Financial risk management (continued)**

| **2014**<br>**Impaired assets by overdue term – unsecured** | **£m** | **%** |
|---|---|---|
| **Credit cards** | | |
| Up to one month | **11.0** | **40.1** |
| One to three months | **8.0** | **29.2** |
| Three to six months | **8.4** | **30.7** |
| Over six months | **—** | **—** |
| **Total** | **27.4** | **100.0** |

| 2013<br>Impaired assets by overdue term – unsecured | £m | % |
|---|---|---|
| Credit cards | | |
| Up to one month | 10.1 | 38.0 |
| One to three months | 7.4 | 27.8 |
| Three to six months | 9.1 | 34.2 |
| Over six months | — | — |
| **Total** | **26.6** | **100.0** |

D. Wholesale Credit Risk

| **Wholesale credit exposures** | **2014**<br>**£m** | 2013<br>£m |
|---|---|---|
| Loans and advances to banks excluding Bank of England | **136.4** | 91.8 |
| Bank of England | **851.3** | 1,423.5 |
| Debt securities held as loans and receivables | **1,407.4** | 1,602.6 |
| Available-for-sale financial assets | **1,539.6** | 1,579.3 |
| Gross positive fair value of derivative contracts | **178.0** | 252.0 |
| Loans and advances to customers – amounts due from group companies | **249.8** | 252.6 |
| **Total** | **4,362.5** | **5,201.8** |

The Company's wholesale credit risk exposures reduced primarily to fund the growth in new loans and advances to customers.

During 2014 the wholesale credit risk framework was enhanced to provide more capacity for covered bonds to form part of Virgin Money's liquidity portfolio. This resulted in an increase in covered bonds from £46.1million at December 2013 to £225.7 million at December 2014. This reflects the upcoming introduction of the Liquidity Coverage Requirement regime, which recognises these instruments as liquid assets available to meet net outflows in a stress event.

**Note 30: Financial risk management (continued)**

At December 2014 the single largest exposure to any single counterparty which is not a sovereign, a supranational or a Gosforth Funding securitisation vehicle obligor was £104.4 million (2013: £59.2 million). These exposures were to large universal banks.

| **Loans and advances to banks excluding Bank of England** | **2014 £m** | 2013[1] £m |
|---|---|---|
| AA- | **15.3** | 8.6 |
| A+ | **15.8** | — |
| A | **61.7** | 46.4 |
| A- | **6.6** | 36.8 |
| BBB+ | **37.0** | — |
| **Total** | **136.4** | **91.8** |

[1] Values in this table as at 31 December 2013 have been re-stated following a review of the approach applied. The re-stated 31 December 2013 classification of credit quality is based on the rating of the Company's counterparties, rather than that of the counterparties ultimate parent entity.

The Company's exposure to the Bank of England was £851.3 million and £1,423.5 million as at year end 2014 and 2013, respectively. These exposures were rated AA+ at both respective dates.

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Debt securities held as loans and receivables £m** | **Available-for-sale financial assets £m** | Debt securities held as loans and receivables £m | Available-for-sale financial assets £m |
| UK sovereign exposures | **—** | **795.0** | — | 646.2 |
| Non-domestic sovereign exposures | **—** | **—** | — | 100.1 |
| Supranational | **—** | **310.7** | — | 420.6 |
| Residential mortgage-backed securities | **11.1** | **62.9** | 12.0 | 86.5 |
| Covered bonds | **—** | **265.7** | — | 46.1 |
| Debt securities issued by banks | **—** | **105.3** | — | 279.8 |
| Securities issued by other Group companies | **1,396.3** | **—** | 1,590.6 | — |
| **Total** | **1,407.4** | **1,539.6** | **1,602.6** | **1,579.3** |

| **Credit rating on debt securities held as loans and receivables and available-for-sale financial assets** | **2014 £m** | 2013 £m |
|---|---|---|
| AAA | **1,272.5** | 2,319.9 |
| AA+ | **978.2** | 139.1 |
| AA | **214.2** | 158.6 |
| AA- | **20.9** | 138.5 |
| A+ | **34.2** | 58.1 |
| A | **—** | 24.0 |
| A- | **9.0** | 9.0 |
| Not rated | **418.0** | 334.7 |
| **Total** | **2,947.0** | **3,181.9** |

**Note 30: Financial risk management (continued)**

The changes to debt securities reflect the alignment of the Company's liquid asset portfolio to the evolving regulatory definition of high quality liquid assets. Debt securities reported as 'Not rated' relate to the retained subordinated notes of Gosforth Funding RMBS debt issuances sponsored by the Company.

| **Exposures by country** | **2014 £m** | 2013[1] £m |
|---|---|---|
| Australia | **39.9** | 133.8 |
| Finland | **—** | 100.1 |
| France | **14.9** | 7.5 |
| UK | **3,896.7** | 4,380.6 |
| *of which UK Banks and Building Societies* | ***407.9*** | *307.6* |
| Germany | **6.6** | 21.5 |
| Netherlands | **84.4** | 115.7 |
| USA | **9.3** | 22.0 |
| Supranational | **310.7** | 420.6 |
| **Total** | **4,362.5** | **5,201.8** |

[1] Values in this table as at 31 December 2013 have been restated following a review of the approach to geographic reporting. The restated 31 December 2013 classification of geography is based on the country of domicile of Virgin Money's counterparties, rather than that of the counterparties' ultimate parent entity.

E. Derivative financial instruments

An analysis of derivative assets is given in note 14. The Company reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Company's maximum credit risk relating to derivative assets of £178.0 million (2013: £252.0 million), cash collateral of £10.2 million (2013: £78.7 million) was held.

Virgin Money measures exposure in over the counter (OTC) derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, IFRS 7 requires that they are represented on the balance sheet on a gross basis. Contracts with positive fair value are disclosed as assets in the balance sheet under 'derivative financial instruments', those with negative fair value are disclosed as liabilities under the same title.

**Note 30: Financial risk management (continued)**

Collateral received is shown as deposits by banks, with collateral posted shown as loans and advances to banks (refer note 15). The notes to the financial statements provide further information on collateral.

| **OTC derivative exposures** | **2014 (unaudited) £m** | 2013 (unaudited) £m |
|---|---|---|
| Gross positive fair value of derivative contracts | **178.0** | 252.0 |
| Netting with gross negative fair value of derivative contracts[1] | **(89.9)** | (103.5) |
| Potential future incremental exposure | **48.0** | 61.9 |
| Collateral received | **(10.2)** | (78.7) |
| **Net OTC derivative exposures** | **125.9** | **131.7** |

| **OTC derivative liabilities** | **2014 (unaudited) £m** | 2013 (unaudited) £m |
|---|---|---|
| Gross negative fair value of derivative contracts | **(222.8)** | (140.2) |
| Netting with gross positive fair value of derivative contracts | **89.9** | 103.5 |
| Collateral pledged | **111.6** | 35.7 |
| **Net OTC derivative liability** | **(21.3)** | **(1.0)** |

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

The only netting agreements in place are in relation to derivative financial instruments.

The table below provides credit quality analysis of the gross OTC derivative exposures by counterparty credit rating of the counterparties.

| **Gross OTC derivative exposures by credit rating** | **2014 £m** | **%** | 2013[1] £m | % |
|---|---|---|---|---|
| AA- | **33.6** | **18.9** | 43.4 | 17.2 |
| A+ | **9.6** | **5.4** | 22.1 | 8.8 |
| A | **42.2** | **23.7** | 103.6 | 41.1 |
| A- | **11.2** | **6.3** | 18.2 | 7.2 |
| BBB+ | **3.5** | **1.9** | — | — |
| Not rated | **77.9** | **43.8** | 64.7 | 25.7 |
| **Total** | **178.0** | **100.0** | **252.0** | **100.0** |

[1] Values in this table as at 31 December 2013 have been restated following a review of the approach applied. The restated 31 December 2013 classification of credit quality is based on the rating of the Company's counterparties, rather than that of the counterparties' ultimate parent entity.

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

**Note 30: Financial risk management (continued)**

F. Collateral held as security for financial assets

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

Loans and receivables to customers

The Company holds collateral in respect of loans and advances to customers as set out below. The Company does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

| **2014 Fair value of collateral against secured loans – capped at loan value**[1] | **Residential mortgage loans £m** | **%** | **Residential buy-to-let mortgage loans £m** | **%** | **Total £m** | **%** |
|---|---|---|---|---|---|---|
| Neither past due nor impaired | **18,493.5** | **100.0** | **3,109.0** | **100.0** | **21,602.5** | **100.0** |
| – *of which in receipt of forbearance* | ***241.5*** | ***100.0*** | ***7.2*** | ***100.0*** | ***248.7*** | ***100.0*** |
| Past due and not impaired | **182.5** | **100.0** | **17.6** | **100.0** | **200.1** | **100.0** |
| Impaired | **68.4** | **99.4** | **7.6** | **100.0** | **76.0** | **99.5** |
| – *of which in possession* | ***1.0*** | ***100.0*** | ***0.3*** | ***100.0*** | ***1.3*** | ***100.0*** |
| **Total** | **18,744.4** | **100.0** | **3,134.2** | **100.0** | **21,878.6** | **100.0** |

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

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

| 2013 Fair value of collateral against secured loans – capped at loan value[1] | Residential mortgage loans £m | % | Residential buy-to-let mortgage loans £m | % | Total £m | % |
|---|---|---|---|---|---|---|
| Neither past due nor impaired | 16,906.2 | 100.0 | 2,341.7 | 100.0 | 19,247.9 | 100.0 |
| – *of which in receipt of forbearance* | *285.4* | 99.9 | *7.9* | *100.0* | *293.3* | 99.9 |
| Past due and not impaired | 170.8 | 100.0 | 17.4 | 100.0 | 188.2 | 100.0 |
| Impaired | 101.4 | 98.8 | 8.4 | 100.0 | 109.8 | 98.9 |
| – *of which in possession* | *2.7* | *96.4* | — | *100.0* | *2.7* | *96.4* |
| **Total** | **17,178.4** | **100.0** | **2,367.5** | **100.0** | **19,545.9** | **100.0** |

[1] The Company has amended the approach to forbearance and impairment in line with FCA guidance as outlined on page 101. Loans in receipt of forbearance have been restated for 2013 comparatives to reflect the change in definition.

**Note 30: Financial risk management (continued)**

| **2014 Negative equity on secured loans** | **Residential mortgage loans £m** | **Residential buy-to-let mortgage loans £m** | **Total £m** |
|---|---|---|---|
| Neither past due nor impaired | **1.5** | **0.1** | **1.6** |
| – *of which in receipt of forbearance* | **—** | **—** | **—** |
| Past due and not impaired | **—** | **—** | **—** |
| Impaired | **0.4** | **—** | **0.4** |
| – *of which in possession* | **—** | **—** | **—** |
| **Total** | **1.9** | **0.1** | **2.0** |

| 2013 Negative equity on secured loans | Residential mortgage loans £m | Residential buy-to-let mortgage loans £m | Total £m |
|---|---|---|---|
| Neither past due nor impaired | 5.1 | 0.6 | 5.7 |
| – *of which in receipt of forbearance* | *0.2* | — | *0.2* |
| Past due and not impaired | — | — | — |
| Impaired | 1.2 | — | 1.2 |
| – *of which in possession* | *0.1* | — | *0.1* |
| **Total** | **6.3** | **0.6** | **6.9** |

The basis of preparation for the four tables above is not comparable with balances shown in the gross secured loans and advances to customers by credit quality table on page 87, as negative equity has been calculated excluding the impact of the Company's effective interest rate asset.

The proportion of secured balances in negative equity has reduced to 0.1% in 2014 (2013: 0.3%). This relates to £16.7 million of asset balances in the mortgage portfolio that are exposed to negative equity (2013: £50.6 million). The amount of negative equity has decreased from £6.9 million in 2013 to £2.0 million as at 31 December 2014 as a result of positive house price index movements.

Loans and advances to banks

The Company requires collateral posting arrangements to be in place as part of entering into a derivative transaction with another bank, depending on the type of financial product and the counterparty involved, and netting arrangements are obtained. The Company's derivative exposures to Gosforth Funding securitisation special purpose vehicles are an exception to collateral requirements.

Other

No collateral is held in respect of retail credit cards or overdrafts.

**Note 30: Financial risk management (continued)**

G. Collateral repossessed

Virgin Money works with customers who have difficulty paying their mortgages, and will only repossess a property when all other possibilities have been exhausted. Where accounts have been repossessed, the Company will obtain the best price that might reasonably be paid taking into account factors such as property and market conditions. The Company uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

| **Possessions as a percentage of total book (number of properties)** | **2014 Number** | **%** | 2013 Number | % |
|---|---|---|---|---|
| Properties in possession | **18** | **0.01** | 17 | 0.01 |
| CML industry average[1] | **6,400** | **0.06** | 8,400 | 0.08 |

[1] CML possession as at Q4 2014. The CML industry average includes banks with portfolios significantly larger than Virgin Money plc that drive up the industry average.

H. Debt management for customers in financial difficulty

The Company operates a number of treatments to assist borrowers who are experiencing financial stress. Further details relating to those cases where the Company has granted a concession, whether temporarily or permanently, are set out below.

Retail customers – Forbearance activities

The Company classifies the treatments offered to retail customers who have experienced financial difficulty into the following categories:

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

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

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

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

Customers receiving support from UK Government sponsored programmes

The Company participates in a UK Government sponsored programme designed to support households (Income Support for Mortgage Interest). Where this scheme provides borrowers with a state benefit that is used to service the loan, there is no change in the reported status of the loan which is managed and reported in accordance with its original terms.

**Note 30: Financial risk management (continued)**

The Company assesses whether a loan benefitting from a UK Government sponsored programme is impaired using the same accounting policies and practices as it does for loans not benefitting from such a programme. Loans included within the Income Support for Mortgage Interest scheme may be impaired, in accordance with the normal definition of impairment.

Customers in financial difficulty receiving support under other schemes

The Company measures the success of a forbearance scheme based upon the proportion of customers maintaining or improving their arrears position over the 12 months following the exit from a forbearance treatment. For temporary treatments, 56% of customers accepting reduced payment arrangements have remained within contractual terms following the end of their treatment and are either fully up to date or had redeemed their loan. For permanent treatments 81% of customers who have accepted interest only concessions, 88% of customers who have had a discretionary payment holiday and 94% of customers who have accepted term extensions have remained within contractual terms following the end of their treatments.

Forbearance identification and classification

The Company has applied revised forbearance definitions based upon FCA guidance. As a result of this, forbearance data for 2013 has been restated to reflect the new definitions. The restated data for 2013 shows overall forbearance balances to be lower than previous financial statements as the balances now exclude accounts with expired terms as this is not a solution offered to customers. All expired term balances will be categorised as impaired assets in line with the definitions detailed on page 86.

The Company classifies a retail account as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty. Where the treatment involves a permanent change to the contractual basis of the customer's account such as conversion to interest only or term extension, the Company classifies the balance as forborne for a period of 12 months, after which no distinction is made between these accounts and others where no change has been made.

Secured retail lending

At 31 December 2014, retail secured loans and advances currently or recently subject to forbearance were £267.3 million (2013: £320.4 million) of total retail secured loans and advances.

Collective impairment assessment of retail secured loans subject to forbearance

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

The Company's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Company uses

**Note 30: Financial risk management (continued)**

sophisticated behavioural scoring to assess customers' credit risk. The underlying behavioural scorecards consider many different characteristics of customer behaviour, both static and dynamic, from internal sources and also from credit bureau data, including characteristics that may identify when a customer has been in arrears on products held with other firms. Hence, these models take a range of potential indicators of customer financial distress into account.

The performance of provision models is monitored and challenged on an ongoing basis, in line with the Retail Credit Provisioning Policy. The models are also regularly recalibrated to reflect up to date customer behaviour and market conditions. Specifically, regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected. Where this is not the case, additional provisions are applied to capture the risk.

Unsecured retail lending

At 31 December 2014, total retail unsecured loans and advances benefitting from forbearance totalled £3.3 million (2013: £4.3 million).

Collective impairment assessment of retail unsecured loans and advances subject to forbearance

Credit risk provisioning for the retail unsecured portfolio is undertaken on a collective basis, except for fraud cases which are fully provided for. The approach used is based on roll rates for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge-off given default.

The outputs of the models are monitored and challenged on an ongoing basis. The models are run monthly meaning that current market conditions and customer processes are reflected in the output. Where the risks identified are not captured in the underlying models, appropriate additional provisions are made.

**Note 30: Financial risk management (continued)**

| 2014 Forbearance stock | Neither past due nor impaired £m | % | Past due not impaired £m | % | Impaired £m | % | Total £m | % |
|---|---|---|---|---|---|---|---|---|
| **Secured** | | | | | | | | |
| Payment arrangement | **2.8** | **1.1** | **0.4** | **2.4** | **0.1** | **4.8** | **3.3** | **1.2** |
| Transfer to interest only | **19.7** | **7.9** | **8.6** | **52.2** | **0.6** | **28.6** | **28.9** | **10.8** |
| Term extension | **162.4** | **65.3** | **4.0** | **24.2** | **0.9** | **42.8** | **167.3** | **62.6** |
| Payment holiday | **63.8** | **25.7** | **3.5** | **21.2** | **0.5** | **23.8** | **67.8** | **25.4** |
| **Total secured forbearance** | **248.7** | **100.0** | **16.5** | **100.0** | **2.1** | **100.0** | **267.3** | **100.0** |
| **Unsecured** | | | | | | | | |
| Accounts where the customer has been approved on a repayment plan | **2.5** | **100.0** | **—** | **—** | **0.8** | **100.0** | **3.3** | **100.0** |
| **Total unsecured forbearance** | **2.5** | **100.0** | **—** | **—** | **0.8** | **100.0** | **3.3** | **100.0** |
| **Total forbearance** | **251.2** | **100.0** | **16.5** | **100.0** | **2.9** | **100.0** | **270.6** | **100.0** |

**Note 30: Financial risk management (continued)**

The value of secured forbearance stock has reduced by £53.1 million since the end of 2013, despite considerable growth in the mortgage portfolio.

| 2013 Forbearance stock[1] | Neither past due nor impaired £m | % | Past due not impaired £m | % | Impaired £m | % | Total £m | % |
|---|---|---|---|---|---|---|---|---|
| **Secured** | | | | | | | | |
| Payment arrangement | 3.4 | 1.2 | 2.0 | 11.1 | 1.1 | 12.4 | 6.5 | 2.0 |
| Transfer to interest only | 38.0 | 12.9 | 7.5 | 41.7 | 4.8 | 53.9 | 50.3 | 15.7 |
| Term extension | 179.0 | 61.0 | 5.9 | 32.8 | 1.1 | 12.4 | 186.0 | 58.1 |
| Payment holiday | 73.1 | 24.9 | 2.6 | 14.4 | 1.9 | 21.3 | 77.6 | 24.2 |
| **Total secured forbearance** | **293.5** | **100.0** | **18.0** | **100.0** | **8.9** | **100.0** | **320.4** | **100.0** |
| **Unsecured** | | | | | | | | |
| Accounts where the customer has been approved on a repayment plan | 3.2 | 100.0 | — | — | 1.1 | 100.0 | 4.3 | 100.0 |
| **Total unsecured forbearance** | **3.2** | **100.0** | **—** | **—** | **1.1** | **100.0** | **4.3** | **100.0** |
| **Total forbearance** | **296.7** | **100.0** | **18.0** | **100.0** | **10.0** | **100.0** | **324.7** | **100.0** |

[1] The value of forbearance stock has been restated to reflect changes in the definition. It is possible for a customer to benefit from more than one forbearance option. In this event, account balances will be categorised in the forbearance category with the greatest probability of default.

**(3) Funding and Liquidity risk**

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

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

The Company carries out weekly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Company's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

**Note 30: Financial risk management (continued)**

The table below shows an analysis of total liquidity. The table is not equivalent to the balance sheet position as it includes off balance sheet liquidity and excludes encumbered assets:

| Composition of the liquidity portfolio | 2014 £m | 2014 Average £m | 2013 £m | 2013 Average £m |
|---|---|---|---|---|
| **Level 1** | | | | |
| Bank of England reserve | **813.3** | **1,120.9** | 1,388.4 | 1,455.4 |
| UK Government securities | **586.2** | **637.8** | 451.7 | 395.6 |
| Other buffer eligible | **—** | **33.9** | 100.1 | 98.3 |
| Supranational securities | **310.7** | **350.1** | 420.6 | 486.7 |
| Treasury bills raised through FLS | **2,260.0** | **1,598.5** | 1,160.0 | 833.1 |
| **Total level 1** | **3,970.2** | **3,741.2** | **3,520.8** | **3,269.1** |
| **Level 2a** | | | | |
| Covered bonds | **225.7** | **127.9** | 46.1 | 41.3 |
| **Total level 2a** | **225.7** | **127.9** | **46.1** | **41.3** |
| **Level 2b** | | | | |
| Eligible RMBS | **40.0** | **42.1** | 25.5 | 55.1 |
| **Total level 2b** | **40.0** | **42.1** | **25.5** | **55.1** |
| **High Quality Liquid Assets (Level 1 + 2a + 2b)** | **4,235.9** | **3,911.2** | **3,592.4** | **3,365.5** |
| **Other liquidity resources** | | | | |
| Non-eligible RMBS | **11.1** | **11.5** | 12.0 | 12.7 |
| Certificates of deposit | **—** | **43.8** | 82.1 | 26.0 |
| Floating rate notes | **—** | **11.1** | 24.1 | 34.8 |
| Fixed rate bonds | **55.3** | **120.3** | 115.6 | 137.5 |
| **Total other liquidity resources** | **66.4** | **186.7** | **233.8** | **211.0** |
| Self-issued RMBS | **92.8** | **433.4** | 650.4 | 1,401.8 |
| **Total liquidity** | **4,395.1** | **4,531.3** | **4,476.6** | **4,978.3** |

**Note 30: Financial risk management (continued)**

The table below analyses assets and liabilities of the Company into relevant maturity groupings based on the remaining contractual period at the balance sheet date; balances with no fixed maturity are included in the over five years category. Certain balances, included in the table below on the basis of their residual maturity, are repayable on demand upon payment of a penalty.

| **2014 Assets and liabilities by maturity profile** | **Within 3 months £m** | **3-12 months £m** | **1-5 years £m** | **After 5 years £m** | **Total £m** |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances at central banks | **813.3** | **—** | **—** | **38.0** | **851.3** |
| Derivative financial instruments | **6.7** | **11.7** | **70.7** | **88.9** | **178.0** |
| Loans and receivables: | | | | | |
| Loans and advances to banks | **136.4** | **—** | **—** | **—** | **136.4** |
| Loans and advances to customers | **1,313.0** | **567.5** | **2,860.3** | **18,607.1** | **23,347.9** |
| Debt securities | **—** | **—** | **—** | **1,407.4** | **1,407.4** |
| Available-for-sale financial assets | **20.1** | **122.2** | **406.0** | **991.3** | **1,539.6** |
| Other assets | **56.7** | **29.6** | **30.4** | **117.5** | **234.2** |
| **Total assets** | **2,346.2** | **731.0** | **3,367.4** | **21,250.2** | **27,694.8** |
| **Liabilities** | | | | | |
| Deposits from banks | **282.5** | **563.0** | **—** | **—** | **845.5** |
| Customer deposits | **18,043.6** | **2,356.7** | **1,967.7** | **0.9** | **22,368.9** |
| Amounts due to securitisation special purpose vehicles | **24.9** | **73.5** | **480.7** | **2,187.8** | **2,766.9** |
| Derivative financial instruments | **6.3** | **6.6** | **133.1** | **81.9** | **227.9** |
| Other liabilities | **194.7** | **42.5** | **19.1** | **3.7** | **260.0** |
| **Total liabilities** | **18,552.0** | **3,042.3** | **2,600.6** | **2,274.3** | **26,469.2** |
| **Net liquidity (gap)/surplus** | **(16,205.8)** | **(2,311.3)** | **766.8** | **18,975.9** | **1,225.6** |

**Note 30: Financial risk management (continued)**

| 2013 Assets and liabilities by maturity profile | Within 3 months £m | 3-12 months £m | 1-5 years £m | After 5 years £m | Total £m |
|---|---|---|---|---|---|
| Assets | | | | | |
| Cash and balances at central banks | 1,388.4 | — | — | 35.1 | 1,423.5 |
| Derivative financial instruments | 6.0 | 14.4 | 124.4 | 107.2 | 252.0 |
| Loans and receivables: | | | | | |
| Loans and advances to banks | 91.8 | — | — | — | 91.8 |
| Loans and advances to customers | 924.1 | 494.1 | 2,428.4 | 16,752.3 | 20,598.9 |
| Debt securities in issue | — | — | — | 1,602.6 | 1,602.6 |
| Available-for-sale financial assets | — | 172.3 | 610.8 | 796.2 | 1,579.3 |
| Other assets | 31.3 | 11.5 | 65.8 | 91.8 | 200.4 |
| **Total assets** | **2,441.6** | **692.3** | **3,229.4** | **19,385.2** | **25,748.5** |
| Liabilities | | | | | |
| Deposits from banks | 232.2 | 150.0 | — | — | 382.2 |
| Customer deposits | 16,625.1 | 2,087.6 | 2,412.3 | 2.2 | 21,127.2 |
| Amounts due to securitisation special purpose vehicles | 22.5 | 71.0 | 479.8 | 2,105.3 | 2,678.6 |
| Derivative financial instruments | 8.2 | 14.8 | 90.4 | 31.8 | 145.2 |
| Other liabilities | 201.7 | 38.6 | 4.6 | 1.7 | 246.6 |
| **Total liabilities** | **17,089.7** | **2,362.0** | **2,987.1** | **2,141.0** | **24,579.8** |
| **Net liquidity (gap)/surplus** | **(14,648.1)** | **(1,669.7)** | **242.3** | **17,244.2** | **1,168.7** |

The composition of the Company's wholesale funding is shown in the table below:

| **Source of wholesale funding** | **2014 £m** | 2013 £m |
|---|---|---|
| Amounts due to securitisation special purpose vehicles | **2,766.9** | 2,678.6 |
| Term repo | **835.3** | 303.5 |
| **Total on-balance sheet sources of funds** | **3,602.2** | **2,982.1** |
| FLS drawings | **2,260.0** | 1,160.0 |
| **Total** | **5,862.2** | **4,142.1** |

| **2014 Residual maturity of the wholesale funding book** | **Within 3 months £m** | **3-12 months £m** | **1-5 years £m** | **After 5 years £m** | **Total £m** |
|---|---|---|---|---|---|
| Amounts due to securitisation special purpose vehicles | **24.9** | **73.5** | **480.7** | **2,187.8** | **2,766.9** |
| Term repo | **272.3** | **563.0** | **—** | **—** | **835.3** |
| **Total on-balance sheet sources of funds** | **297.2** | **636.5** | **480.7** | **2,187.8** | **3,602.2** |
| FLS drawings | **—** | **—** | **2,260.0** | **—** | **2,260.0** |
| **Total** | **297.2** | **636.5** | **2,740.7** | **2,187.8** | **5,862.2** |

**Note 30: Financial risk management (continued)**

| 2013<br>Residual maturity of the wholesale funding book | Within 3 months<br>£m | 3-12 months<br>£m | 1-5 years<br>£m | After 5 years<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| Amounts due to securitisation special purpose vehicles | 22.5 | 71.0 | 479.8 | 2,105.3 | 2,678.6 |
| Term repo | 153.5 | 150.0 | — | — | 303.5 |
| **Total on-balance sheet sources of funds** | **176.0** | **221.0** | **479.8** | **2,105.3** | **2,982.1** |
| FLS drawings | — | — | 1,160.0 | — | 1,160.0 |
| **Total** | **176.0** | **221.0** | **1,639.8** | **2,105.3** | **4,142.1** |

Encumbered assets

Virgin Money's assets can be used to support funding collateral requirements for central bank operations or third-party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes.

| | **Encumbered assets** | | **Unencumbered assets** | | |
|---|---|---|---|---|---|
| **2014**<br>**Asset encumbrance** | **Pledged as collateral**<br>**£m** | **Other[1]**<br>**£m** | **Available as collateral**<br>**£m** | **Other[2]**<br>**£m** | **Total**<br>**£m** |
| Cash balances at central banks | **38.0** | **—** | **—** | **813.3** | **851.3** |
| Debt securities held as loans and receivables | **671.3** | **—** | **103.9** | **632.2** | **1,407.4** |
| Available-for-sale financial assets | **321.7** | **—** | **1,217.9** | **—** | **1,539.6** |
| Derivative financial assets | **—** | **—** | **—** | **178.0** | **178.0** |
| Loans and advances to banks | **—** | **120.0** | **—** | **16.4** | **136.4** |
| Loans and advances to customers[3,4] | **6,609.4** | **—** | **2,075.0** | **14,663.5** | **23,347.9** |
| Other assets | **—** | **—** | **—** | **234.2** | **234.2** |
| **Total assets** | **7,640.4** | **120.0** | **3,396.8** | **16,537.6** | **27,694.8** |

[1] Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These include cash reserves supporting secured funding structures.

[2] All other assets are defined as 'unencumbered assets'. These comprise assets that are readily available to secure funding or to meet collateral requirements, and assets that are not subject to any restrictions and are not readily available for use.

[3] Loans and advances to customers are classified as available collateral only if they are already in such a form that they can be used immediately to raise funding.

[4] Loans and advances to customers includes collateral pledged to the Bank of England and securitised mortgage pools. See note 11.

**Note 30: Financial risk management (continued)**

| 2013<br>Asset encumbrance | Encumbered assets<br>Pledged as collateral<br>£m | <br>Other<br>£m | Unencumbered assets<br>Available as collateral<br>£m | <br>Other<br>£m | <br>Total<br>£m |
|---|---|---|---|---|---|
| Cash balances at central banks | 35.1 | — | — | 1,388.4 | 1,423.5 |
| Debt securities held as loans and receivables | 551.8 | — | 483.3 | 567.5 | 1,602.6 |
| Available-for-sale financial assets | 313.5 | — | 1,265.8 | — | 1,579.3 |
| Derivative financial assets | — | — | — | 252.0 | 252.0 |
| Loans and advances to banks | — | 91.8 | — | — | 91.8 |
| Loans and advances to customers | 4,291.9 | — | 2,355.7 | 13,951.3 | 20,598.9 |
| Other assets | — | — | — | 200.4 | 200.4 |
| **Total assets** | **5,192.3** | **91.8** | **4,104.8** | **16,359.6** | **25,748.5** |

Cashflow profile

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

| **2014<br>Maturity groupings for non-derivative cash outflows** | **Within 3 months<br>£m** | **3-6 months<br>£m** | **6-12 months<br>£m** | **1-5 years<br>£m** | **Over 5 years<br>£m** | **Total<br>£m** |
|---|---|---|---|---|---|---|
| Deposits from banks | **283.1** | **565.0** | **—** | **—** | **—** | **848.1** |
| Customer deposits | **18,154.1** | **1,372.6** | **1,141.0** | **2,204.9** | **1.0** | **22,873.6** |
| Amounts due to securitisation special purpose vehicles | **260.9** | **235.7** | **406.0** | **1,987.4** | **370.1** | **3,260.1** |
| **Total** | **18,698.1** | **2,173.3** | **1,547.0** | **4,192.3** | **371.1** | **26,981.8** |

**Note 30: Financial risk management (continued)**

| 2013 Maturity groupings for non-derivative cash outflows | Within 3 months £m | 3-6 months £m | 6-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|---|---|---|---|---|---|---|
| Deposits from banks | 232.9 | 0.5 | 150.9 | — | — | 384.3 |
| Customer deposits | 16,772.6 | 1,145.6 | 1,108.3 | 2,627.3 | 2.3 | 21,656.1 |
| Amounts due to securitisation special purpose vehicles | 403.0 | 308.7 | 420.1 | 1,877.5 | — | 3,009.3 |
| **Total** | **17,408.5** | **1,454.8** | **1,679.3** | **4,504.8** | **2.3** | **25,049.7** |

Virgin Money's contractual cash flow profile of customer deposits has shortened. This has been offset by the lengthening of the cash flow profile of amounts due to securitisation special purpose vehicles following the Gosforth Funding 2014-1 RMBS transaction.

The table below divides the derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. Cash flows for the floating legs of derivative transactions are computed based on market indications of future interest rates. As a result totals in this table are not intended to be identical to tables on OTC derivatives or other notes to the financial statements by definition.

| **2014 Maturity groupings for derivative cash outflows** | **Within 3 months £m** | **3-6 months £m** | **6-12 months £m** | **1-5 years £m** | **Over 5 years £m** | **Total £m** |
|---|---|---|---|---|---|---|
| **Settled on a net basis** | | | | | | |
| Derivatives in economic and not accounting hedges | **(3.1)** | **(3.4)** | **(7.4)** | **(8.6)** | **(2.2)** | **(24.7)** |
| Derivatives in accounting hedge relationships | **(31.3)** | **(21.7)** | **(43.7)** | **(92.0)** | **(12.9)** | **(201.6)** |
| | **(34.4)** | **(25.1)** | **(51.1)** | **(100.6)** | **(15.1)** | **(226.3)** |
| **Settled on a gross basis** | | | | | | |
| Outflows | — | — | — | — | — | — |
| Inflows | — | — | — | — | — | — |
| | — | — | — | — | — | — |
| **Total** | **(34.4)** | **(25.1)** | **(51.1)** | **(100.6)** | **(15.1)** | **(226.3)** |

**Note 30: Financial risk management (continued)**

| 2013 Maturity groupings for derivative cash outflows | Within 3 months £m | 3-6 months £m | 6-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|---|---|---|---|---|---|---|
| Settled on a net basis | | | | | | |
| Derivatives in economic and not accounting hedges | (3.0) | (1.9) | (0.4) | (10.6) | (0.7) | (16.6) |
| Derivatives in accounting hedge relationships | (20.6) | (14.8) | (21.4) | (66.5) | (3.2) | (126.5) |
| | **(23.6)** | **(16.7)** | **(21.8)** | **(77.1)** | **(3.9)** | **(143.1)** |
| Settled on a gross basis | | | | | | |
| Outflows | — | — | (0.7) | (25.0) | — | (25.7) |
| Inflows | 0.1 | 0.1 | 0.2 | 25.1 | — | 25.5 |
| | **0.1** | **0.1** | **(0.5)** | **0.1** | **—** | **(0.2)** |
| **Total** | **(23.5)** | **(16.6)** | **(22.3)** | **(77.0)** | **(3.9)** | **(143.3)** |

External credit ratings

The Company's short and long-term credit ratings as at 31 December 2014 are as follows.

| | Long Term | Short Term | Outlook | Date of last rating action | Rating action type |
|---|---|---|---|---|---|
| Fitch | BBB+ | F2 | Stable | 27 November 2014 | Affirmed |

In January 2014 Fitch upgraded its long and short-term ratings to BBB+ and F2, respectively. These ratings were further affirmed by Fitch in November 2014.

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

| | **Cumulative adjustment for a one-notch downgrade £m** | **Cumulative adjustment for a two-notch downgrade £m** |
|---|---|---|
| **2014** | **—** | **10.0** |

**Note 31: Cash flow statements**

(a) Change in operating assets

| | **2014 £m** | **2013 £m** |
|---|---|---|
| Changes in loans and advances to customers | **(2,402.1)** | (2,520.3) |
| Change in derivative financial assets | **74.0** | 29.3 |
| Change in other operating assets | **(28.4)** | (18.4) |
| **Change in operating assets** | **(2,356.5)** | **(2,509.4)** |

**Note 31: Cash flow statements (continued)**

(b) Change in operating liabilities

| | 2014 £m | 2013 £m |
|---|---|---|
| Changes in customer deposits | **1,241.7** | 3,155.2 |
| Change in derivative financial liabilities | **82.7** | (134.9) |
| Change in other operating liabilities | **565.0** | (2,123.8) |
| **Change in operating liabilities** | **1,889.4** | **896.5** |

(c) Non-cash and other items

| | 2014 £m | 2013 £m |
|---|---|---|
| Depreciation and amortisation | **11.5** | 7.8 |
| Gain on sale of subsidiary | **—** | (193.8) |
| Other non-cash items | **(50.2)** | 156.9 |
| **Total non-cash and other items** | **(38.7)** | **(29.1)** |

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

| | 2014 £m | 2013 £m |
|---|---|---|
| Cash and balances at central banks | **851.3** | 1,423.5 |
| Less: mandatory reserve deposits[1] | **(38.0)** | (35.1) |
| | **813.3** | **1,388.4** |
| Loans and advances to banks | **136.4** | 91.8 |
| Less: amounts with a maturity of three months or more | **—** | — |
| | **136.4** | **91.8** |
| **Total cash and cash equivalents** | **949.7** | **1,480.2** |

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

**Note 32: Capital resources**

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

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

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

**Note 32: Capital resources (continued)**

The following table analyses the composition of the regulatory capital resources of the Company on a CRD IV basis. The 2013 comparatives have been restated using the CRD IV rules and the restated 2013 balance sheet positions. They therefore differ from the Basel II capital positions reported to the PRA and disclosed in the 2013 Company statutory accounts.

Throughout 2014, transitional rules for calculating capital under CRD IV were in place. Capital numbers below have been quoted using both these transitional rules and the fully loaded CRD IV rules which came into effect from 1 January 2015.

Net gains in the AFS reserve are excluded from capital under the transitional CRD IV rules adopted by the PRA.

For regulatory capital purposes, the special purpose vehicles detailed in note 16 form part of the Virgin Money plc regulated entity. As such, these companies have been consolidated within these capital disclosures.

Own funds

| | **Fully loaded** | | **Transitional rules** | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | **£m** | £m | **£m** | £m |
| **Common Equity Tier 1** | | | | |
| Ordinary share capital | **1,400.0** | 1,400.0 | **1,400.0** | 1,400.0 |
| Retained earnings | **(180.0)** | (232.8) | **(180.0)** | (232.8) |
| Other reserves | **5.6** | 1.5 | **5.6** | 1.5 |
| **Total equity** | **1,225.6** | **1,168.7** | **1,225.6** | **1,168.7** |
| **Regulatory capital adjustments (unaudited)** | | | | |
| Net assets/(liabilities) of special purpose vehicles | **4.5** | (10.8) | **4.5** | (10.8) |
| Other reserves | **—** | (1.3) | **(5.6)** | (1.5) |
| Intangibles | **(45.0)** | (23.1) | **(45.0)** | (23.1) |
| Excess of expected loss over impairment | **(33.4)** | (41.1) | **(33.4)** | (41.1) |
| Deferred tax (after consolidation of special purpose vehicles) | **(38.1)** | (62.0) | **(38.1)** | (62.0) |
| **Common Equity Tier 1 capital (unaudited)** | **1,113.6** | **1,030.4** | **1,108.0** | **1,030.2** |
| **Tier 1 capital (unaudited)** | **1,113.6** | **1,030.4** | **1,108.0** | **1,030.2** |
| **Tier 2 capital (unaudited)** | | | | |
| General credit risk adjustments | **5.9** | 10.9 | **5.9** | 10.9 |
| **Tier 2 capital** | **5.9** | 10.9 | **5.9** | 10.9 |
| **Total own funds (unaudited)** | **1,119.5** | **1,041.3** | **1,113.9** | **1,041.1** |

Movements in fully loaded Common Equity Tier 1 capital are summarised below.

**Note 32: Capital resources (continued)**

Common Equity Tier 1

| (unaudited) | Fully loaded 2014 £m |
|---|---|
| **Common Equity Tier 1 capital at 1 January** | **1,030.4** |
| Movement in retained earnings | **52.8** |
| Movement in other reserves | **4.1** |
| Movement in cashflow hedge reserve | **1.3** |
| Movement in net liabilities of SPVs | **15.3** |
| Movement in intangible assets | **(21.9)** |
| Movement in excess of expected loss over impairment | **7.7** |
| Movement in deferred tax on tax losses carried forward | **23.9** |
| **Common Equity Tier 1 capital at 31 December** | **1,113.6** |

Risk-weighted assets – Pillar 1

| | Fully loaded | | Transitional rules | |
|---|---|---|---|---|
| (unaudited) | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Retail mortgages | **3,489.7** | 3,854.6 | **3,489.7** | 3,854.6 |
| Retail unsecured lending | **830.0** | 595.3 | **830.0** | 595.3 |
| Treasury | **182.6** | 232.6 | **181.4** | 232.6 |
| Other assets | **282.2** | 235.5 | **282.2** | 235.5 |
| Credit valuation adjustments | **13.4** | 15.1 | **13.4** | 15.1 |
| Operational risk | **284.8** | 152.9 | **284.8** | 152.9 |
| Market risk | **—** | — | **—** | — |
| **Total risk-weighted assets** | **5,082.7** | **5,086.0** | **5,081.5** | **5,086.0** |

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

Capital ratios

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

| | Fully loaded | | Transitional rules | |
|---|---|---|---|---|
| (unaudited) | 2014 % | 2013 % | 2014 % | 2013 % |
| Common Equity Tier 1 | **21.9** | 20.3 | **21.8** | 20.3 |
| Tier 1 | **21.9** | 20.3 | **21.8** | 20.3 |
| **Total capital** | **22.0** | **20.5** | **21.9** | **20.5** |

## Note 33: Related party transactions

(a) Key Management personnel

Key Management personnel refer to the Executive Committee and Non-Executive Directors of the Group.

| | **2014 £m** | 2013 £m |
|---|---|---|
| Compensation | | |
| Salaries and other short-term benefits | **6.3** | 4.9 |
| Amounts received under long-term incentive plans | **1.2** | 2.7 |
| Share based payments (refer note 6) | **10.2** | 0.5 |
| Pension contributions | **0.6** | 0.5 |
| **Total compensation** | **18.3** | **8.6** |

Aggregate contributions in respect of Key Management personnel to defined contribution pension schemes £0.6 million (2013: £0.5 million).

| | **2014 £m** | 2013 £m |
|---|---|---|
| Deposits | | |
| At 1 January | **0.8** | 0.3 |
| Placed | **0.1** | 0.6 |
| Withdrawn | **(0.2)** | (0.1) |
| **Deposits outstanding at 31 December** | **0.7** | **0.8** |

Deposits placed by Key Management personnel attracted interest rates of up to 2.8% (2013: 2.8%). At 31 December 2014, the Company did not provide any guarantees in respect of Key Management personnel (2013: £nil).

At 31 December 2014, transactions, arrangements and agreements entered into with Key Management personnel included amounts outstanding in respect of loans and credit card transactions of £nil with 4 Key Management personnel (2013: £nil with 4 Key Management personnel).

(b) Group Companies and other transactions

Details of subsidiaries are presented in note 16.

Transactions during the year:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Recharges (to)/from fellow Group Companies | **(4.6)** | 33.8 |
| Interest on loans to fellow Group Companies | **2.7** | 2.6 |
| Virgin Enterprises Limited | **4.1** | 2.1 |
| Other costs to Virgin Management Group Companies | **0.2** | 0.6 |
| Purchase of customer loans from Church House Trust Limited | **4.3** | — |
| Virgin Atlantic Airways | **2.8** | 4.3 |

**Note 33: Related party transactions (continued)**

Balance outstanding at year end:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Trading balances with fellow Group Companies | **6.5** | (4.8) |
| Loans to fellow Group Companies | **106.6** | 96.2 |
| Virgin Enterprises Limited | **(0.4)** | (0.3) |
| Other balances with Virgin Management Group Companies | **(0.1)** | (0.1) |
| Virgin Atlantic Airways | **—** | 4.2 |

Recharges and trading balances from/(to) fellow Group Companies

Interest payable on amounts owed to Virgin Money Cards Limited was £nil (2013: £1.0 million).

Loans to fellow Group Companies

Interest was charged on monies loaned to fellow Group Companies at 2% over 6 month LIBOR (2013: 2% over 6 month LIBOR).

Virgin Enterprises Limited

The Company paid license fees to Virgin Enterprises Limited for use of the Virgin Brand.

Other costs to Virgin Management Group Companies

Other Virgin Management Group Companies include amounts due to Companies with the Virgin Group.

The Company incurs credit card point of sale discount fees to Virgin Holidays Limited.

Purchase of customer loans from Church House Trust Limited

On 30 September 2014, the Company purchased £4.3 million customer loans from Church House Trust Limited, a fellow subsidiary of the Group at that time.

A number of banking transactions are entered into with related parties as part of normal banking business. These include deposits.

**Note 33: Related party transactions (continued)**

(c) Securitisation special purpose vehicles

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

| 2014 | Interest income £m | Interest expense £m | Fair value gains and (losses) on financial instruments £m | Investment securities held as loans and receivables £m | Derivative financial instruments £m | Amounts due from SPVs £m | Prepayments and accrued interest £m | Amounts due to SPVs £m |
|---|---|---|---|---|---|---|---|---|
| Gosforth Funding plc | — | — | — | — | — | — | — | — |
| Gosforth Funding 2011-1 plc | **4.6** | **11.7** | **7.9** | **140.9** | **9.0** | **23.1** | **0.8** | **376.8** |
| Gosforth Funding 2012-1 plc | **6.2** | **12.0** | **0.1** | **164.2** | **9.6** | **17.6** | **0.2** | **288.7** |
| Gosforth Funding 2012-2 plc | **13.6** | **17.4** | **(0.8)** | **702.4** | **21.9** | **19.0** | **1.1** | **746.7** |
| Gosforth Funding 2014-1 plc | **1.9** | **5.5** | **1.0** | **388.9** | **37.4** | **53.0** | **1.9** | **1,354.7** |
| **Total** | **26.3** | **46.6** | **8.2** | **1,396.4** | **77.9** | **112.7** | **4.0** | **2,766.9** |

| 2013 | Interest income[1] £m | Interest expense[1] £m | Fair value gains and (losses) on financial instruments £m | Investment securities held as loans and receivables £m | Derivative financial instruments £m | Amounts due from SPVs £m | Prepayments and accrued interest £m | Amounts due to SPVs £m |
|---|---|---|---|---|---|---|---|---|
| Gosforth Funding plc | 4.0 | 4.0 | 0.2 | — | — | — | — | — |
| Gosforth Funding 2011-1 plc | 5.2 | 16.2 | 11.8 | 140.9 | 17.6 | 38.9 | 0.9 | 526.0 |
| Gosforth Funding 2012-1 plc | 8.5 | 21.0 | (1.9) | 250.2 | 15.0 | 38.5 | 0.3 | 596.6 |
| Gosforth Funding 2012-2 plc | 23.6 | 33.2 | (0.8) | 1,199.5 | 32.0 | 78.3 | 2.1 | 1,556.0 |
| **Total** | **41.3** | **74.4** | **9.3** | **1,590.6** | **64.6** | **155.7** | **3.3** | **2,678.6** |

[1] The Company undertook a review of the allocation of interest income and interest expense during the year and as a result the 2013 comparatives have been restated.

**Note 34: Events after balance sheet date**

There have been no significant events between 31 December 2014 and the date of approval of the financial statements which would require a change to or additional disclosure in the financial statements.

**Note 35: Parent undertaking**

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

Virgin Money Holdings (UK) plc is the largest and smallest group in which the financial statements of the Company are consolidated. The consolidated financial statements of Virgin Money Holdings (UK) plc may be obtained from Companies House, Crown Way, Cardiff, CF4 3ZU.

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

**Note 36: Restatement of prior period information**

As set out in Note 1, the Company has adopted IFRIC 21 'Levies' which has a resulted in a reassessment of the liability recognised in previous periods in relation the FSCS levy.

During the year, the Company undertook a review of the allocation and classification of both costs and income. Following this review, the Company has realigned elements of interest and similar income, interest and similar expense, fee and commission income, fee and commission expense and operating expenses to better reflect the nature of these costs and income.

The Company has restated information for the preceding comparative periods.

The following tables summarise the adjustments arising on the adoption of IFRIC 21 'Levies' and the reclassification of income and expenses to the Company's:

- Income statement, statement of comprehensive income and cash flow statement for the year ended 31 December 2013; and
- Balance sheets at 31 December 2013 and 1 January 2013.

**Note 36: Restatement of prior period information (continued)**

**Income statement – year ended 31 December 2013**

| | As previously stated £million | IFRIC 21 £million | Presentation re-classification £million | Restated £million |
|---|---|---|---|---|
| Interest and similar income | 871.8 | — | (46.0)[1] | 825.8 |
| Interest and similar expense | (558.4) | — | 46.0[2] | (512.4) |
| **Net interest income** | **313.4** | **—** | **—** | **313.4** |
| Fee and commission income | 32.8 | — | — | 32.8 |
| Fee and commission expense | (13.2) | — | 13.0[3] | (0.2) |
| **Net fee and commission income** | **19.6** | **—** | **13.0** | **32.6** |
| Fair value losses on financial instruments | (10.2) | — | — | (10.2) |
| Other operating income | 22.2 | — | (15.0)[4] | 7.2 |
| **Other income** | **31.6** | **—** | **(2.0)** | **29.6** |
| **Total income** | **345.0** | **—** | **(2.0)** | **343.0** |
| **Total operating expenses** | **(327.2)** | **5.9** | **2.0[5]** | **(319.3)** |
| **Profit before tax from operating activities** | **17.8** | **5.9** | **—** | **23.7** |
| Impairment | (50.7) | — | — | (50.7) |
| Dividends | 109.1 | — | — | 109.1 |
| Gain on sale of subsidiary | 193.8 | — | — | 193.8 |
| **Profit before tax** | **270.0** | **5.9** | **—** | **275.9** |
| Taxation | 1.7 | (1.3) | — | 0.4 |
| **Profit for the year** | **271.7** | **4.6** | **—** | **276.3** |
| Profit attributable to equity shareholders | 271.7 | 4.6 | — | 276.3 |
| **Profit for the year** | **271.7** | **4.6** | **—** | **276.3** |

[1] The 2013 comparative for 'Interest and similar income' decreased by £46.0 million to £825.8 million.
[2] The 2013 comparative for 'Interest and similar expense' decreased by £46.0 million to £512.4 million.
[3] The 2013 comparative for 'Fee and commission expense' decreased by £13.0 million to £0.2 million.
[4] The 2013 comparative for 'Credit card income' decreased by £15.0 million to £2.9 million
[5] The 2013 comparative for 'Other operating expenses' decreased by £2.0 million to £319.3 million.

**Note 36: Restatement of prior period information (continued)**

**Statement of comprehensive income – year ended 31 December 2013**

| | As previously stated £million | IFRIC 21 £million | Restated £million |
|---|---|---|---|
| **Profit for the year** | 271.7 | 4.6 | 276.3 |
| **Other comprehensive income** | | | |
| Movements in revaluation reserve in respect of available-for-sale financial assets: | | | |
| Change in fair value | 5.6 | — | 5.6 |
| Income statement transfers in respect of disposals | (3.5) | — | (3.5) |
| Taxation | (0.5) | — | (0.5) |
| | 1.6 | — | 1.6 |
| Movements in cash flow hedge reserve: | | | |
| Effective portion of changes in fair value taken to other comprehensive income | 7.0 | — | 7.0 |
| Net income statement transfers | 4.8 | — | 4.8 |
| Taxation | (0.3) | — | (0.3) |
| | 11.5 | — | 11.5 |
| **Other comprehensive income for the year, net of tax** | **13.1** | **—** | **13.1** |
| **Total comprehensive income for the year** | **284.8** | **4.6** | **289.4** |
| **Total comprehensive income attributable to equity shareholders** | **284.8** | **4.6** | **289.4** |

In accordance with IAS 8 'Accounting policies, changes in accounting estimates and errors' the adoption of IFRIC 21 'Levies' required a prior period restatement which was adjusted through opening reserves.

# Notes to the financial statements

**Note 36: Restatement of prior period information (continued)**

**Cash flow statement – year ended 31 December 2013**

| | As previously stated £million | IFRIC 21 £million | Restated £million |
|---|---|---|---|
| **Profit before taxation** | **270.0** | **5.9** | **275.9** |
| **Adjustments for:** | | | |
| Change in operating assets | (2,509.4) | — | (2,509.4) |
| Change in operating liabilities | 902.4 | (5.9) | 896.5 |
| Non-cash and other items | (29.1) | — | (29.1) |
| **Net cash used in by operating activities** | **(1,366.1)** | **—** | **(1,366.1)** |
| **Cashflows from investing activities** | | | |
| Net investment in intangible assets | (32.8) | — | (32.8) |
| Purchase of fixed assets | (2.0) | — | (2.0) |
| Disposal of subsidiary undertaking | 192.5 | — | 192.5 |
| Purchase of investment in securities | (746.3) | — | (746.3) |
| Proceeds from sale and redemption of investment securities | 1,876.7 | — | 1,876.7 |
| Net investment in credit card portfolio | (1,019.6) | — | (1,019.6) |
| **Net cash provided by investing activities** | **268.5** | **—** | **268.5** |
| Change in cash and cash equivalents | (1,097.6) | — | (1,097.6) |
| Cash and cash equivalents at beginning of year | 2,577.8 | — | 2,577.8 |
| **Cash and cash equivalents at end of year** | **1,480.2** | **—** | **1,480.2** |

# Notes to the financial statements

**Note 36: Restatement of prior period information (continued)**

**Balance sheet – 31 December 2013**

| | As previously stated £million | IFRIC 21 £million | Restated £million |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | 1,423.5 | — | 1,423.5 |
| Derivative financial instruments | 252.0 | — | 252.0 |
| Loans and receivables: | | | |
| Loans and advances to banks | 91.8 | — | 91.8 |
| Loans and advances to customers | 20,598.9 | — | 20,598.9 |
| Debt securities | 1,602.6 | — | 1,602.6 |
| | 22,293.3 | — | 22,293.3 |
| Available-for-sale financial assets | 1,579.3 | — | 1,579.3 |
| Intangible assets | 23.1 | — | 23.1 |
| Tangible fixed assets | 68.7 | — | 68.7 |
| Deferred tax assets | 66.8 | (3.9) | 62.9 |
| Other assets | 45.7 | — | 45.7 |
| **Total assets** | **25,752.4** | **(3.9)** | **25,748.5** |
| **Equity and liabilities** | | | |
| **Liabilities** | | | |
| Deposits from banks | 382.2 | — | 382.2 |
| Customer deposits | 21,127.2 | — | 21,127.2 |
| Amounts due to SPVs | 2,678.6 | — | 2,678.6 |
| Derivative financial instruments | 145.2 | — | 145.2 |
| Other liabilities | 239.1 | — | 239.1 |
| Provisions | 25.8 | (18.3) | 7.5 |
| **Total liabilities** | **24,598.1** | **(18.3)** | **24,579.8** |
| **Equity** | | | |
| Share capital and share premium | 1,400.0 | — | 1,400.0 |
| Other reserves | 1.5 | — | 1.5 |
| Retained earnings | (247.2) | 14.4 | (232.8) |
| **Total equity** | **1,154.3** | **14.4** | **1,168.7** |
| **Total liabilities and equity** | **25,752.4** | **(3.9)** | **25,748.5** |

**Note 36: Restatement of prior period information (continued)**

**Balance sheet – 1 January 2013**

| | As previously stated £million | IFRIC 21 £million | Restated £million |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | 1,604.5 | — | 1,604.5 |
| Derivative financial instruments | 281.3 | — | 281.3 |
| Loans and receivables: | | | |
| Loans and advances to banks | 991.6 | — | 991.6 |
| Loans and advances to customers | 17,114.5 | — | 17,114.5 |
| Debt securities | 3,112.4 | — | 3,112.4 |
| | 21,218.5 | — | 21,218.5 |
| Investment in subsidiary undertakings | 9.6 | — | 9.6 |
| Available-for-sale financial assets | 1,255.8 | — | 1,255.8 |
| Intangible assets | 28.2 | — | 28.2 |
| Tangible fixed assets | 72.5 | — | 72.5 |
| Deferred tax assets | 66.7 | (2.5) | 64.2 |
| Other assets | 38.5 | — | 38.5 |
| **Total assets** | **24,575.6** | **(2.5)** | **24,573.1** |
| **Equity and liabilities** | | | |
| **Liabilities** | | | |
| Deposits from banks | 0.7 | — | 0.7 |
| Customer deposits | 17,972.0 | — | 17,972.0 |
| Amounts due to SPVs | 5,172.5 | — | 5,172.5 |
| Derivative financial instruments | 280.1 | — | 280.1 |
| Other liabilities | 255.8 | — | 255.8 |
| Provisions | 25.4 | (12.3) | 13.1 |
| **Total liabilities** | **23,706.5** | **(12.3)** | **23,694.2** |
| **Equity** | | | |
| Share capital and share premium | 1,400.0 | — | 1,400.0 |
| Other reserves | (11.6) | — | (11.6) |
| Retained earnings | (519.3) | 9.8 | (509.5) |
| **Total equity** | **869.1** | **9.8** | **878.9** |
| **Total liabilities and equity** | **24,575.6** | **(2.5)** | **24,573.1** |

# Notes to the financial statements

**Note 37: Future accounting developments**

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

| Pronouncement | Nature of change | IASB effective date |
|---|---|---|
| IFRS 15 'Revenue from Contracts with Customers' | Current revenue recognition accounting standards have led to inconsistencies in accounting for similar transactions and inadequate disclosures. IFRS 15 specifies comprehensive principles on whether, how much and when an entity should recognise revenue arising from customer contracts. In addition, extensive disclosure requirements have been introduced to provide more informative and relevant disclosures, particularly around estimates and judgements.<br><br>The Company is reviewing the requirements of the new standard to determine its effect, if any, on its financial reporting. | 1 January 2017 (has not been EU endorsed) |
| IFRS 9 'Financial Instruments' | This new accounting standard has been split into three phases:<br><br>Phase 1 of the IFRS 9 project addresses the recognition and measurement of financial assets and liabilities. Financial assets are classified and measured on the business model in which they are held and the characteristics of their contractual cash flows. Financial liabilities designated under the fair value option will be required to generally present fair value changes that are attributable to the liability's credit risk in other comprehensive income rather than in profit or loss.<br><br>Phase 2 of the IFRS 9 project addresses the impairment of financial assets and will replace the current incurred loss model in IAS 39 with an expected loss model. In addition, extensive new disclosure requirements in relation to impairment losses are introduced.<br><br>Phase 3 of the IFRS 9 project introduces a principles based approach to hedge accounting and requirements which will align hedge accounting more closely with risk management.<br><br>This new accounting standard is expected to have a significant impact on the Company when adopted. | 1 January 2018 (has not been EU endorsed) |

**Note 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.

The initial disclosure requirements in 2014 were limited to disclose the name, nature of activities and geographical location of the Group, total operating income and number of employees within the Group split by country of operation. Refer to Virgin Money Holdings (UK) plc Group's annual report and accounts for country by country reporting disclosures.

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