Virgin money

Final Results

Released : 27/02/2018 07:00

RNS Number : 9862F
Virgin Money Holdings (UK) PLC
27 February 2018

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Pursuant to Listing Rule 9.6.1, the Annual Report and Accounts 2017 has been submitted to the UK Listing Authority and will shortly be available for inspection at the UK Listing Authority's Document Viewing Facility, via the National Storage Mechanism, which is located at: www.hemscott.com/nsm.do.

A copy of the Annual Report and Accounts 2017, Pillar 3 Disclosures 2017 and an investor presentation are available within the Investor Relations section of our website located at www.virginmoney.com.

This announcement also contains additional information for the purposes of compliance with the Disclosure Guidance and Transparency Rules.

Reference to pages and numbers refer to page numbers and notes to the financial statements in the Annual Report and Accounts 2017.

THIS ANNOUNCEMENT CONTAINS INSIDE INFORMATION

Virgin Money Holdings (UK) plc

Full year Results

BASIS OF PRESENTATION

This report covers the results of Virgin Money Holdings (UK) plc together with its subsidiaries ("Virgin Money" or "the Group") for the year ended 31 December 2017.

Statutory basis

Statutory information is set out in the Financial Statements section of this announcement.

Underlying results

In order to present a more meaningful view of business performance, the results of the Group are presented on an underlying basis of reporting as described below. The following items have been excluded from underlying profits:

- IPO share based payments;
- Strategic items;
- Simplification costs;
- Fair value losses on financial instruments.

Unless otherwise stated, income statement commentaries throughout this document compare the year ended 31 December 2017 to the year ended 31 December 2016, and the balance sheet analysis compares the Group balance sheet as at 31 December 2017 to the Group balance sheet as at 31 December 2016.

Alternative performance measures

The Group uses a number of alternative performance measures, in the discussion of its business performance and financial position. Further information on these measures is set out on page 262 of the Annual Report and Accounts 2017.

Financial Information

Financial information contained in this document does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006 ('the Act'). The statutory accounts for the year ended 31 December 2017 will be published on the Group's website. The report of the auditor on those statutory accounts was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) or (3) of the Act. The statutory accounts for the year ended 31 December 2017 will be filed with the Registrar of Companies.

Forward looking statements

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

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

VIRGIN MONEY GROUP RESULTS FOR 2017

Full year highlights

- **Underlying profit before tax increased by 28 per cent to £273.3 million**
- **Return on tangible equity strengthened to 14.0 per cent**
- **Common Equity Tier 1 ratio of 13.8 per cent with potential for risk-weighted asset model improvement**
- **Strategic initiatives on track - SME deposit gathering commenced in January; digital bank beta-testing expected in H2 2018**

- Disciplined approach to lending growth and consistently high underwriting standards delivered a 14 per cent increase in total customer loan balances and a low and stable cost of risk at 13 basis points
- Total income increased by 13.5 per cent to £666.0 million, from £586.9 million in 2016
- Cost:income ratio improved to 52.3 per cent, from 57.2 per cent in 2016. Exited 2017 with a ratio of 49.4 per cent in the fourth quarter
- Statutory profit after tax increased by 37 per cent to £192.1 million, compared to £140.0 million in 2016
- Profit attributable to equity shareholders increased to £167.3 million, from £130.0 million in 2016
- Statutory basic earnings per share increased to 37.8 pence, compared to 29.4 pence in 2016
- Recommended final dividend of 4.1 pence per ordinary share, resulting in a total dividend for the year of 6.0 pence per ordinary share - an increase of 17.6 per cent compared to 2016
- Total capital ratio of 18.1 per cent and leverage ratio of 3.9 per cent
- Tangible net asset value per share increased by 9 per cent to £2.97, from £2.73 in 2016
- Total net interest margin (NIM) of 157 basis points as guided; banking NIM of 172 basis points as guided
- Customer advocacy reached record highs with an overall Net Promoter Score of +40, up from +29 in 2016

Jayne-Anne Gadhia, Chief Executive said:

"I am delighted to report that our customer-focused strategy of growth, quality and returns continued to drive strong financial and operational performance in 2017. We generated market-beating growth across our core products as we continued to capture high-quality market share in mortgages and credit cards. We maintained our uncompromising focus on asset quality and we continued to improve our operating leverage.

In doing so, we met or exceeded all of our financial targets for the year. Underlying profit before tax increased by 28 per cent to £273.3 million and return on tangible equity improved to 14.0 per cent. We continue to experience robust customer demand and stable customer behaviour in a resilient housing market, and we expect to maintain solid double-digit returns in 2018.

We remain focused on providing our customers with good value, straightforward products and achieved a significant increase in overall customer advocacy in 2017. More customers than ever before would recommend Virgin Money to their friends and family, with our overall Net Promoter Score (NPS) increasing to +40, up from +29 in 2016. That continues to make Virgin Money one of the best-rated UK retail banks.

We refreshed our strategy during the year to address and capture the strategic opportunities arising from the technological and regulatory changes shaping UK retail banking. Broadening our customer appeal through the development of our SME and digital bank propositions will provide access to a wider pool of UK retail banking revenues and further diversify our funding base.

The strength of the business, our customer-focused strategy and our new strategic initiatives position us well to continue growing profitably while serving and growing our customer base."

Continued growth in customer balances

- Retail deposit balances increased by 10 per cent to £30.8 billion, from £28.1 billion in 2016.
- Mortgage balances increased by 13 per cent to £33.7 billion, from £29.7 billion in 2016.
- Gross mortgage market share of 3.3 per cent, in the upper half of our guided range, and net lending share of 8.9 per cent.
- Credit card balances increased to £3.0 billion, from £2.4 billion in 2016.

Maintained balance sheet strength and asset quality

- Strong capital generation supported the growth of our lending portfolios together with ongoing investment in both our core business and the build of our digital bank. As a result, our Common Equity Tier 1 (CET1) ratio was 13.8 per cent, our total capital ratio was 18.1 per cent and our leverage ratio was 3.9 per cent at the end of 2017.
- During 2017, analysis of our mortgage risk-weight models identified the potential for reductions to average risk-weights for the portfolio. Any material changes would require regulatory approval but the analysis reinforces the strength of current capital ratios.
- Customer lending continued to be underpinned by consistently high underwriting standards and resulted in a low and stable cost of risk at 13 basis points.
- The high quality of our mortgage business continued to be reflected in low arrears levels. Secured 3 month+ arrears levels were 0.12 per cent, compared to 0.15 per cent in 2016, and significantly below the latest UK Finance industry average of 0.82 per cent.
- The cost of risk in our credit card business improved by 19 basis points to 1.51 per cent, from 1.70 per cent in 2016. This reflected our continued focus on the highest quality customer segment, a rigorous approach to underwriting and the relatively benign economic environment.

Continued to deliver for all stakeholders

- Customers: Total customer numbers increased to 3.34 million and the proportion of new product sales to existing customers increased to 12.2 per cent, compared to 10.7 per cent in 2016. We further improved customer advocacy with our overall Net Promoter Score (NPS) increasing to +40, up from +29 in 2016.
- Colleagues: We maintained strong colleague engagement with an overall engagement score of 76 per cent. We were accredited as a Best Employer for Race by Business in the Community, and in January 2018 we entered Stonewall's Top 100 employer index for LGBT+ inclusivity. Our mean gender pay gap reduced by 10 per cent, to 32.5 per cent in 2017. As we make further progress towards achieving 50:50 gender balance throughout the business by the end of 2020, our gender pay gap will continue to reduce.
- Communities: More than £600 million has been donated to charities through Virgin Money Giving, our not-for-profit online donation service, since its launch in 2009, £95 million of which was donated in 2017. The Virgin Money Foundation awarded grants of nearly £3 million in 2017 to organisations working in areas such as housing, employability and financial inclusion.
- Corporate partners: We continue to work closely with our intermediary partners to drive our mortgage business and were delighted to be awarded the prestigious 'Best Lender for Partnership with Mortgage Club' at the L&G Mortgage Club annual awards for the third year running. In 2017 we announced a new partnership with BGL Group to provide our new life insurance proposition, which has performed well in its first year since launch.

2018 outlook and guidance

- Our central planning scenario for the year assumes a continuation of resilient economic conditions and modest economic growth.
- We expect to maintain solid double-digit returns and a progressive dividend in 2018.
- We expect to grow mortgage balances at a single digit percentage rate during 2018.
- The product mix of our credit card business will continue to evolve more towards retail spend cards with the launch of Virgin Atlantic Airways affinity products in 2018. Growth in credit card balances will be in single digits for the year.
- We anticipate a banking NIM in the range of 165-170 basis points for the year. As a result of lower front book spreads in the mortgage market our current expectation for banking NIM is at the lower end of that range.
- Since year end, the remaining Funding for Lending Scheme (FLS) drawings of £2.0 billion were repaid in full and Term Funding Scheme (TFS) drawings were extended to £6.4 billion.
- Our lending discipline will support asset quality and, including the impact of IFRS 9, we expect our cost of risk to be less than 20 basis points in 2018.
- Investment in our core business and strategic priorities will total £100 million in 2018. Despite this investment, we will maintain a CET1 ratio of around 13 per cent.
- We will continue to manage costs tightly and drive operating leverage through the business. As a result we expect a cost:income ratio of no more than 50 per cent in 2018.
- We are preparing our business case for the RBS alternative remedies package. We have the brand, the relationships and the capability to compete strongly in the SME market and look forward to participating in the process.
- We will continue to make progress with our SME banking roll-out and the development of our digital bank. Over time, these initiatives will significantly increase the breadth of our proposition, drive enhanced returns and support sustainable value creation for shareholders over the longer term.

CONSOLIDATED INCOME STATEMENT

	2017	2016	**Change**
	£ million	£ million	**%**
Net interest income	**594.6**	519.0	**14.6**
Other income	**71.4**	67.9	**5.2**
Total income	**666.0**	586.9	**13.5**
Costs	**(348.5)**	(336.0)	**3.7**
Impairment	**(44.2)**	(37.6)	**17.6**
Underlying profit before tax	**273.3**	213.3	**28.1**

CONSOLIDATED BALANCE SHEET

	2017	2016	**Change**

	£ million	£ million	%
Assets			
Cash and balances at central banks	**2,579.0**	786.3	**228.0**
Loans and receivables	**37,099.9**	33,003.4	**12.4**
Available-for-sale financial assets	**1,051.8**	858.8	**22.5**
Other	**377.1**	407.1	**(7.4)**
Total assets	**41,107.8**	35,055.6	**17.3**
Liabilities and equity			
Deposits from banks	**5,379.0**	2,132.5	**152.2**
Customer deposits	**30,808.4**	28,106.3	**9.6**
Debt securities in issue	**2,736.9**	2,600.0	**5.3**
Other	**358.6**	546.3	**(34.4)**
Total liabilities	**39,282.9**	33,385.1	**17.7**
Total equity	**1,824.9**	1,670.5	**9.2**
Total liabilities and equity	**41,107.8**	35,055.6	**17.3**

KEY METRICS

		2017	2016	Change
Banking net interest margin	%	**1.72**	1.75	**(3)bps**
Net interest margin	%	**1.57**	1.60	**(3)bps**
Cost:income ratio	%	**52.3**	57.2	**(4.9)pp**
Cost of risk	%	**0.13**	0.13	**-**
Statutory basic earnings per share	p	**37.8**	29.4	**8.4 pence**
Tangible net asset value per share	£	**2.97**	2.73	**24 pence**
Total Capital Ratio	%	**18.1**	20.4	**(2.3)pp**
Common Equity Tier 1 ratio	%	**13.8**	15.2	**(1.4)pp**
Leverage ratio	%	**3.9**	4.4	**(0.5)pp**
Return on tangible equity	%	**14.0**	12.4	**1.6pp**

Key ratios are presented on an underlying basis except where stated.

RECONCILIATION TO STATUTORY PROFIT

	2017	2016	**Change**
	£ million	£ million	**%**
Underlying profit before tax	**273.3**	213.3	**28.1**
IPO share based payments	**(0.9)**	(2.0)	
Strategic items	**(6.5)**	(2.4)	
Simplification costs	**-**	(5.6)	
Fair value losses on financial instruments	**(3.3)**	(8.9)	
Statutory profit before tax	**262.6**	194.4	**35.1**

CHIEF EXECUTIVE'S REVIEW

We have delivered strong financial performance in 2017 and made considerable progress against our strategic objectives. We met or exceeded all of our financial targets for the year and we are confident about the long term prospects for the company.

The strength of the business, our customer focused strategy, and our new strategic initiatives, including SME and digital, position us well to continue growing profitably while serving and growing our customer base with good value, straightforward products and outstanding customer service.

Overview

We have delivered strong financial performance in 2017 as we continued to deliver on our customer focused strategy of growth, quality and returns. As a result of continuing operational leverage and our focus on maintaining excellent asset quality we met or exceeded all of our financial targets for the year. Underlying profit before tax increased to £273.3 million and return on tangible equity improved to 14.0 per cent.

On an underlying basis, total income increased by 13.5 per cent while cost growth was limited to 3.7 per cent. As a result, our cost:income ratio improved to 52.3 per cent, from 57.2 per cent in 2016, and we exited 2017 with a ratio of 49.4 per cent in the fourth quarter.

Statutory profit after tax increased by 37.1 per cent to £192.1 million, generating 182 basis points of Common Equity Tier 1 (CET1) capital after distributions to Additional Tier 1 capital holders. This strong capital generation supported the ongoing growth of our lending portfolios together with ongoing investment in both our core business and the build of our digital bank.

As a consequence, our Common Equity Tier 1 ratio was 13.8 per cent at the end of 2017, while our total capital ratio was 18.1 per cent and our leverage ratio was 3.9 per cent. The cost of risk remained at 13 basis points, demonstrating continued high asset quality as well as a benign economic environment.

As a result of our performance in 2017 the Board has recommended a final dividend of 4.1 pence per ordinary share, bringing the total dividend per share for the year to 6.0 pence. This represents an increase of 17.6 per cent compared to 2016.

Over the course of the year, we announced new strategic developments which will enable us to continue serving and growing our customer base, while meeting the challenges of regulatory change and an increasingly competitive market environment in the key markets in which we operate.

The strength of the business combined with these new strategic initiatives position us well to continue growing profitably and we are confident about the long term prospects for the business.

Customers and distribution

We provide our customers with good value products, supported by outstanding service with the aim of driving long lasting relationships and deeper product engagement. By ensuring that customers are at the heart of our strategy, the proportion of new product sales to existing customers increased to 12.2 per cent, compared to 10.7 per cent in 2016. We also further improved customer advocacy across all areas of the business, with our overall Net Promoter Score (NPS) increasing to +40, up from +29 at 2016.

Our customers continue to choose our digital channels. Our website remains the most popular channel, with over 28 million website visits, up from 22 million in 2016. 78 per cent of sales were delivered digitally during the year and the use of mobile devices to access products and services increased to 52 per cent of all our digital interactions, up from 50 per cent in 2016.

Our Lounges complement our Store network and continue to be a standout success. They deliver excellent customer satisfaction with an NPS score of +87 matching best in class peers in the retail sector. As a result, we will be opening a new Lounge in Cardiff in 2018. Our Store network continues to play an important role for customers with a 25 per cent increase in new accounts opened in-Store year-on-year.

As a result of improving the Virgin Money Giving (VMG) customer journey we now have 1.4 million registered users of our not-for-profit online donation service. £95 million was donated to charities from 2.2 million individual donations in 2017. We will aim to build deeper relationships with our VMG customer base by engaging them beyond charitable donations and exploring ways to meet more of their financial needs.

Business performance

We offer good value, straightforward and transparent products and our multi-channel distribution model supports cost effective growth in our deposit business. We continue to offer our savings customers both good value and sustainable savings rates in the context of the market. Our approach delivered further improvements to our average cost of retail funds and supported strong retention levels. We increased deposit balances by 9.6 per cent year-on-year, while reducing our cost of funds to 59 basis points from 80 basis points in 2016. In a competitive overall market for retail deposits, we were delighted that customers continue to recognise the value of our proposition with 89 per cent retention of fixed rate maturities.

Our mortgage business remains high quality and performance continues to benefit from strong retention of maturing balances and an award-winning intermediary proposition. Improvements in our intermediary proposition drove a further increase in our intermediary NPS to +61 from +55 in 2016 and supported mortgage balance growth of 13 per cent to £33.7 billion in 2017. During the year we extended our mortgage proposition to help more people onto the housing ladder and launched custom build and shared ownership products. Overall we achieved a market share of gross lending of 3.3 per cent despite lowering volumes towards the end of the year to manage margins and protect returns in an increasingly competitive market. Further progress in our direct channel saw the number of mortgage applications increase by 12 per cent from 2016 with the value of direct mortgages exceeding £1 billion for the first time.

In our credit card business our focus has always been on delivering strong and sustainable risk-adjusted returns through a first-rate card proposition for customers in the prime segment of the market. We now have 1.2 million customers and I am pleased to report that we reached our target of £3.0 billion high-quality credit card balances by the end of 2017. As a result of our stringent underwriting criteria we recruited 98 per cent of new balance transfer customers from the highest quality customer segment. Customer engagement increased as we improved our online service for mobile usage and Virgin Money Back, our customer cashback platform, supported an 8 per cent increase in average retail spend per active account.

Our straightforward and transparent investment funds continue to support growing funds under management of £3.7 billion. New money inflows increased by 27 per cent year-on-year and, supported by the increased ISA savings allowance to £20,000, transfers of ISA balances into stocks and shares ISAs were strong during the year.

Our new life insurance proposition performed well in its first year since launch with sales, policies in force and income all exceeding previous life insurance partnerships. The contribution from travel insurance and currency services was flat year-on-year as we focused on higher margin travel insurance business at lower volumes.

Regulatory developments

From 1 January 2019 UK banks will be required to establish ring-fenced operations separating retail from wholesale activities. All of Virgin Money's activities will be within the ring-fence and we are on track to meet the relevant requirements. As the high street banks may seek to deploy excess ring-fenced deposits into the market, this could lead to heightened competition. We remain well-placed to continue competing for mortgage market share despite this competitive backdrop.

The second Payment Services Directive (PSD2), which took effect from 13 January 2018, together with Open Banking, allows customers to choose to share data from their banking products with third parties. This will increase competition in money transmission by allowing new entrants, including new financial technology companies, to compete with the established clearing banks. Although the impact is likely to be felt most strongly and immediately in the personal current account (PCA) market, in which we are not currently a material participant, in the long-term we believe Open Banking and PSD2 represent an opportunity for us to attract customers from the high street banks.

Refreshed strategy

At IPO we set out a number of ambitious targets to maintain a high quality balance sheet while growing income and driving shareholder returns. We have successfully delivered on those initial targets, and we are confident about the next phase in Virgin Money's strategy.

To ensure that we continue to meet the changing needs of our customers and navigate the wider changes in the market, we are investing in our digital future and have updated our customer-focused strategy of growth, quality and returns to provide a strong platform for us to continue to grow responsibly and profitably in the years ahead.

As part of this strategy, we are developing a data-driven, customer-centric digital bank which will allow us to take advantage of the significant technological and regulatory changes shaping UK retail banking, broaden our customer appeal and provide access to a wider pool of UK retail banking revenues.

The new strategy will also diversify our funding through both Small and Medium Enterprises (SMEs) deposits and increased reach into the current accounts and savings markets. We launched an SME deposit product in January 2018 and plan to launch a Business Current Account (BCA) by the end of 2018.

The Virgin Money digital bank will be underpinned by next generation technology and architecture, offering customers a Universal Account that can be personalised to create a unique proposition tailored to individual needs. In addition to our current presence in the mortgage, credit card and retail deposit markets, the digital bank will allow us to expand into the current account and linked primary savings markets.

As such, we will provide an attractive proposition for customers that will enable us to compete against the incumbent banks for lower cost current account balances. The operating cost per customer of the digital bank will also be lower than in our core bank, improving our cost-efficiency once operating at scale. Overall, we expect that our strategy will not only result in enhanced returns for shareholders in the longer term, but also enable us to continue delivering innovative products and outstanding service to our customers.

Colleagues

Our goal is to nurture a high performing, diverse and committed workforce. We aim to ensure that all colleagues can reach their full potential, feel valued and are empowered to thrive in a truly inclusive business. To achieve this we have extended our use of technology to support flexible working and invested in the development of our people managers to make sure they both value and support a diverse workforce. Our latest colleague survey results showed that we achieved a strong staff engagement score of 76 per cent, which compares well against industry standards.

Outlook

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

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

Our natural long term share of the UK mortgage market remains at 3 to 3.5 per cent. In 2018 we expect to grow our mortgage and cards lending at a single digit percentage rate with banking NIM towards the lower end of a 165 to 170 basis points range. Cost discipline will continue as we invest in our strategic developments and we expect the 2018 cost:income ratio to be no higher than 50 per cent.

Our lending discipline will support asset quality and, including the impact of IFRS 9, we expect our cost of risk to be no higher than 20 basis points and to maintain a CET1 ratio towards 13 per cent at the end of 2018.

We expect to maintain a solid double-digit return on tangible equity in 2018.

We will continue to make progress with our SME roll-out and the development of our digital bank over the course of 2018.

Over time, these initiatives will significantly increase the breadth of our proposition, drive new sources of income and reduce operating costs. A broader proposition, lower cost to serve and new sources of funding will drive enhanced returns and support sustainable value creation for shareholders over the longer term.

Jayne-Anne Gadhia CBE
Chief Executive

FINANCIAL RESULTS

Summary of Group results

Our 2017 financial performance demonstrated continued progression across the three pillars of our strategy - Growth, Quality and Returns:

- Growth - our market share of new lending continued to outstrip our share of stock resulting in continued growth in balances, with loans and advances to customers increasing by 13.5 per cent. This growth was funded predominantly by the continued strength of the retail deposit franchise with customer deposits growing 9.6 per cent;
- Quality - we maintained a disciplined approach to managing balance sheet growth with consistently high underwriting standards leading to our low and stable cost of risk. Growth in retail deposits was supported by further diversification of our long-term wholesale funding, including additional RMBS and drawings from the Term Funding Scheme (TFS). Capital resources grew through retained earnings and enabled us to absorb additional investment in the build of our new digital bank; and
- Returns - higher balances drove income growth which, combined with disciplined cost control, resulted in strong operational leverage. As a consequence our cost:income ratio improved by 4.9 percentage points to 52.3 per cent for the year. Combined with our growth and low cost of risk, this resulted in a 28.1 per cent increase in underlying profit before tax with return on tangible equity (RoTE) increasing to 14.0 per cent, compared to 12.4 per cent in the prior year. Statutory profit after tax was £192.1 million, a 37.1 per cent increase on 2016.

Gross mortgage lending of £8.4 billion was combined with strong retention performance to deliver mortgage balances of £33.7 billion at year end. Lending was carefully managed to optimise returns in an increasingly competitive mortgage market. New business mortgage spreads were 19 basis points lower than 2016 at 168 basis points.

Credit card balances increased by 23.6 per cent to £3.0 billion. This was in line with our expected growth and continued to demonstrate the strength of the franchise. We continued to closely monitor the performance of our credit card book, with the latest observed customer behaviour reflected in the assumptions underlying the effective interest rate (EIR) accounting.

The growth in mortgage and credit card balances was funded predominantly through growth in deposits as our retail savings franchise performed well, with balances reaching £30.8 billion at year end.

Our operating platforms continued to support increasing scale of customer activity which, in turn, enhanced Group operational leverage. Underlying income growth of 13.5 per cent significantly exceeded the 3.7 per cent growth in underlying costs, resulting in favourable JAWS of 9.8 per cent.

This continued improvement in operational leverage also reflected our disciplined cost management and helped to create the capacity for increased investment in the business. Total investment in the core business was £52.8 million, of which £41.8 million was capital expenditure. A further £38.3 million of capital expenditure was invested in the development of our new digital banking platform.

The quality of our lending continued to be underpinned by the consistent application of our risk appetite. This was reflected in a cost of risk of 13 basis points which was in line with the prior year, despite a slightly greater proportion of credit card balances. Whilst our low cost of risk benefits in part from the benign economic environment in the UK, it undoubtedly reflects the consistent application of our risk appetite and our disciplined approach to credit risk management across both our mortgage and credit card portfolios. The application of strict affordability requirements, robust credit decisioning and prudent underwriting standards across our portfolios ensured asset quality performance was ahead of our expectations. Balance growth has therefore been achieved without any deterioration in the quality of new lending or the credit characteristics of the portfolios as a whole. Across both portfolios all key credit metrics remain strong and this is reflected in low arrears experience.

Leverage and total capital ratios remained above regulatory requirements with higher retained earnings supporting lending growth and investment. The Common Equity Tier 1 (CET1) ratio remained well above our internal minimum required CET1 ratio of 12.0 per cent at 13.8 per cent, with average mortgage risk weight density at 17.2 per cent. The liquidity and funding profile benefitted from another successful issuance from our established Gosforth Residential Mortgage Backed Security (RMBS) programme and we continued to access the TFS. Additionally, we have received approval for a regulated covered bonds programme, and expect our inaugural issuance to follow in 2018.

Our commercial agility during a year which saw strong competition on both sides of the balance sheet allowed us to manage asset pricing and the cost of funds, which reduced to 59 basis points (2016: 80 basis points). This resulted in a Banking NIM of 172 basis points compared to 175 basis points for the prior year, in line with our expectations.

The combination of strong lending growth, improved operational leverage and our low cost of risk delivered a 28.1 per cent increase in underlying profit before tax, to £273.3 million.

As a consequence of this continued progression measures of shareholder returns were materially improved. Return on tangible equity increased to 14.0 per cent and underlying basic earnings per share rose by 21.7 per cent to 39.8 pence. Unburdened by legacy issues, growth in underlying profit before tax flowed to statutory profit before tax, which increased by 35.1 per cent to £262.6 million.

Our effective tax rate in 2017 was 26.8 per cent. The overall tax rate for UK banks increased by 8 percentage points in 2016 as a result of the bank tax surcharge, adding £18.9 million to the Group's tax charge in 2017. The Group recognised a corporation tax charge of £70.5 million for the year. Statutory profit after tax was therefore £192.1 million, a 37.1 per cent increase on 2016. After distributions to AT1 holders, the profit attributable to equity shareholders increased by 28.7 per cent to £167.3 million.

As a result of this strong financial performance, the Board has recommended a final dividend that takes the total dividend in 2017 to 6.0 pence per ordinary share, an increase of 17.6 per cent compared to 2016.

Summary income statement

	2017 £m	2016 £m	Change
Net interest income	**594.6**	519.0	14.6%
Other income	**71.4**	67.9	5.2%
Total income	**666.0**	586.9	13.5%
Costs	**(348.5)**	(336.0)	3.7%
Impairment	**(44.2)**	(37.6)	17.6%
Underlying profit before tax	**273.3**	213.3	28.1%
Reconciling items between underlying and statutory profit before tax (see page 48)	**(10.7)**	(18.9)	(43.4)%
Statutory profit before tax	**262.6**	194.4	35.1%
Taxation	**(70.5)**	(54.3)	29.8%
Statutory profit after tax	**192.1**	140.1	37.1%
Distributions to Additional Tier 1 security holders (net of tax)	**(24.8)**	(10.1)	145.5%
Profit attributable to equity shareholders	**167.3**	130.0	28.7%
Basic earnings per share - statutory (pence)	**37.8**	29.4	28.6%

Consolidated balance sheet

	2017 £m	2016 £m	Change
Assets			
Cash and balances at central banks	**2,579.0**	786.3	228.0%
Loans and receivables	**37,099.9**	33,003.4	12.4%
Available-for-sale financial assets	**1,051.8**	858.8	22.5%
Other	**377.1**	407.1	(7.4)%
Total assets	**41,107.8**	35,055.6	17.3%
Liabilities and equity			
Deposits from banks	**5,379.0**	2,132.5	152.2%
Customer deposits	**30,808.4**	28,106.3	9.6%
Debt securities in issue	**2,736.9**	2,600.0	5.3%
Other	**358.6**	546.3	(34.4)%
Total liabilities	**39,282.9**	33,385.1	17.7%
Total equity	**1,824.9**	1,670.5	9.2%
Total liabilities and equity	**41,107.8**	35,055.6	17.3%

Key metrics

		2017	2016	Change

Banking net interest margin	%	**1.72**	1.75	(3)bps
Net interest margin	%	**1.57**	1.60	(3)bps
Cost:income ratio	%	**52.3**	57.2	(4.9)pp
Cost of risk	%	**0.13**	0.13	-
Statutory basic earnings per share	p	**37.8**	29.4	8.4 pence
Tangible net asset value per share	£	**2.97**	2.73	24 pence
Total Capital Ratio	%	**18.1**	20.4	(2.3)pp
Common Equity Tier 1 ratio	%	**13.8**	15.2	(1.4)pp
Leverage ratio	%	**3.9**	4.4	(0.5)pp
Return on tangible equity	%	**14.0**	12.4	1.6pp

Key ratios are presented on an underlying basis except where stated. Definitions, including bases of calculation, are set out on page 262.

Balance sheet growth

	At 31 Dec 2017 £m	At 31 Dec 2016 £m	Change
Loans and advances to customers	**36,740.2**	32,367.1	13.5%
Customer deposits	**30,808.4**	28,106.3	9.6%
Wholesale funding (including government funding)	**8,102.9**	4,718.0	71.7%
Wholesale funding <1 year maturity	**855.0**	575.0	48.7%
Loan-to-deposit ratio	**119.1%**	114.5%	4.6pp
High Quality Liquid Assets[1]	**5,264.4**	4,222.6	24.7%

[1]These include Funding for Lending Scheme drawings of £1.9 billion (2016: £2.7 billion) which are held off balance sheet but are available for repo and hence count towards liquidity resources.

The continuing strength of our lending franchise delivered 13.5 per cent growth in loans and advances to customers in 2017.

This lending was funded by continued growth in our retail and wholesale funding franchises, as well as further drawings from the TFS. Total customer deposits grew by 9.6 per cent to £30.8 billion at 31 December 2017, in excess of market growth of 3.5 per cent. We repriced four tranches of existing deposits of approximately £15 billion during 2017, and all were completed with lower than expected attrition.

In September 2017 we completed a successful issuance of RMBS through our established 'Gosforth' franchise. This included dollar and sterling tranches and raised sterling equivalent funding of approximately £750 million. The issuance was significantly oversubscribed, delivering long-dated term funding whilst also diversifying our investor base in the US.

We will continue to diversify and build out our funding sources in the coming year in line with the long term aim of wholesale funding providing up to 20 per cent of total funding. In July 2017 we received authorisation from the FCA for a regulated covered bonds programme, and expect that our inaugural issuance will take place this year. We also expect to access RMBS markets again during 2018.

As we work towards the full implementation of minimum requirements for own funds and eligible liabilities (MREL) on 1 January 2022, during 2018 we will issue further unsecured funding through our established Global Medium Term Note programme. The Bank of England provided MREL guidance, including transitional arrangements, in late 2016. This set an interim MREL requirement of 18 per cent of risk-weighted assets from 1 January 2020 until 31 December 2021. The BoE will advise the Group on its ultimate MREL requirement in 2020. We therefore expect to issue further senior debt gradually over the next four years to ensure compliance with MREL requirements.

The balance sheet structure is managed within a clearly defined risk appetite. The loan-to-deposit ratio increased to 119.1 per cent at the end of 2017 from 114.5 per cent at the end of 2016, in line with guidance of towards 120 per cent while we are participating in the TFS.

We continued to make use of the TFS in 2017, with total drawings at 31 December 2017 of £4.2 billion. The scheme provides the Group with a cost effective source of funding, supporting lending growth and further strengthening our liquidity position.

The Group's liquidity position remained strong throughout the period, with high quality liquid assets at £5.3 billion at 31 December 2017. This reflects an increase in cash and balances held at the central bank. The Group held increased levels of liquidity at 31 December 2017, reflected in an increase in balances held at the central bank in part due to the repayment of £650.2 million of Funding for Lending Scheme (FLS) drawings which have been replaced by on balance sheet liquidity. As a result our liquidity coverage ratio (LCR) of 203 per cent was significantly above the regulatory minimum of 90 per cent. From 1 January 2018 the regulatory minimum has increased to 100 per cent. The high quality liquid asset portfolio represented more than six times our wholesale funding with a maturity of less than one year.

Income benefitted from growth in asset balances

	2017 £m	2016 £m	Change
Net interest income	**594.6**	519.0	14.6%

Other income	**71.4**	67.9	5.2%
Total income	**666.0**	586.9	13.5%
Banking net interest margin	**1.72%**	1.75%	(3)bps
Average interest earning banking assets	**34,536**	29,691	16.3%
Net interest margin	**1.57%**	1.60%	(3)bps
Average interest earning assets	**37,991**	32,521	16.8%

Net interest income increased by 14.6 per cent to £594.6 million, driven by balance growth across the mortgage and credit card books and a Banking net interest margin (NIM) of 172 basis points.

Mortgage spreads were at lower levels than 2016, driven by competition as well as lower funding costs, in part as a result of the TFS. As a result, new mortgage lending in 2017 was priced at an average spread of 168 basis points, compared to 187 basis points in 2016.

However, further optimisation of our funding base continued to support Banking NIM in a competitive environment. We successfully repriced four tranches of deposits and this, along with drawings from the TFS, contributed to a reduction in the cost of funds from 80 basis points in 2016 to 59 basis points in 2017.

Taken together, these factors reduced Banking NIM to 172 basis points in 2017 from 175 basis points in 2016. Total NIM also reduced by 3 basis points to 157 basis points.

Credit card income has benefitted from further growth in the cards book, resulting in an increasing contribution to total net interest income (NII) in the year. Credit card NII in the year includes an accrual of £78.0 million (2016: £61.5 million) arising from the credit card effective interest rate (EIR) method. Credit card EIR is calculated over the expected card life, up to a maximum of seven years. Historical evidence and data continue to support our modelling assumptions and the use of a seven year modelling life.

Other income increased by 5.2 per cent to £71.4 million reflecting stable income from our Investments and Pensions business together with small increases in credit card interchange and foreign exchange income and sales of investment assets.

Other income included a gain of £6.1 million from the sale of the investment in Vocalink in the first half of 2017. Excluding the gain from the sale of Vocalink and the gain of £5.3 million on the investment held in Visa Europe during the first half of 2016, other income increased by 4.3 per cent.

Costs remained tightly controlled

	2017 **£m**	2016 £m	Change
Costs	**348.5**	336.0	3.7%
Cost:income ratio	**52.3%**	57.2%	(4.9)pp

Cost growth in 2017 was constrained to just 3.7 per cent. Set against income growth of 13.5 per cent, this produced positive JAWS of 9.8 per cent and reduced the cost:income ratio by 4.9 percentage points to 52.3 per cent. This performance meant that we successfully achieved our stated target of exiting 2017 with a cost:income ratio of less than 50 per cent, delivering a ratio of 49.4 per cent for the fourth quarter.

This controlled growth in costs was achieved despite higher depreciation and amortisation during the year. Efficiency improvements continued across the business with our ongoing programme of operational effectiveness and the ability to leverage our central functions being key drivers.

Our strong cost performance helped to create the capacity for increased investment in the business. Total investment in the core business was £52.8 million, of which £41.8 million was capital expenditure. A further £38.3 million of capital expenditure was invested in the development of our new digital banking platform.

Impairments reflected a resilient economy and rigorous credit risk management

	2017 **£m**	2016 £m	Change
Mortgages			
Impairment charge	**2.2**	2.8	(21.4)%
Cost of risk	**0.01%**	0.01%	-
Credit Cards			
Impairment charge	**42.0**	34.8	20.7%
Cost of risk	**1.51%**	1.70%	(19)bps
Group			
Impairment charge	**44.2**	37.6	17.6%
Cost of risk	**0.13%**	0.13%	-

Provisions as a % of arrears balances[1]	**32.9%**	29.4%	3.5pp
Impaired loans as a % of loans and advances	**0.5%**	0.4%	0.1pp
Provisions as a % of impaired loans	**33.5%**	40.0%	(6.5)pp

[1] Arrears are defined in the risk report on page 140

We maintained a low cost of risk in 2017 through our established risk appetite framework, ongoing focus on underwriting rigour and the origination of high credit quality customers and prime assets.

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

In credit cards, set against growth of 23.6 per cent in balances, the impairment charge for the portfolio increased by only 20.7 per cent to £42.0 million. The resulting cost of risk for credit cards decreased by 19 basis points to 1.51 per cent in 2017. This underlines the high credit quality of new and existing cards which continue to have a low rate of default. Performance of new cohorts of cards remained strong with all cohorts showing a cost of risk lower than or in line with previous vintages. When accounts under 18 months old are excluded the cost of risk remains low at 1.66 per cent.

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

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

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

Further information on the performance of our loan portfolios is provided in the Risk Management Report, on pages 134 to 152.

Underlying profit before tax to statutory profit before tax reconciliation

	2017 **£m**	2016 £m	Change
Underlying profit before tax	**273.3**	213.3	28.1%
IPO share based payments	**(0.9)**	(2.0)	
Strategic items	**(6.5)**	(2.4)	
Simplification costs	**-**	(5.6)	
Fair value losses on financial instruments	**(3.3)**	(8.9)	
Reconciling items between underlying and statutory profit before tax	**(10.7)**	(18.9)	(43.4)%
Statutory profit before tax	**262.6**	194.4	35.1%

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). Aspects of the results are adjusted for certain items, which are listed below, to reflect how the Executive assesses the Group's underlying performance without distortions caused by items that are not reflective of the Group's ongoing business activities. These reconciling items were 43.4 per cent lower in 2017, as the absence of simplification costs, lower fair value losses on financial instruments and a reduction in share based payments related to the IPO more than offset the increased investment in strategic items. The following items have been excluded from underlying profits:

- IPO share based payments

  These costs relate to share based payment charges triggered by our successful IPO in 2014, which are recognised over their vesting period. By their nature, these payments are not reflective of ongoing trading performance and are not, therefore, considered part of the underlying results. 2017 is the last year in which such charges will be incurred.

- Strategic items

  We incurred strategic investment costs of £6.5 million in 2017, entirely due to the development of our digital banking platform which is not, at this stage, considered part of our underlying results. Included within this amount is a non-cash impairment charge of £4.8 million in respect of previous software development on an earlier digital project which has been discontinued in light of the strategic decision taken in May 2017 to consolidate activities within the digital bank programme.

- Simplification costs

  In 2016 we took the opportunity to focus on simplification activity, including de-layering our organisation structure. This led to one-off costs incurred in 2016 including those in relation to a number of senior leavers, which included accelerated share based payment charges. These were not considered part of the underlying results and were not repeated in 2017.

- Fair value losses on financial instruments

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

The reconciliations of the Group's statutory and underlying results are reported above and in note 2 to the consolidated financial statements.

The Group uses a number of Alternative Performance Measures (APMs), in addition to underlying profit, in the analysis and discussion of its financial performance and financial position. APMs do not have standardised definitions and may not be directly comparable to measures defined within IFRS. A full list of APMs used by the Group, including their bases of calculation, are set out on page 262.

Continued strong progression in returns

		2017	2016	Change
Return on tangible equity	%	**14.0**	12.4	1.6pp
Return on assets	%	**0.46**	0.44	2bp
Tangible net asset value per share	p	**297**	273	24p

The strength of income growth and improved operational leverage, combined with our asset quality, has driven material enhancement to returns in 2017.

Return on tangible equity increased by 1.6 percentage points to 14.0 per cent in 2017, from the 12.4 per cent achieved in 2016. At the same time, the return on assets grew by 2 basis points to 0.46 per cent in 2017, from 0.44 per cent in 2016. On a statutory basis, return on assets increased to 0.47 per cent from 0.40 per cent in 2016. This statutory measure excludes AT1 coupons and benefitted from lower reconciling items in 2017.

Tangible net asset value per share also increased, by 24 pence to 297 pence, as improving profitability flowed through to retained earnings.

Capital strength whilst investing in the future

		2017	2016	Change
Common Equity Tier 1 capital (CET1)	£m	**1,264.2**	1,172.7	7.8%
Risk-weighted assets (RWAs)	£m	**9,178.6**	7,694.8	19.3%
- of which mortgage credit risk RWAs	£m	**5,790.5**	4,764.5	21.5%
- of which credit card credit risk RWAs	£m	**2,282.9**	1,847.4	23.6%
- of which all other RWAs	£m	**1,105.2**	1,082.9	2.1%
Common Equity Tier 1 ratio	%	**13.8**	15.2	(1.4)pp
Tier 1 ratio	%	**18.0**	20.2	(2.2)pp
Total capital ratio	%	**18.1**	20.4	(2.3)pp
Leverage ratio	%	**3.9**	4.4	(0.5)pp

During the year we generated capital, after distributions to AT1 holders and before investment and dividends, of £167.3 million, which was equivalent to 182 basis points of CET1 capital.

This was used to invest in the business, provide dividends for shareholders and increase capital resources. The net investment in intangible assets, including capital investment in our digital banking platform, was £47.8 million. Accrued dividends for equity shareholders amounted to £26.5 million.

After further small balancing items, this resulted in an increase in CET1 capital of £91.5 million which was in turn used to support customer lending.

Lending growth resulted in a 19.3 per cent increase in RWAs to £9.2 billion. In mortgages, growth in credit risk RWAs of 21.5 per cent was higher than balance growth of 13.2 per cent as the average mortgage risk weight density, as a percentage of balance sheet assets, increased to 17.2 per cent from 16.0 per cent, in line with expectations.

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

Other RWAs increased by 2.1 per cent. This reflected growth in operational risk RWAs in line with the standardised approach, where the growth in average income over the past three years is recognised in a higher level of operational RWAs. This was largely offset by a reduction in exposure to higher risk-weighted instruments and counterparties in our liquid asset portfolio.

As a result of the above movements, the CET1 ratio reduced to 13.8 per cent at 31 December 2017 compared with 15.2 per cent at the end of 2016. This was in line with the expected development of our business and is in excess of our internal minimum CET1 ratio of 12 per cent.

The total capital ratio of 18.1 per cent also reduced in line with the movements described above, and remains significantly in excess of our total regulatory requirements of 15.0 per cent:

The capital requirement of 15.0 per cent at 31 December 2017 comprised Pillar 1, Pillar 2A and the capital conservation buffer. At 31 December 2017, as per our Individual Capital Guidance (ICG), the Basel I floor was our binding constraint and equivalent to a Pillar 2A capital add-on requirement of 5.71 per cent. Any PRA buffer, if applicable, is a matter between the PRA and Virgin Money. The PRA buffer also takes account of the capital conservation buffer.

The leverage ratio was 3.9 per cent at the end of the year compared to 4.4 per cent at the end of 2016. The reduction reflected higher growth in leverage ratio eligible assets than in capital resources. Growth in eligible assets was due to increased customer balances and higher levels of on balance sheet liquidity as FLS was repaid.

We manage our capital resources to support shareholder returns and ensure that the bank is well capitalised to meet our current and future business plans and our assessment of regulatory risks and requirements.

Dividend

The strength of our profitability and our capital base continues to give the Board confidence to recommend the payment of a final dividend. In addition to the interim dividend for 2017 of 1.9 pence per ordinary share, paid to shareholders in September 2017, the Board has recommended a final dividend of 4.1 pence per ordinary share in respect of 2017 which will be paid, subject to approval at our AGM in May 2018. The total dividend per share for 2017 will therefore be 6.0 pence, an increase of 17.6 per cent compared to 2016. Our intention is to maintain a progressive approach to dividends and to pay an interim and final dividend for 2018, subject to performance.

IFRS 9

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

This impact would reduce the Group's CET 1 ratio by approximately 1 basis point as at 1 January 2018 taking into account the recently published capital transitional arrangements. Excluding the transitional arrangements the reduction to the CET 1 ratio would be approximately 36 bps. These impacts remain within expectation and are included within the Group's capital plans. We continue to refine, monitor and validate certain elements of the impairment models and related controls ahead of full reporting of IFRS 9 impacts later in 2018.

Conclusion

2017 represented a further year of significant financial progress for Virgin Money. High-quality lending growth combined with further operational leverage has driven improved returns for our shareholders across RoTE, earnings per share and tangible net asset value. This has been achieved with no degradation of asset quality, further diversification of the funding base and with continued focus on the strength of the capital base and capital ratios.

As the business has become increasingly capital generative we have been able to invest in the next stage of our strategic development with our initiatives to develop the digital bank and our proposition for the SME market.

Peter Bole

Chief Financial Officer

BUSINESS LINE RESULTS

	Mortgages & Savings £m	Credit Cards £m	Financial Services £m	Central Functions £m	Group £m
2017					
Net interest income	430.2	164.4	-	-	594.6
Other income	3.1	19.4	37.2	11.7	71.4
Total income	433.3	183.8	37.2	11.7	666.0
Total costs				(348.5)	(348.5)
Impairment charge	(2.2)	(42.0)	-	-	(44.2)
Net interest margin	1.35%	5.95%	-	-	1.57%
Cost of risk	0.01%	1.51%	-	-	0.13%
Key balance sheet items at 31 December 2017					
Loans and advances to customers[1]	33,672.4	3,024.1	-	-	36,696.5
Customer deposits	30,808.4	-	-	-	30,808.4
Total customer balances	64,480.8	3,024.1	-	-	67,504.9
Risk-weighted assets	6,308.1	2,467.6	53.4	349.5	9,178.6

	Mortgages & Savings £m	Credit Cards £m	Financial Services £m	Central Functions £m	Group £m
2016					
Net interest income	383.0	136.0	-	-	519.0
Other income	2.0	17.7	37.5	10.7	67.9
Total income	385.0	153.7	37.5	10.7	586.9
Total costs				(336.0)	(336.0)
Impairment charge	(2.8)	(34.8)	-	-	(37.6)
Net interest margin	1.38%	6.69%	-	-	1.60%
Cost of risk	0.01%	1.70%	-	-	0.13%
Key balance sheet items at 31 December 2016					
Loans and advances to customers[1]	29,740.8	2,447.1	-	-	32,187.9
Customer deposits	28,106.3	-	-	-	28,106.3
Total customer balances	57,847.1	2,447.1	-	-	60,294.2
Risk-weighted assets	5,204.5	2,012.3	50.4	427.6	7,694.8

[1] Excluding fair value of portfolio hedging

The Group allocates interest expense arising from retail and wholesale funding activities between the Mortgage and Savings and Credit Cards business lines.

MORTGAGES AND SAVINGS

We provide mortgages, savings and current accounts to almost 1.8 million customers. Mortgages are sold primarily through our intermediary partners and retail deposits are largely originated through our digital channel. Our Mortgages and Savings business line is an important revenue driver for the Group, contributing 65.1 per cent of total income in 2017.

Mortgage Strategy

Our approach to mortgages is very straightforward. We offer a wide range of mortgage products to prime credit quality customers. Distribution is principally through our intermediary partners, supplemented by direct distribution and supported by excellent service.

We have continued to develop our mortgage proposition to broaden our presence across segments of the market where we are under-represented. These have been delivered within our existing risk appetite.

We continued to strengthen our intermediary proposition to enrich existing intermediary relationships, which have been a driver of value for us during 2017. Additionally, we continue to invest in the retention of our existing customers.

Key developments - Mortgages

We delivered gross lending of £8.4 billion in the year to 31 December 2017. This was achieved with a consistent risk profile, with the average loan-to-value of new lending stable at 68 per cent.

In an increasingly competitive environment and with the gross lending market growing by 4 per cent to £257 billion, our performance was in line with the prior year and represented a 3.3 per cent market share of gross lending.

Mortgage retention rates at product maturity remained strong with 72 per cent of customers with maturing fixed rate or tracker products being successfully retained during 2017, compared with 68 per cent in 2016.

The combined effect of new business and retention performance resulted in net lending of £3.9 billion. This represented an 8.9 per cent market share of net lending. This steady progression continued to bring our share of stock towards our share of flow, within a stable credit risk appetite. In 2017 our share of stock increased to 2.45 per cent from 2.23 per cent in 2016 as mortgage balances increased by 13.2 per cent to £33.7 billion in 2017.

Prime residential balances grew by 12.5 per cent to £27.3 billion, representing 81.1 per cent of the overall mortgage book and 81.7 per cent of new lending in 2017. Buy-to-let balances of £6.4 billion represented 18.9 per cent of the overall mortgage book at year end. The private rental sector remains a key component of meeting UK housing demand and we retained a strong presence in the buy-to-let market, particularly in the remortgaging segment.

Completion spreads across the market trended downwards in 2017 as a result of competitive pressures. Both incumbents and new entrants looked to build market share and the market was impacted by lower funding costs, in part as a result of the TFS. Our dynamic approach to adjusting pricing in response to competitor movements, expanded reach into new customer segments, and strong intermediary relationships enabled us to offset these pressures to a degree. We ended 2017 with a completion spread of 168 basis points, down from 187 basis points in 2016.

Geographically our lending is broadly consistent with the general distribution of balances across the UK. We retain a consistent presence in more affluent areas such as London and the South East where arrears are lower and our underwriting ensures a lower loan-to-value of new business. This affords us protection should house prices fall in the future.

We remain committed to helping customers to achieve their home ownership aspirations and continue to develop our mortgage franchise to this end. We launched a Shared Ownership proposition to enhance customers' options and we became the first mainstream bank to enter the Custom Build sector. The number of customers using Virgin Money to buy a New Build property increased by 41 per cent year on year. These developments enabled us to increase the value of gross lending to First Time Buyers by 20 per cent. Lending at a loan-to-value over 90 per cent remained low however, and represented under 4 per cent of our new business loans. Customer demographics were stable and performance remained robust.

We continued to deliver enhancements for mortgage brokers. Our partnerships with key national intermediaries continued to develop as we strengthened the intermediary proposition by expanding access to our New Build offering and through entering new market segments such as Shared Ownership. These initiatives, together with our strong service levels, were recognised by our partners as our intermediary NPS increased to +61 from +55 in 2016.

Thanks to developments in our innovative Mortgage Lab, we also made progress on our proposition for customers who wish to use our direct channel. As a result, the proportion of new mortgage applications from direct customers increased to 12 per cent in 2017 from 10 per cent in 2016, and exceeded £1 billion for the first time.

The quality of our mortgage franchise was recognised with several industry awards over the course of the year: Legal & General Best Lender for Partnership (for the third consecutive year); Yourmoney Best Online Mortgage Provider; Mortgage Strategy Awards Best Mortgage Lender and Sesame Bankhall Group Best Innovative Lender.

Savings Strategy

We offer customers a range of instant access and fixed term savings products, also making these available as ISAs. We also offer a basic bank account. Savings products are sold primarily through our digital channels supplemented by our Stores and contact centres. We attract and retain customers with enduring, good value offers and excellent service.

Key developments - Savings

We opened more than 370,000 new savings accounts in the year. At the end of 2017 we had more than 1.3 million savings customers and balances had grown to £30.8 billion, up from £28.1 billion at 31 December 2016.

This balance growth of 9.6 per cent compared to market growth of 3.5 per cent over the course of 2017. Our market share of savings stock was 1.7 per cent at 31 December 2017.

Performance was underpinned by strong customer retention. We retained 89 per cent of customers with maturing fixed rate balances and successfully repriced £15 billion of funds on our existing book across four phases of repricing. Attrition rates on each reprice were consistently better than expectations.

Cash ISA performance was particularly strong in 2017 with balances increasing by 27 per cent compared to a flat market, reflecting the strong appeal of our proposition to ISA customers. We had a market share of Cash ISA balances of 6.1 per cent at the end of December 2017, up from 4.8 per cent at the end of 2016.

We continued to develop new propositions to broaden our access to savings customers with differing needs. Our regular saver product helps attract customers who are new to saving and had attracted over 45,000 customers by the end of 2017. We were also pleased to grow our savings products partnership with Manchester United to reach 10,000 customer accounts during the year.

Our Essential Current Account continues to attract customers looking for a straightforward transparent product, and is endorsed as one of the best basic bank accounts in the market by Money Saving Expert. We have maintained our account opening run rate at the level experienced through 2016, opening 12,000 new accounts in 2017.

We continue to focus on providing best in class customer service. Improvements to the customer proposition and journey are reflected in our strong retention rates and continued growth in customer advocacy, with Savings NPS increasing to +37 in 2017 from +16 in 2016.

Ongoing active management of retail funding costs in the context of competitive market conditions contributed to a reduction in the total cost of funds from 80 basis points in 2016 to 59 basis points in 2017.

2017 financial highlights - Mortgages and Savings

- mortgage balances grew by 13.2 per cent to £33.7 billion, driven by gross lending of £8.4 billion, and strong customer retention. In a competitive marketplace, spreads on new business reduced 19 basis points to 168 basis points;
- deposit balances grew by 9.6 per cent to £30.8 billion. With TFS helping to reduce market funding costs, our active management of pricing enabled us to reduce spreads and partially offset downward pressure on asset pricing;
- NIM for the full year 2017 was 1.35 per cent in the mortgage and savings business. The 3 basis point reduction in NIM relative to 2016 reflects the dilutive effect of new lending and competitive market conditions, partially mitigated by our active management of pricing and mix in both the mortgage and savings markets;
- net interest income increased by 12.3 per cent to £430.2 million, driven by growth in mortgage balances. Combined with a £1.1 million increase in other income, total income in this business line rose by 12.5 per cent to £433.3 million;
- the high quality of our mortgage business continued to be reflected in the cost of risk which remained stable at 1 basis point for the year. Our already low arrears levels reduced further in 2017. The percentage of loans over three months in arrears was 0.12 per cent at the end of 2017, compared to 0.15 per cent at the end of 2016;
- at £2.2 million, the impairment charge in 2017 was below the £2.8 million incurred in 2016, reflecting our strong credit management and resulting high-quality mortgage book, as well as benign economic conditions; and
- risk-weighted assets in this business line increased by 21.2 per cent to £6.3 billion, reflecting lending growth with new business coming onto the book at risk weights higher than more seasoned stock.

Performance summary - Mortgages and Savings

	2017 £m	2016 £m	Change
Net interest income	**430.2**	383.0	12.3%
Other income	**3.1**	2.0	55.0%
Total underlying income	**433.3**	385.0	12.5%
Impairment charge	**(2.2)**	(2.8)	(21.4)%
Mortgages and savings net interest margin	**1.35%**	1.38%	(3)bps
Cost of risk	**0.01%**	0.01%	-

	2017 £m	2016 £m	Change
Key balance sheet items at 31 December			
Loans and advances to customers	**33,672.4**	29,740.8	13.2%
- of which prime residential	**27,306.4**	24,273.6	12.5%
- of which buy-to-let	**6,366.0**	5,467.2	16.4%
Customer deposits	**30,808.4**	28,106.3	9.6%
Total customer balances	**64,480.8**	57,847.1	11.5%
Risk-weighted assets	**6,308.1**	5,204.5	21.2%

CREDIT CARDS

We provide credit card products, predominantly online, to 1.2 million customers. Our portfolio is a mix of balance transfer and retail credit cards, and our offering continues to develop with the launch of our Virgin Atlantic Airways affinity products in the first half of 2018. Our credit card business contributed 27.6 per cent of total income in 2017.

Strategy

Our Credit Card business has continued to build on the foundations laid by the successful migration of the book purchased from MBNA onto our own platform in early 2015. The functionality of our credit card platform has allowed us to continue to grow the business through simple, transparent products offered to high credit quality applicants, supported by strong risk management and analytical capability.

The product portfolio has been expanded to cater for different customer needs in the balance transfer and retail card segments. We have achieved this with a range of products that focus on core customer needs: debt consolidation, borrowing and everyday spending.

Key developments

Balances grew by 23.6 per cent during 2017 as we achieved our target of £3.0 billion of balances by the end of 2017, with a stable customer profile and improving credit quality.

In 2017 we launched new customer initiatives such as 'Virgin Money Back' offering cashback on purchases, together with promotions to encourage contactless transactions. These supported an 8 per cent increase in average retail spend per active account. These initiatives, together with improvements in customer service resulting from an upgrade to our online service platform, led to credit card NPS improving to +46 (2016: +42)

We opened close to 300,000 customer accounts during 2017, in line with the prior year. We continued to move the focus of customer acquisition towards retail-led cards, which represented over 40 per cent of new accounts in 2017 compared to 30 per cent in 2016. As a result of the ongoing diversification of our portfolio, retail spend on our cards was 41 per cent higher than in 2016.

Our customer indebtedness scores remained significantly below the market average, driven by strong affordability established at the point of underwriting. The profile of newly acquired customers remained broadly stable following additional tightening of criteria for all customers.

In 2017 over 98 per cent of new balance transfer customers were booked at an expected loss rate of less than 1 per cent. This compared with 74 per cent of new balance transfer customers booked at an expected loss rate of less than 1 per cent in the overall market. We do not book customers outside our credit risk appetite, and do not downsell to applicants who do not pass our initial credit score assessment.

This all ensured that our early arrears continued to outperform the industry, as did portfolio arrears levels.

We maintained our in-depth monthly review of customer spending, borrowing and repayment behaviour. This demonstrated stable usage and a highly consistent pattern of activity.

During the year, the first cohorts of business underwritten on our own platform in 2015 reached the end of promotional terms. These cohorts represented a relatively low volume of balances. In 2018 greater volumes of balances will reach the end of promotional terms. In line with this, we will see a natural increase in balance attrition which will result in lower levels of overall portfolio balance growth. Our co-branded partnership with Virgin Atlantic Airways (VAA) will help us to diversify the mix in our portfolio further with a higher proportion of borrowing from retail spend and reward based cards complementing our balance transfer offers. The first VAA products will be launched in the first half of 2018.

The strength of our customer proposition and experience was recognised by winning the British Bank Awards Best Credit Card Provider and the Your Money Awards Best Online Credit Card Provider for 2017.

2017 financial highlights - Credit Cards

- credit card balances increased by 23.6 per cent to £3.0 billion at year end;
- net interest income grew by 20.9 per cent to £164.4 million reflecting growth in balances;
- the performance of the book continued to be closely monitored with the latest observed customer behaviour reflected in the assumptions underlying our effective interest rate (EIR) accounting. Historical evidence and data continue to support our use of a seven year modelling life;
- net interest margin decreased by 74 basis points to 5.95 per cent reflecting book growth and the relatively lower yield on more recent cohorts of lending;
- other income increased by 9.6 per cent. This increase was driven by higher interchange and foreign exchange income reflecting an increase in retail volumes and a higher mix of retail accounts;
- as a result of the above factors total income increased by 19.6 per cent;
- the impairment charge for credit cards increased by 20.7 per cent to £42.0 million reflecting balance growth. The high credit quality of new and existing cohorts, which continue to have a low rate of default, meant the cost of risk for credit cards reduced by 19 basis points to 1.51 per cent in 2017, from 1.70 per cent in 2016; and
- risk-weighted assets in the business line increased by 22.6 per cent from 2016, driven by the growth in balances.

Performance summary - Credit Cards

	2017 £m	2016 £m	Change
Net interest income	**164.4**	136.0	20.9%
Other income	**19.4**	17.7	9.6%
Total income	**183.8**	153.7	19.6%
Impairment charge	**(42.0)**	(34.8)	20.7%
Credit cards net interest margin	**5.95%**	6.69%	(74)bps
Cost of risk	**1.51%**	1.70%	(19)bps

	2017 £m	2016 £m	Change
Key balance sheet items at 31 December			
Loans and advances to customers	**3,024.1**	2,447.1	23.6%
Total customer balances	**3,024.1**	2,447.1	23.6%
Risk-weighted assets	**2,467.6**	2,012.3	22.6%

FINANCIAL SERVICES

The Financial Services business line offers customers investment, insurance and currency products and services. We work in partnership with a number of specialist organisations to deliver these products, which generate attractive returns and consume low levels of capital. This business line contributed 5.6 per cent of total income in 2017.

Strategy

Our Financial Services strategy is based on a partnership model. We seek partners who share our commitment to straightforward, transparent and good value customer propositions. We leverage their capabilities with our brand and marketing expertise to access profitable sectors and capital-light product lines, whilst limiting our exposure to financial risk.

Key developments

The investment business performed well in 2017 as inflows increased by 27 per cent compared to 2016. Stocks and Shares ISA sales and transfers were a particular highlight, with annual growth of 40 per cent and 160 per cent respectively. These were driven by the increased ISA threshold in combination with strong Virgin Atlantic Airways partnership sales and continued improvements to the customer journey.

In the insurance business, we successfully re-launched our life insurance product with our new partner BGL. This features a straightforward proposition with a simple and transparent quotation process, and has already delivered 4,000 policy sales.

The travel insurance market continues to be competitive. In order to adapt to this environment we focused on attracting higher volumes of direct customers. We achieved this by enhancing the customer journey, including a new 'quick quote' facility. This narrower focus resulted in lower volumes overall but increased income per policy. We also saw the NPS of Travel Insurance customers improve to +38 from +35 in 2016.

2017 financial highlights - Financial Services

- income in the Financial Services business line continued to be driven by our investment funds business, where income was up 0.9 per cent compared with 2016;
- funds under management stood at £3.7 billion at 31 December 2017, an increase of 9.6 per cent from 2016 driven by increases in the FTSE, and sales of stocks and shares ISAs. The Group mitigated the risk associated with stock market movements and their impact on earnings through the use of a FTSE hedge, and as a consequence income growth did not fully benefit from the rise in the FTSE;
- insurance and other income in 2017 decreased by 10.3 per cent, reflecting continued competitive pressure in the travel insurance market; and
- as a result, total income from the Financial Services business fell by 0.8 per cent year-on-year.

Performance summary - Financial Services

	2017 £m	2016 £m	Change
Investments and pensions	**32.0**	31.7	0.9%
Insurance and other	**5.2**	5.8	(10.3%)
Total income	**37.2**	37.5	(0.8%)

	2017 £m	2016 £m	Change
Key balance sheet items at 31 December			
Risk-weighted assets	**53.4**	50.4	6.0%

CENTRAL FUNCTIONS

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

This part of our business contributed 1.8 per cent of total income in 2017 from the sale of available-for-sale assets and debt securities by our Treasury function.

Key developments

Management of operating expenses is a key discipline for the business. We have continued to invest in our people and in developing the long term future of the bank through digital investment whilst stringently managing costs through further simplification and efficiency activity. This approach has driven continued improvements in operational leverage, delivering a Cost:Income ratio of less than 50 per cent for the fourth quarter.

Fixed costs were held broadly flat as the benefit of simplification undertaken in 2016 and other operational efficiencies offset inflationary and volume driven cost increases.

Property and IT costs were tightly managed, whilst we worked closely with strategic partners to create efficiencies.

We continued to optimise and prioritise our project delivery in 2017, investing £52.8 million effectively to deliver a wide range of initiatives that helped grow and protect our business, as well as meet key regulatory requirements. These included the delivery of operational and customer efficiencies from our Mortgage and Savings Lab, an upgrade of colleague IT equipment, investment in Cyber-crime and Financial crime prevention as well as the build of our IFRS 9 capability.

To support the evolution of our strategy, we have also invested £38.3 million in the development of our new digital banking platform.

During 2017 we actively managed the mix of our liquid asset portfolio to reduce our exposure to higher risk-weighted instruments and counterparties.

2017 financial highlights - Central Functions

- interest income and expense incurred from Treasury funding and liquidity operations is allocated to the Mortgage, Savings and Credit Cards businesses;
- other income is primarily driven by gains from the sale of available-for-sale assets and debt securities. In 2017 this included a gain of £6.1 million arising from the sale of our investment in Vocalink. 2016 other income included a gain of £5.3 million on the investment held in Visa Europe;
- operating costs remained tightly controlled with continuous improvement across the organisation. In our savings operation the implementation of additional automation led to a 21 per cent improvement in new accounts opened per FTE.
- an £8.5 million increase in depreciation and amortisation arose from capital expenditure in prior years, as we continued to invest in the future of the bank; and

- an 18.3 per cent reduction in risk-weighted assets primarily due to the reduction in higher risk-weighted instruments in the liquidity portfolio.

Performance summary - Central Functions

	2017 £m	2016 £m	Change
Other income	**11.7**	10.7	9.3%
Total income	**11.7**	10.7	9.3%
Total costs	**(348.5)**	(336.0)	3.7%

	2017 £m	2016 £m	Change
Key balance sheet items at 31 December			
Risk-weighted assets	349.5	427.6	(18.3)%

Operating Costs

	2017 £m	**2016 £m**	**Change**
Staff costs	**190.7**	188.9	1.0%
Premises and equipment	**30.0**	28.5	5.3%
Other expenses	**97.4**	96.7	0.7%
Depreciation, amortisation and impairment	**30.4**	21.9	38.8%
Total costs	**348.5**	336.0	3.7%

Research and development activities

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

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL FINANCIAL REPORT

The responsibility statement below has been prepared in connection with the Group's full annual report for the year ending 31 December 2017. Certain parts thereof are not included within this announcement.

Each of the Directors who currently is in office confirms that to the best of their knowledge:

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

This responsibility statement was approved by the board of directors on 26 February 2018 and is signed on its behalf by:

Jayne-Anne Gadhia, Chief Executive

Glen Moreno, Chair of the Board

PRINCIPAL RISKS AND UNCERTAINTIES

Effective risk management is a core part of our strategy.

The Board-approved risk appetite reflects our tolerance for risk in pursuit of our strategic objectives. It is designed to achieve an appropriate balance between risk and reward. Risk appetite is embedded in the business through delegation of authority from the Board to the Executive. Our risk management approach is fully aligned with Board risk appetite, regulatory requirements and industry good practice. Risks are identified, managed and mitigated using our risk management framework (see page 131). Our risk-aware culture and strong, independent Risk function help to ensure adherence to our risk management framework. An effective governance structure, rapid escalation of threats and the sharing of information across the Group results in a timely response to emerging risks.

We use a 'Three Lines of Defence' model which describes clear accountabilities, appropriate segregation of duties and effective independent assurance. The principal risks which could impact the delivery of our strategy are outlined on pages 36 to 37.

As a UK retail bank we are focused on serving domestic customers. We are subject to risks arising from macro-economic conditions in the UK, geopolitical uncertainty, the competitive environment and new structural and regulatory changes which will come into force over the next few years.

Our ongoing focus on maintaining a strong retail deposit franchise and high-quality lending portfolios is supported by our robust approach to both financial and non-financial risk management.

Achievements in 2017

Our key achievements during 2017 included continued rigorous focus on credit quality, the strength of our capital and funding bases, significant programmes of work addressing key regulatory initiatives and further strengthening our framework for the management of cyber-crime and financial crime risks.

Credit

The application of strict affordability requirements, robust credit decisioning and prudent underwriting standards across our mortgage and credit card portfolios ensured that asset quality performance was ahead of our expectations. This is reflected in our low overall cost of risk of 0.13 per cent (2016: 0.13 per cent). We are responsive to the changing macro-economic environment and regularly refine our credit risk management approaches.

Mortgage lending grew by 13.2 per cent to £33.7 billion during 2017, despite increased competition from incumbent lenders and new entrants looking to enhance their market share. The mortgage portfolio represents 91.6 per cent (2016: 92.3 per cent) of gross loans and advances to customers. Prime residential lending grew to £27.3 billion during 2017, representing 81.1 per cent (2016: 81.6 per cent) of total secured loans.

- The high quality of our mortgage business is reflected in our low arrears levels. Secured 3+ arrears levels were 0.12 per cent at the end of 2017, compared to 0.15 per cent in 2016, substantially below the latest UK Finance industry average of 0.82 per cent. Additionally, the proportion of secured assets classified as neither past due nor impaired remained stable during 2017 at 99.0 per cent (2016: 99.1 per cent);
- The consistent application of our lending criteria and robust underwriting gives us confidence that our mortgage book would be resilient in the event of a downturn. In 2017, we further strengthened our lending criteria in relation to buy-to-let properties, which constitute 18.9 per cent (2016: 18.4 per cent) of total secured loans;
- The indexed portfolio LTV remained stable at 55.8 per cent at the end of 2017 (2016: 55.4 per cent); and
- Our low cost of risk for mortgages has remained stable at 0.01 per cent (2016: 0.01 per cent).

During 2017, our credit card book, net of impairments grew to £3.0 billion, representing a market share of 4.1 per cent. The credit card portfolio accounts for 8.4 per cent (2016: 7.7 per cent) of total loans and advances to customers.

In February 2017, the Bank of England (BoE) noted that unsecured lending standards had fallen across the market. In contrast, the quality of our credit card lending has remained strong. Average credit card behavioural scores have improved during the year as we continue to focus on monitoring customer behaviour and book performance closely. Application quality is strong and there is a growing gap between our benchmarked asset quality and market averages. However, we recognise the potential for economic headwinds and during the first half of 2017 further tightened our lending criteria.

- Revised credit card scorecard cut-offs were implemented in April 2017. Policy restrictions were made in May 2017 to reinforce our focus on the acquisition of customers with low levels of indebtedness. Growth in credit card balances continues to be driven by targeting low risk customer segments. For instance, in 2017 over 98 per cent of new balance transfer customers were booked at an expected loss rate of less than 1 per cent;
- Credit card book quality remained stable with 98.6 per cent (2016: 98.7 per cent) of the book currently classified as neither past due nor impaired. Unsecured 2+ arrears levels remained low at 0.88 per cent (2016: 0.78 per cent) with the small increase during 2017 primarily due to expected increases in arrears levels on balances originated during 2015 and 2016 as these cohorts mature. Arrears levels remain well within our forecast position and compare favourably to industry benchmarks; and
- Our low cost of risk for credit cards of 1.51 per cent (2016: 1.70 per cent) reflects a rigorous approach to underwriting, account management and credit decisioning, supported by the benign economic environment.

Capital and funding

Maintaining a well-capitalised business supports balance sheet growth, credit ratings and regulatory requirements. Our capital base is managed to ensure that the business is well placed to react to current and forecast economic, market and regulatory conditions, as well as any material downturn in the economy.

- As at 31 December 2017, our Common Equity Tier 1 (CET1) ratio was 13.8 per cent (2016: 15.2 per cent), our total capital ratio was 18.1 per cent (2016: 20.4 per cent), and our leverage ratio was 3.9 per cent (2016: 4.4 per cent). Movements in 2017 reflect the utilisation of capital to support further lending growth and investment in business development. All capital ratios remain significantly above the regulatory minima.

Our funding strategy is retail deposit-led. We hold high-quality liquid assets (HQLA) to address the liquidity needs of the business and, in addition to retail deposits, we diversify our funding through a number of wholesale funding programmes;

- Retail deposits increased by 9.6 per cent during the year to £30.8 billion, with a lower cost of funds. This was achieved through close management of pricing and product mix. The retail product mix included a higher proportion of fixed rate products, increasing overall contractual tenor. Almost nine out of ten fixed rate savings customers opted to stay with us at maturity, highlighting the strength of our retention offering;
- Our strong funding position is reflected in a liquidity coverage ratio of 203 per cent (2016: 154 per cent) as at 31 December 2017;
- Our loan-to-deposit ratio increased to 119.1 per cent during 2017, from 114.5 per cent at 31 December 2016, in line with internal limits of up to 120 per cent;
- In September, we successfully completed a further issuance of Residential Mortgage Backed Securities (RMBS), raising £745.9 million in both USD and GBP tranches. Wholesale funding supplements our core retail deposit base and cost of funding. Wholesale funding also helps to extend tenor and ensures we have appropriate diversification in the funding base;
- During the year, we made further drawings from the BoE Term Funding Scheme (TFS) taking overall drawings at 31 December 2017 to £4.2 billion. In parallel, we repaid £650.2 million of Funding for Lending Scheme (FLS) funding. This low-cost funding creates additional lending capacity and supports our overall funding plan; and
- In July 2017, the Financial Conduct Authority (FCA) confirmed that our Covered Bonds application had been approved. We expect to make our inaugural issuance in 2018.

Regulatory initiatives

Our work during the year focused on the following regulatory changes:

- During 2017, the FCA published its approach to implementing the revised Payment Services Directive (PSD2), which came into force on 13 January 2018. As well as promoting innovation, PSD2 aims to improve consumer protection, increase the security of payments, and reduce the cost of payment services;
- The General Data Protection Regulation (GDPR) provides an updated EU data protection framework to replace the existing 1995 Data Protection Directive (the Directive). GDPR will come into force in May 2018;

During 2017 we made significant investment in undertaking the required preparatory work in relation to the above change programmes.

- On 3 April 2017, the FCA published a consultation paper setting out proposals for new rules and guidance to address persistent credit card debt. These proposals complement the remedies arising from the Credit Card Market Study published in 2016, which aim to reduce the number of customers with problem credit card debt. While we have very limited exposure to such customers, we are working with the FCA to trial strategies relating to the identification of and support for customers in persistent debt; and

- The final report in relation to the FCA Asset Management Market Study was published in June 2017. The package of remedies is focused on providing increased investor protection, driving price transparency and improving the effectiveness of intermediaries for both retail and institutional investors. We endorsed these and will implement the limited changes required to achieve full compliance with the recommendations.

Cyber-crime and financial crime risk

We have a well-developed Cyber Security Strategy to manage the increasing risk of cyber-crime. During 2017 we deployed a security risk framework that enables us to manage exposures in line with internationally recognised security standards. We improved our network security controls to protect us against emerging security threats and improved security advice to colleagues.

The FCA continues to emphasise the need for firms to ensure they have adequate and effective systems and controls to manage financial crime risk. In 2017 we continued to develop our strategic financial crime programme. This programme is designed to enhance our systems and controls and, during the year, delivered improvements to client screening, transaction monitoring solutions and due diligence procedures.

In addition, we implemented our approach to the EU's Fourth Money Laundering Directive which was transposed into UK law on 26 June 2017 as the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.

Outlook

The macro-economic environment, strong credit management of our lending portfolios, strength in capital and funding and proactive engagement with forthcoming macro-structural and regulatory change will be the key areas of focus in 2018.

Macro-economic environment

The UK economy and housing market remained resilient in 2017. We continue to see strong customer demand and no evidence of material changes in customer behaviour. However, potential risks could crystallise if inflation remains higher than wage growth, causing a reduction in households' real earnings. Lower real earnings could in turn reduce consumer spending which, combined with a potentially more uncertain macro environment, leads us to remain cautious in our outlook. We will continue to monitor key exposures in light of the prevailing economic outlook. We have implemented additional oversight activities, alongside contingency plans, which are designed to respond to and mitigate the impact of adverse macro-economic conditions that may emerge.

The Bank of England increased interest rates from 0.25 per cent to 0.50 per cent in November 2017. Our expectation is for gradual further rate increases over the next three years. Low wage growth, and higher inflation, may put pressure on some household budgets and we remain alert to signs of financial strains on our customers. Changes to central bank rates can represent a risk to future financial performance. We have an ongoing programme of stress testing to assess our resilience to changing macro-economic conditions.

Maintaining strong credit quality

Our focus on asset quality will continue in 2018. Credit policy and decision systems are regularly reviewed and tested to ensure they respond to changes in customer and competitor behaviours, maintaining the quality of the portfolios.

Management of the mortgage portfolio: Housing market changes play a crucial part in the development of our business. During 2017, UK house prices remained resilient.

- Low unemployment and record low mortgage rates support consumer affordability while supply shortages continue to support house prices. Although the potential for the weakening of regional house prices exists, we have well-established early warning indicators and will continue to monitor and manage our exposure to regional house price variations and potential areas of weakness;
- A number of measures relating to the housing market were announced in the Autumn Budget, including a permanent stamp duty land tax relief for first-time buyers. We increased lending to first-time buyers by 20 per cent during 2017 and this will continue to be a focus in 2018;
- The PRA introduced stricter stress testing for landlords with four or more mortgaged buy-to let properties, effective from September 2017. We have taken a conservative approach to applying these minimum standards. Further information can be found in the Risk Management Report on page 135; and
- The mortgage market saw heightened competition in the second half of 2017 and this may continue in 2018. We will continue to focus on our competitive strengths and will manage volumes in order to protect asset quality and returns.

Management of the credit card portfolio: We will continue to focus on strong credit management of our credit card exposures. A rise in unemployment or pressure on customer affordability could lead to increased impairments. We will continue to monitor this closely in 2018.

- Our new co-branded partnership with Virgin Atlantic will encourage high-quality credit card growth. It aims to materially increase retail spend and provide further diversification of the credit card customer base;
- We will continue to grow our credit card portfolio in a controlled manner, given our assessment of market conditions and our view of risk and reward; and
- The commercial performance of our credit card portfolio is exposed to potential changes in expected consumer behaviour. We will monitor this closely and take timely action to respond to any observed or anticipated changes.

Capital and funding

We will continue to build on our core retail deposit base and develop our SME offering which commenced in January 2018 with the launch of our Business Deposit Account. We will also target new sources of funding following the launch of our digital bank which aims to increase our access to the current account and primary savings markets.

Although we will remain a predominantly retail funded bank, we do also have a well-established wholesale funding programme. With the Bank of England funding schemes we have used coming to an end, we have put in place a carefully structured funding plan to avoid undue re-financing risk. We will continue to diversify and build out our funding sources in the coming year in line with the long term aim of wholesale funding providing up to 20 per cent of total funding. In July 2017 we received authorisation from the FCA for a regulated covered bonds programme, and expect that our inaugural issuance will take place this year. We also expect to access RMBS markets again during 2018. As we work towards the full implementation of minimum requirements for own funds and eligible liabilities (MREL) on 1 January 2022, we will begin to issue further unsecured funding through our established Global Medium Term Note programme.

We benefit from AIRB models in calculating Pillar 1 capital for the mortgage portfolio. Ensuring that these models remain well calibrated to portfolio performance and aligned to the most recent regulatory guidance will be key in 2018.

Macro-structural changes

Our strategic planning addresses the new structural and regulatory changes which come into force in the coming years:

- A capital conservation buffer of 0.625 per cent was introduced on 1 January 2016, and increased to 1.25 per cent on 1 January 2017. This will increase each year to a maximum of 2.5 per cent in 2019. During 2017, the Bank of England increased the countercyclical buffer from 0 per cent to 0.5 per cent of risk-weighted assets. This will come into force in June 2018. A further increase of 0.5 per cent, to 1.0 per cent, will come into force in November 2018, subject to review in the first half of 2018. These changes are fully reflected in our capital and funding plans;
- Minimum Requirements for Own Funds and Eligible Liabilities (MREL) will be fully phased in by 1 January 2022. The Bank of England provided MREL guidance, including transitional arrangements, in late 2016. Prior to 31 December 2019 our MREL requirement will be equal to our minimum regulatory capital requirements. From 1 January 2020 until 31 December 2021, our MREL requirement will be equal to 18 per cent of our risk-weighted assets. This guidance has been fully reflected in our capital and funding plans;

- The Financial Services Banking Reform Act 2013 will result in the ring-fencing of retail banking operations to separate them from investment banking activities. We are in the process of agreeing our detailed ring-fence compliance plans with the PRA and do not anticipate any material change to our structure or business model as a result. We will, however, have to participate directly in inter-bank payments systems and work is well advanced to achieve this;
- IFRS 9 will be implemented in 2018 and will result in a new approach to provisioning and additional disclosure requirements. We have developed new models and business practices to meet these requirements. Additional information regarding IFRS 9 can be found in note 37 to the financial statements; and
- The Basel Committee published their final Basel III framework in December 2017. A key objective of the revisions is to reduce excessive variability of risk-weighted assets (RWAs) and improve the comparability of banks' capital ratios. Implementation dates range from 2022 to 2027 and transitional arrangements will be put in place regarding the new standards. Our initial analysis suggests that the impact of the new requirements will be broadly neutral for us from a capital perspective.

Regulatory change

The delivery of the following regulatory change programmes will be a core focus in 2018:

- **Open Banking, General Data Protection Regulation and Payment Services Directive:** PSD2 and Open Banking will have a material impact on the competitive environment in which we operate, with non-bank firms likely to enter the market by leveraging new payments regulation and data sharing protocols. Although this may intensify competition in the mortgage, credit card and savings markets over time, the impact will be most significant for the personal current account market, in which we are not currently a material participant;
- **FCA Strategic Review of Retail Banking Business Models:** The FCA are reviewing the business models used in the retail banking sector and evaluating the impact of changes on competition and conduct. The FCA engaged with relevant financial service providers during 2017 and will provide an update in the first half of 2018;
- **FCA Mortgage Market Study:** In December 2016, the FCA published the terms of reference of their Mortgage Market Study. We responded to an information request in March 2017 and await the findings of the interim report which is due to be published in March 2018; and
- **FCA Interest Only Thematic Review:** In January 2018 the FCA published the findings of their Thematic Review into Interest Only customers. Their response acknowledged the progress that lenders had made and emphasised the need for customers to contact lenders for further support. We were aware of all points raised by the FCA and are addressing them within existing programmes of work.

Cyber-crime

Cyber-crime remains a material risk for all banks and we recognise the pace of change in the external threat environment. We will continue to monitor the external threat landscape and develop our capability to protect against cyber-crime through ongoing enhancement of our control environment and protections. We will continue to develop our strategic financial crime programme in 2018 and further enhance our anti-money laundering capabilities.

Third party administration

Outsourced relationships with parties which support the credit card, investment and insurance business lines, such as DST (formerly IFDS) for unit trust management and TSYS/TMS for our credit card business, are fundamental to the success of the business and remain a significant area of management focus. Reliance on key corporate partners and strategic suppliers involves the potential risk of disruption to service arising from the failure of a third party. Thorough risk assessment during the on-boarding process, and robust ongoing oversight, are key to managing these outsourced relationships.

Principal risks

Credit risk

Credit risk is the risk of loss resulting from a borrower or counterparty failing to pay amounts due.

We provide residential and buy-to-let mortgages and credit cards to customers across the UK. There is a risk that any adverse changes in the macro-economic environment and/or the credit quality or behaviour of borrowers results in additional impairment losses, thereby reducing profitability.

Wholesale exposures arise through our liquid asset portfolio and the use of derivative instruments to manage interest rate risk.

Key mitigating actions

- credit risk is managed through risk appetite and risk limits reflected in approved credit policy;
- a robust credit risk framework helps ensure that the credit quality and composition of the portfolios remain within risk appetite limits. This is monitored and reported through governance committees regularly;
- stress and scenario testing allows us to confirm portfolio resilience;
- credit risk metrics are benchmarked against competitors and industry averages;
- customer behaviour is closely monitored with timely action taken in response to any adverse change; and
- credit risk arising from derivatives and from securities financing transactions is mitigated by collateralising exposures on a daily basis.

Commentary

Impaired loans as a percentage of overall balances increased but remained at a low level in 2017.

Wholesale credit quality remains strong with 100.0% of debt security counterparties rated AA or above.

Provisions as a percentage of impaired loans reduced reflecting growth in secured loans with expired terms which do not require increased impairment provisions given the high level of collateral cover on these loans. Expired term loans which are more than six months past their maturity date have an average LTV of 25.8 per cent.

Future focus

We will continue to deliver strong asset quality aligned to growth of the mortgage and credit card books.

We will maintain our 'no loss' position for the wholesale credit portfolio.

Market risk

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

Key mitigating actions

- market risk is managed through Board-approved risk appetite limits and policies;
- exposures are mitigated through the use of natural offsets and derivatives; and
- stress and scenario testing focuses on the impacts of differing interest rate environments.

Commentary

As a consequence of the increase in the size of the balance sheet, Capital at Risk has increased in a positive rate shock scenario. The interest rate risk exposure remains safely within limits.

Future focus

We will look to refine our interest rate risk management systems and approaches to reflect the evolving regulatory landscape.

Operational risk

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

Key mitigating actions

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

Commentary

The absolute amount of losses has developed in line with business growth, but has remained low.

Future focus

We will continue to invest in cyber-crime defense, fraud and anti-money laundering infrastructure.

Conduct risk and compliance

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

Key mitigating actions

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

Commentary

Complaints per 1,000 accounts remained low at 4.91, compared to 3.65 in 2016.

Future focus

We will focus on our Complaints Transformation project to continue to improve the volume of complaints resolved at first point of contact.

Strategic and financial risk

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

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

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

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

Key mitigating actions

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

Commentary

The development of the digital bank and SME propositions will ensure we provide services that meet the future needs of customers and further diversify our business and funding franchises.

In order to manage concentration risk we seek to spread the risk in the areas in which we operate. This is done through the controlled management of LTVs and the implementation of strict counterparty limits to minimise wholesale industry exposures.

Our pricing discipline and management of the cost of funds enabled us to mitigate pressure on asset spreads, as the Banking NIM reduced to 172 basis points compared to 175 basis points for the prior year.

Future focus

Focus will be on the development of the digital bank and SME propositions, in addition to the ongoing development of wider customer propositions and digital capability.

Funding and liquidity risk

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

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

Key mitigating actions

- Board-approved risk appetite and funding and liquidity policies define a limit structure;
- liquid resources are maintained in adequate quantity and quality to meet stressed outflows;
- a prudent mix of funding sources is maintained with a maturity profile set in risk appetite and policy limits; and

- stress and scenario testing considers threats to funding plans and changes in consumer behaviour.

Commentary

Improved diversity of funding has been achieved through our registration as a covered bonds issuer, and our entrance into the SME market.

Future focus

We will continue to improve balance sheet efficiency and resilience through measured diversification of wholesale funding and building of the SME deposit base.

Capital risk

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

Key mitigating actions

- Board-approved risk appetite ensures we are holding sufficient capital within regulatory requirements;
- the capital management policy sets out minimum standards for the management of capital;
- capital procedures are subject to independent oversight; and
- stress and scenario testing assesses capital adequacy under a range of severe market wide stress scenarios and idiosyncratic stress events.

Commentary

Our total capital and leverage ratios have remained in line with expectation and well in excess of regulatory requirements.

Future focus

We will continue to maintain a high-quality capital base with ratios in excess of regulatory requirements.

Credit quality of assets

Loans and receivables

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

Secured credit exposures are segmented according to the credit quality classification and a point-in-time PD. The point-in-time PD is an internal parameter used within the Group's 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 the 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% and 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 but are 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. The Group's wholesale exposures are investment grade and therefore classified as low risk.

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

Further asset quality categorisation is disclosed on page 140 which reflects the impairment status of assets.

Credit risk portfolio as at 31 December 2017

The tables below show the total credit risk exposure for the Group's retail and wholesale portfolios.

	Secured		**Unsecured**		**Wholesale**		
	Residential mortgage loans	**Residential buy-to-let mortgage loans**	**Credit cards**	**Overdrafts**	**Treasury assets**	**Derivative exposures**	**Total**
2017	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total gross loans and advances to customers	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	-	-	**36,755.9**
- of which are low risk	*26,770.5*	*6,322.5*	*3,025.2*	*0.1*	-	-	*36,118.3*
- of which are medium risk	*220.0*	*11.7*	*3.5*	-	-	-	*235.2*
- of which are higher risk	*326.7*	*33.1*	*42.6*	-	-	-	*402.4*
Loans and advances to banks	-	-	-	-	**359.4**	-	**359.4**
Cash and balances at central banks	-	-	-	-	**2,579.0**	-	**2,579.0**
Debt securities classified as loans and receivables	-	-	-	-	**0.3**	-	**0.3**
Available-for-sale financial assets	-	-	-	-	**1,051.8**	-	**1,051.8**

Gross positive fair value of derivative assets	-	-	**-**	**-**	**-**	**78.8**	**78.8**
Total	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**3,990.5**	**78.8**	**40,825.2**

All of the Group's wholesale exposures are categorised as 'low' risk.

	Secured		Unsecured		Wholesale		
	Residential mortgage loans	Residential buy-to-let mortgage loans	Credit cards	Overdrafts	Treasury assets	Derivative exposures	Total
2016	£m	£m	£m	£m	£m	£m	£m
Total gross loans and advances to customers	24,283.0	5,468.4	2,486.5	0.1	-	-	32,238.0
- of which are low risk	*21,565.5*	*5,256.8*	*2,451.2*	*0.1*	-	-	*29,273.6*
- of which are medium risk	*1,699.5*	*172.1*	*2.9*	-	-	-	*1,874.5*
- of which are higher risk	*1,018.0*	*39.5*	*32.4*	-	-	-	*1,089.9*
Loans and advances to banks	-	-	-	-	635.6	-	635.6
Cash and balances at central banks	-	-	-	-	786.3	-	786.3
Debt securities classified as loans and receivables	-	-	-	-	0.7	-	0.7
Available-for-sale financial assets	-	-	-	-	858.8	-	858.8
Gross positive fair value of derivative assets	-	-	-	-	-	104.2	104.2
Total	**24,283.0**	**5,468.4**	**2,486.5**	**0.1**	**2,281.4**	**104.2**	**34,623.6**

In addition, the maximum credit risk exposure of the Group includes off-balance sheet items. These items relate to applications that have been approved and have not yet been drawn by the customer, and undrawn loan commitments. These commitments represent agreements to lend in the future and may be decreased or removed by the Group, subject to product notice requirements. No account is taken of any collateral held, other credit enhancements or provisions for impairment. As at 31 December 2017, off-balance sheet items totalled £6.2 billion (2016: £5.3 billion) and were all classified as 'low' risk.

Interest rate risk

The Group quantifies the impact to economic value and earnings arising from a shift to interest rates using stress scenarios. These scenarios examine the interest rate re-pricing gaps, asset and liability interest rate bases and product optionality.

The Group maintains IRRBB management practices in line with applicable regulatory expectations.

Interest rate risk exposure is measured as follows:

- Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Group's capital position.
- Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period, measuring the adverse change to net interest income from a change in interest rates.

IRRBB is measured considering both positive and negative instantaneous shocks to interest rates. The measurement is enhanced with non-parallel stress scenarios (basis risk), swap spread risk and behavioural volume stresses (pipeline and optionality risk). Both EaR and CaR are controlled by a defined risk appetite limit and supporting metrics.

CaR measurements are based on a 2% parallel stress over the balance sheet horizon, for term mismatch. EaR measurements are based on a 1% parallel stress over a 12 month period. The stress scenarios capture the risk of negative interest rates. The magnitude of stress used within the Group's internal risk appetite differs from the standardised regulatory stress, based on observed rate movements and internally defined exposure holding periods. In the case of basis risk, the Group uses an internal stress test outcome for CaR and EaR.

The Group has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

Capital at Risk

CaR as at 31 December 2017 increased to £25.5 million from £14.1 million at 31 December 2016 in a negative rate shock scenario. In a positive rate shock scenario, it increased to £52.2 million at 31 December 2017 from £34.2 million as at 31 December 2016. In both rate shock scenarios this was due to the increase in the balance sheet, and the consequential increase in interest rate mismatch risk, and optionality risk arising from the increase in potential mortgage early repayments and savings redemptions.

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

	2017		2016	
	Positive 2% rate	**Negative 2% rate**	Positive 2% rate	Negative 2% rate

	shock	shock	shock	shock
	£m	**£m**	£m	£m
Interest rate mismatch risk	**(6.3)**	**0.4**	1.6	0.7
Basis Risk	**(1.4)**	**(1.4)**	-	-
Pipeline risk	**(4.7)**	**(5.5)**	(5.7)	(7.1)
Optionality risk	**(39.8)**	**(19.0)**	(30.1)	(7.7)
Total interest rate risk - Capital at Risk	**(52.2)**	**(25.5)**	(34.2)	(14.1)

Earnings at Risk

EaR has decreased over the year by £36.1 million in a positive rate shock scenario and by £11.9 million in a negative shock scenario. These improvements are due to the Group's savings pricing strategy and changes in customer terms and conditions, which has benefitted interest rate mismatch risk. Additionally, the further utilisation of basis swapped positions has reduced the level of basis risk arising in these rate shock scenarios.

The table below shows that, due to reductions in the structural mismatches of assets and liabilities on the balance sheet across the year, the Group's net interest income at 31 December 2017 is significantly less likely to suffer from a large, sudden shock to interest rates than it was at 31 December 2016.

	2017		2016	
	Positive 1% rate shock	**Negative 1% rate shock**	Positive 1% rate shock	Negative 1% rate shock
	£m	**£m**	£m	£m
Interest rate mismatch risk	**21.3**	**2.2**	(1.7)	(1.4)
Basis risk	**(0.1)**	**(9.0)**	(10.4)	(17.6)
Pipeline risk	**(2.5)**	**(1.3)**	(3.0)	(2.3)
Optionality risk	**(6.3)**	**(1.6)**	(8.6)	(0.3)
Total interest rate risk - Earnings at Risk	**12.4**	**(9.7)**	(23.7)	(21.6)

Funding and liquidity management in 2017

During 2017, the Group maintained a strong funding and liquidity position in excess of risk appetite and the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Group's LCR as at 31 December 2017 was 203.1%, representing a material surplus above the UK regulatory minimum requirement of 90%. The LCR improved from 153.7% at 31 December 2016 due to strong deposit raising activity throughout the year, net TFS drawings made during the year, and an RMBS issuance in September 2017, increasing High Quality Liquid Assets (HQLA). The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting.

Wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify sources of funding. The Group has made use of the TFS during the year, taking overall drawings to £4.2 billion.

Cash flow profile

The tables below allocate the Group'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.

	Within 3 months	**3-6 months**	**6-12 months**	**1-5 years**	**Over 5 years**	**Total**
2017	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Deposits from banks	**23.2**	**858.9**	**12.4**	**4,567.9**	**-**	**5,462.4**
Customer deposits	**27,338.1**	**847.3**	**1,495.7**	**1,571.6**	**0.6**	**31,253.3**
Debt securities in issue	**169.4**	**169.7**	**335.4**	**2,102.3**	**-**	**2,776.8**
Total	**27,530.7**	**1,875.9**	**1,843.5**	**8,241.8**	**0.6**	**39,492.5**

	Within 3 months	3-6 months	6-12 months	1-5 years	Over 5 years	Total
2016	£m	£m	£m	£m	£m	£m

Deposits from banks	514.1	76.7	3.1	1,556.8	-	2,150.7
Customer deposits	24,628.0	680.8	1,371.3	1,835.9	-	28,516.0
Debt securities in issue	158.7	161.2	297.3	2,056.5	-	2,673.7
Total	**25,300.8**	**918.7**	**1,671.7**	**5,449.2**	**-**	**33,340.4**

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

2017	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.5)**	**(0.1)**	**(1.5)**	**(4.4)**	**-**	**(7.5)**
Derivatives in accounting hedge relationships	**(12.9)**	**(8.1)**	**(14.1)**	**(32.3)**	**(7.6)**	**(75.0)**
	(14.4)	**(8.2)**	**(15.6)**	**(36.7)**	**(7.6)**	**(82.5)**
Settled on a gross basis						
Outflows	**30.0**	**28.9**	**54.7**	**224.9**	**-**	**338.5**
Inflows	**(29.4)**	**(28.4)**	**(53.9)**	**(230.0)**	**-**	**(341.7)**
Total	**(13.8)**	**(7.7)**	**(14.8)**	**(41.8)**	**(7.6)**	**(85.7)**

2016	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	(1.8)	(0.5)	(4.5)	(12.2)	(0.3)	(19.3)
Derivatives in accounting hedge relationships	(26.1)	(21.2)	(37.6)	(110.0)	(6.2)	(201.1)
	(27.9)	(21.7)	(42.1)	(122.2)	(6.5)	(220.4)
Settled on a gross basis						
Outflows	1.4	2.6	2.5	23.3	-	29.8
Inflows	(1.5)	(3.0)	(2.8)	(26.6)	-	(33.9)
Total	**(28.0)**	**(22.1)**	**(42.4)**	**(125.5)**	**(6.5)**	**(224.5)**

FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December

	Note	**2017 £ million**	2016 £ million
Interest and similar income		**958.0**	948.1
Interest and similar expense		**(363.4)**	(425.7)

Net interest income	3	**594.6**	522.4
Fee and commission income		**29.6**	28.8
Fee and commission expense		**-**	(1.2)
Net fee and commission income	4	**29.6**	27.6
Other operating income	5	**41.8**	40.3
Fair value losses on financial instruments	13	**(3.3)**	(8.9)
Other income		**68.1**	59.0
Total income		**662.7**	581.4
Operating expenses	6	**(355.9)**	(349.4)
Profit before tax from operating activities		**306.8**	232.0
Impairment	8	**(44.2)**	(37.6)
Profit before tax		**262.6**	194.4
Taxation	9	**(70.5)**	(54.3)
Profit for the year		**192.1**	140.1
Profit attributable to equity owners		**192.1**	140.1
Profit for the year		**192.1**	140.1
Basic earnings per share (pence)	10	**37.8**	29.4
Diluted earnings per share (pence)	10	**37.5**	29.1

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	Note	**2017 £ million**	2016 £ million
Profit for the year		**192.1**	140.1
Other comprehensive income/(expense) Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	29	**14.1**	44.4
Income statement transfers in respect of disposals	29	**(13.5)**	(38.3)
Taxation	29	**(0.1)**	(1.7)
		0.5	4.4
Movements in cash flow hedge reserve:			
Effective portion of changes in fair value taken to other comprehensive income	29	**(1.2)**	(36.1)
Net income statement transfers	29	**12.6**	13.6
Taxation	29	**(2.6)**	6.3
		8.8	(16.2)
Other comprehensive income/(expense) for the year, net of tax		**9.3**	(11.8)
Total comprehensive income for the year		**201.4**	128.3

Total comprehensive income attributable to equity owners	**201.4**	128.3

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

CONSOLIDATED BALANCE SHEET

As at 31 December

	Note	**2017 £ million**	2016 £ million
Assets			
Cash and balances at central banks		**2,579.0**	786.3
Derivative financial instruments	13	**78.8**	104.2
Loans and receivables:			
– Loans and advances to banks	14	**359.4**	635.6
– Loans and advances to customers	15	**36,740.2**	32,367.1
– Debt securities		**0.3**	0.7
		37,099.9	33,003.4
Available-for-sale financial assets	16	**1,051.8**	858.8
Intangible assets	19	**128.4**	80.6
Tangible fixed assets	20	**74.5**	77.4
Deferred tax assets	21	**11.5**	23.0
Other assets	22	**83.9**	121.9
Total assets		**41,107.8**	35,055.6

CONSOLIDATED BALANCE SHEET

As at 31 December

Equity and liabilities	Note	**2017 £ million**	2016 £ million
Liabilities			
Deposits from banks	23	**5,379.0**	2,132.5
Customer deposits	24	**30,808.4**	28,106.3
Derivative financial instruments	13	**93.5**	229.7
Debt securities in issue	25	**2,736.9**	2,600.0
Other liabilities	26	**241.5**	299.9
Current tax liabilities		**23.6**	16.7
Total liabilities		**39,282.9**	33,385.1
Equity			
Share capital and share premium	27	**654.6**	654.6
Other equity instruments	28	**384.1**	384.1
Other reserves	29	**(18.1)**	(27.4)
Retained earnings	30	**804.3**	659.2
Total equity		**1,824.9**	1,670.5
Total liabilities and equity		**41,107.8**	35,055.6

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

The financial statements on pages 200 to 250 were approved and authorised for issue by the Board and were signed on its behalf on 26 February 2018.

Glen Moreno, Chair

Jayne-Anne Gadhia CBE, Chief Executive

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

Attributable to equity holders

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2017	654.6	384.1	(27.4)	659.2	1,670.5
Comprehensive income					
Profit for the year	-	-	-	192.1	192.1
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	-	-	0.5	-	0.5
Net movement in cash flow hedge reserve	-	-	8.8	-	8.8
Total other comprehensive income	-	-	9.3	-	9.3
Total comprehensive income for the year	-	-	9.3	192.1	201.4
Transactions with equity holders					
Dividends paid to ordinary shareholders	-	-	-	(23.9)	(23.9)
Distribution to Additional Tier 1 security holders	-	-	-	(32.7)	(32.7)
Tax attributable to Additional Tier 1 securities	-	-	-	8.4	8.4
Purchase of own shares	-	-	-	(8.5)	(8.5)
Share based payments - charge for the year (net of tax)	-	-	-	9.9	9.9
Other distributions	-	-	-	(0.2)	(0.2)
Total transactions with equity holders	-	-	-	(47.0)	(47.0)
Balance at 31 December 2017	654.6	384.1	(18.1)	804.3	1,824.9

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

Further details of movements in the Group's share capital and reserves are provided in notes 27 to 30.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

Attributable to equity holders

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2016	654.6	156.5	(15.6)	544.8	1,340.3
Comprehensive income					
Profit for the year	-	-	-	140.1	140.1
Other comprehensive income/(expense)					
Net movement in revaluation reserve in respect of available-for-sale financial assets	-	-	4.4	-	4.4
Net movement in cash flow hedge reserve	-	-	(16.2)	-	(16.2)

Total other comprehensive expense	-	-	(11.8)	-	(11.8)
Total comprehensive (expense)/income for the year	-	-	(11.8)	140.1	128.3
Transactions with equity holders					
Dividends paid to ordinary shareholders	-	-	-	(20.8)	(20.8)
Distribution to Additional Tier 1 security holders	-	-	-	(12.6)	(12.6)
Tax attributable to Additional Tier 1 securities	-	-	-	2.5	2.5
Purchase of own shares	-	-	-	(7.3)	(7.3)
Issue of Additional Tier 1 securities	-	227.6	-	-	227.6
Share based payments - charge for the year	-	-	-	12.8	12.8
Deferred tax on share based payments	-	-	-	(0.3)	(0.3)
Total transactions with equity holders	-	227.6	-	(25.7)	201.9
Balance at 31 December 2016	654.6	384.1	(27.4)	659.2	1,670.5

The accompanying notes are an integral part of these consolidated financial statements.
Further details of movements in the Group's share capital and reserves are provided in notes 27 to 30.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December

	Note	**2017 £ million**	2016 £ million
Profit before taxation		**262.6**	194.4
Adjustments for:			
Changes in operating assets	34(a)	**(4,357.8)**	(5,387.3)
Changes in operating liabilities	34(b)	**5,806.6**	3,957.3
Non-cash and other items	34(c)	**48.2**	60.3
Tax paid		**(45.1)**	(22.1)
Net cash provided by/(used in) operating activities		**1,714.5**	(1,197.4)
Cash flows from investing activities			
Purchase of securities		**(541.5)**	(670.0)
Proceeds from sale and redemption of securities		**497.1**	1,150.0
Purchase and investment in intangible assets		**(74.3)**	(31.6)
Purchase of tangible fixed assets		**(5.8)**	(8.6)
Disposal of tangible fixed assets		**-**	0.7
Net cash (used in)/provided by investing activities		**(124.5)**	440.5
Cash flows from financing activities			
Dividends paid to ordinary shareholders	11	**(23.9)**	(20.8)
Distributions to Additional Tier 1 security holders		**(32.7)**	(12.6)
Other distributions		**(0.2)**	-
Net proceeds from issue of debt securities	25	**746.2**	1,278.9
Repayments of debt securities in issue	25	**(608.3)**	(798.1)
Purchase of own shares		**(8.5)**	(7.3)
Issue of Additional Tier 1 securities (net of costs)		**-**	227.6
Net cash provided by financing activities		**72.6**	667.7

Change in cash and cash equivalents		**1,662.6**	(89.2)
Cash and cash equivalents at beginning of year		**1,372.2**	1,461.4
Cash and cash equivalents at end of year	34(d)	**3,034.8**	1,372.2

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of preparation and accounting policies

1.1 Reporting entity

Virgin Money Holdings (UK) plc (the Company) is a public limited company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-Upon-Tyne, NE3 4PL.

The Company was incorporated on 4 August 1995 as a private limited company with registered number 03087587. On 24 July 2014 the Company was re-registered as a public limited company.

The Company is the parent entity and the ultimate controlling party of the Virgin Money Group (the Group), which consists of the Company and its subsidiaries.

1.2 Basis of preparation

The Group consolidated 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, including interpretations issued by the IFRS Interpretations Committee, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the IFRS Interpretations Committee (IFRS IC) and its predecessor body. The EU endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

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

1.3 Changes in accounting policy

New standards, amendments to standards and interpretations adopted

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

The adoption of the amendments to IAS 12 'Income Taxes' had no impact on these financial statements or the accounting polices applied in their preparation. In adopting the amendments to IAS 7 'Statement of cash flows' reconciliation disclosures have been provided in the notes to these financial statements on liabilities included within 'financing activities' in the consolidated and parent cash flow statements.

New accounting standards issued by the IASB that are relevant to the Group and effective in future periods are presented in note 37.

1.4 Presentation of information

Presentation of risk and capital management disclosures

Disclosures under IFRS 7 'Financial Instruments: Disclosure' concerning the nature and extent of risks relating to financial instruments and under IAS 1 'Presentation of financial statements' concerning objectives, policies and processes for managing capital have been included within the audited sections of the Risk Management Report. Where marked as 'audited' these are covered by the Independent Auditors' Report.

1.5 Basis of consolidation

The Group consists of the Company and its subsidiaries. The subsidiaries are listed in note 2 of the parent company financial statements. The consolidated financial statements comprise the financial statements of the Group.

Entities are regarded as subsidiaries where the Group has the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to affect those returns. Inter-company transactions and balances are eliminated upon consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that power over an investee, exposure or rights to variable returns and the ability to affect these returns ceases. Accounting policies are applied consistently across the Group.

Special Purpose Vehicles (SPV) are entities created to accomplish a narrow and well defined objective. For the Group this is the securitisation of mortgage assets. An SPV is consolidated if the Group has control over the SPV, through its exposure to variable returns from its involvement in the SPV and the ability to affect those returns through its power over the entity. The Virgin Money Foundation is classified as an associate.

1.6 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments and available-for-sale financial assets held at fair value. A summary of the material accounting policies of the Group are included within note 1.9. Policies which are relevant to the financial statements as a whole are set out below.

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

1.7 Client money

The Group's unit trust management and investment intermediary subsidiary administers money on behalf of some clients in accordance with the Client Money Rules of the Financial Conduct Authority. Client money is not recognised in the balance sheet or in the notes to the financial statements as the Group is not the beneficial owner.

1.8 Foreign currency translation

The Group's financial statements are presented in Sterling, which is the functional currency of the Company, all of its subsidiaries and the SPVs included within the consolidated financial statements.

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

1.9 Accounting policies

The accounting policies of the Group are set out below.

(a) Operating segments

The Group's chief operating decision maker (which has been determined by the Group to be the Executive Committee) assesses performance and makes decisions regarding the allocation of the Group's resources, in accordance with IFRS 8 'Operating Segments'. All of the Group's product lines are managed under a single centralised commercial function, with the Group's performance assessed, and resource allocation decisions made, on a centralised basis. Therefore the Group has determined that it has only one reportable segment.

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in profit or loss determined under IFRSs as adopted by the EU.

(b) 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 Group 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 Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument, loan commitment fees and all other premiums and discounts.

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

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accruals 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.

(c) 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.

Income from general insurance and life insurance policies is recognised in full on the effective date of commencement or renewal of the related policies to reflect underlying contracts with product providers.

(d) 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 the sale and management of stocks and shares ISAs, pensions, authorised unit trusts and other financial services products.

Other operating income from sales of units in managed funds is recognised daily based on the average volume of funds under management.

Other income includes commission on donations and other sundry income.

(e) Operating expenses

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

Staff costs

The Group accounts for 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 Group has a present obligation to its employees that can be measured reliably and are recognised over the period that employees are required to provide services.

- **Other long-term employee benefits**

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

- **Retirement benefit obligations**

A defined contribution plan is a post-employment benefit plan into which the Group pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in profit or loss in the periods during which related employee services are fulfilled.

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

Leases

If the lease agreement in which the Group 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.

(f) Share based payments

The Group operates a number of equity settled share based payment schemes in respect of services received from certain of its employees.

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

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

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

(g) Impairment losses

The Group 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 a loss event (or events) has occurred after initial recognition, and on or before the balance sheet date, that has an impact on the estimated future cash flows of the financial assets or groups of financial assets that can be reliably measured. Losses incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements.

Loans and receivables at amortised cost

The Group assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. Financial assets that are not individually significant are assessed on a collective basis, except for such assets where there are specific circumstances indicating evidence of impairment (for example loans that have entered possession or where fraud has been committed).

Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events:

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

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

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

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

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

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

Available-for-sale financial assets

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

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

(h) 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 Group has adopted the Code of Practice on Taxation for Banks issued by HM Revenue and Customs.

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

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

(i) Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the period excluding own shares held in employee benefit trusts or held for trading.

The diluted earnings per share is calculated by adjusting profit or loss that is attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options and awards granted to employees.

For the calculation of diluted earnings per share the weighted-average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, if any, that arise in respect of share options and rewards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

(j) Financial instruments

Financial assets

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

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

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

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

Loans and receivables at amortised cost

The Group's loans and advances to banks and customers, and asset backed securities for which there is no active market, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group 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 (refer policy (m)). With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

Held to maturity financial assets

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

Financial assets at fair value through profit or loss

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

Financial liabilities

The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (n)). 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 Group does not hold any financial liabilities classified as held for trading.

Offsetting financial instruments

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

Sale and repurchase agreements

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

Derecognition of financial assets and liabilities

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

(k) Loans and advances to banks

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

(l) Loans and advances to customers

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

(m) Available-for-sale financial assets

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

(n) Derivative financial instruments and hedge accounting

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

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the accounting hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group 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 non-prepayable fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a micro 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. This solution is used to establish micro fair value hedges for foreign currency denominated fixed rate investments.

(o) Securitisation transactions

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers. Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless:

- a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised;
- substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised; and
- a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement.

The Group has also entered into self-issuance of securitised debt which may be used as collateral for repurchase or similar transactions. Investments in self-issued debt and the equivalent deemed loan, together with the related income, expense and cash flows, are not recognised in the financial statements.

Debt securities in issue

Issued securities are classified as financial liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities.

Financial liabilities are carried at amortised cost using the effective interest rate method. Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities.

Securitisation is a means used by the Group 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 principal value to Special Purpose Vehicles (SPV) and have been funded through the issue of amortising mortgage backed securities to investors.

In accordance with note 1.5, the Group has assessed that it controls the SPVs and therefore consolidates the assets and liabilities of the SPVs, on a line by line basis.

(p) Funding for Lending Scheme

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

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

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

(q) 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 to 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 Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

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

Banking platforms

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

Impairment of intangible assets

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

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

(r) 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	Computer equipment	3-5 years
Leasehold property	Unexpired period of the lease	Office equipment	3-10 years
Plant and leasehold improvements	5-30 years	Motor vehicles	4 years

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

Impairment of tangible fixed assets

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

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

(s) Other assets

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

(t) 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.

(u) 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.

(v) Provisions

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

(w) Other liabilities

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

Trade creditors and accruals represent amounts the Group 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 Group is due to pay to third parties in the normal course of business.

(x) Share capital and share premium

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

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

Share issue costs

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

Dividends

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

Share premium

Share premium substantially represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued Ordinary and Deferred Shares. Certain expenses in relation to the issue of share capital can be offset against the share premium account. These expenses must be the incremental expenses arising on issue of the shares.

(y) Other equity instruments

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

(z) Other reserves

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

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

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.

(aa) 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.

(ab) 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 Group has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Group will not fulfil an obligation), including the Group's own credit risk.

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

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

Refer to note 32 for a description of different levels within the fair value hierarchy. Levels are reviewed at each balance sheet date and this determines whether transfers between levels are required.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price - i.e. the fair value of consideration given or received. The Group does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Group's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets at bid price and liabilities at ask price.

1.10 Critical estimates and judgements

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

(a) Critical assumptions and sources of estimation uncertainty

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

Effective interest rates

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

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

The Group offers a range of credit card products. Interest income is recorded under the EIR method, which provides a level yield over the life of the card. Management model expected future cash flows over the estimated customer life, restricted to a maximum of 7 years, which is supported by observed experience. Income recognition can differ significantly from actual cash receipts over that period. Similarly, the selection of expected life for modelling purposes also has a material bearing on the EIR rate used for each cohort. A shorter modelling period results in a lower rate for income recognition. If the modelled period had been restricted to five years at origination, the profit for the year would have been reduced by approximately £25.2 million in 2017 and £15.8 million in 2016.

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

In the calculation of EIR, Management uses estimates and assumptions of future customer behaviour. These include the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period. Should Management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured lending cohorts were all reduced by 0.1%, the present value adjustment to interest income, in relation to the revised future cash flows, would be approximately £(10.2) million as at 31 December 2017.A significant proportion of the Group's credit card portfolio includes customers within promotional periods. The level of repayment immediately post promotional period is a key sensitivity within the EIR assumptions. There is evidence to support the expected behaviour of customers after the end of promotional periods, however there is inherent risk that this data may not be indicative of actual future behaviour. If the proportion of customers who repay their balance post-promotion differs to Management's estimate it can have a material impact on the revised future cash flows.

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

Impairment of loans and receivables

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

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

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

In relation to the measurement of the unsecured impairment allowance, the estimation of the period over which incurred losses emerge is considered to be the most significant estimation. To the extent that the emergence period of 6 months differs by +/-3 months, the impairment allowance would be an estimated £7.1 million higher (2016: £5.9 million) or £7.1 million lower (2016: £5.9 million) respectively.

Fair value of financial assets and liabilities

Management must use estimation when calculating the fair value of financial instruments categorised as level 2 and level 3 (as defined by IFRS 13). In these instances the necessary valuation inputs are not observable and/or specific factors may need to be considered. Details of the Group's level 2 and level 3 financial instruments are included in note 32.

The most significant area of estimation uncertainty relates to the Group's level 2 derivative financial instruments, where valuations are not derived from quoted prices. The accuracy of fair value calculations would be affected by unexpected market movements and any inaccuracies within the discounted cash flow models used, particularly use of incorrect interest yield curves. For example, to the extent the interest yield curve differed by +/-10 bps, the net impact on fair values of derivative financial instruments would be an estimated increase of £41.5 million (2016: £33.1 million) or decrease of £41.7 million (2016: £33.3 million) respectively.

(b) Critical judgements in applying accounting policies

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

Capitalisation of intangibles and assessment for impairment

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

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

Note 2: Segmental analysis and reconciliation to underlying basis

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

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

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results, of which further information is provided on page 48. The table below reconciles the statutory results to the underlying basis.

		Adjusted for			
	Statutory results £m	IPO share based awards £m	Strategic items £m	Fair value losses on financial instruments £m	Underlying basis £m
Year ended 31 December 2017					
Net interest income	**594.6**	**-**	**-**	**-**	**594.6**
Other income	**68.1**	**-**	**-**	**3.3**	**71.4**
Total income	**662.7**	**-**	**-**	**3.3**	**666.0**
Total operating expenses	**(355.9)**	**0.9**	**6.5**	**-**	**(348.5)**
Profit before tax from operating activities	**306.8**	**0.9**	**6.5**	**3.3**	**317.5**
Impairment	**(44.2)**	**-**	**-**	**-**	**(44.2)**
Profit before tax	**262.6**	**0.9**	**6.5**	**3.3**	**273.3**

		Adjusted for				
	Statutory results	IPO share based awards	Strategic items	Simplification costs	Fair value losses on financial instruments	Underlying basis

	£m	£m	£m	£m	£m	£m
Year ended 31 December 2016						
Net interest income	522.4	-	(3.4)	-	-	519.0
Other income	59.0	-	-	-	8.9	67.9
Total income	581.4	-	(3.4)	-	8.9	586.9
Total operating expenses	(349.4)	2.0	5.8	5.6	-	(336.0)
Profit before tax from operating activities	232.0	2.0	2.4	5.6	8.9	250.9
Impairment	(37.6)	-	-	-	-	(37.6)
Profit before tax	194.4	2.0	2.4	5.6	8.9	213.3

Note 3: Net interest income

	2017 £m	2016 £m
Interest and similar income:		
Loans and advances to customers	**945.2**	933.1
Loans and advances to banks	**0.9**	2.3
Interest receivable on loans and receivables	**946.1**	935.4
Available-for-sale financial assets	**5.6**	8.9
Cash and balances at central banks	**6.3**	3.8
Total interest and similar income	**958.0**	948.1
Interest and similar expense:		
Deposits from banks	**(16.5)**	(7.6)
Customer deposits	**(310.8)**	(370.7)
Debt securities in issue	**(31.0)**	(40.6)
Other	**(5.1)**	(6.8)
Total interest and similar expense	**(363.4)**	(425.7)
Net interest income	**594.6**	522.4

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

Note 4: Net fee and commission income

	2017 £m	2016 £m
Fee and commission income:		
On loans and advances to customers	**21.3**	19.5
Other fee and commission income	**8.3**	9.3
Total fee and commission income	**29.6**	28.8
Fee and commission expense:		
Other fee and commission expense	**-**	(1.2)
Net fee and commission income	**29.6**	27.6

Note 5: Other operating income

	2017 £m	2016 £m
Investment and pension income	**32.0**	31.7
Gains on sale of available-for-sale financial assets	**8.4**	6.8
Other	**1.4**	1.8
Total other operating income	**41.8**	40.3

Note 6: Operating expenses

	2017	2016

	£m	£m
Staff costs:		
Wages and salaries	**161.9**	160.7
Social security costs	**15.5**	14.6
Other pension costs	**10.9**	10.7
Employee share schemes	**9.9**	12.8
	198.2	198.8
Premises and equipment:		
Hire of equipment	**4.6**	4.6
Rent and rates	**14.4**	14.3
Other property costs	**11.0**	9.6
	30.0	28.5
Other expenses:		
Marketing costs	**21.8**	21.0
Telecommunications and IT	**18.5**	17.4
Professional fees	**23.1**	20.0
Other	**29.1**	42.7
	92.5	101.1
Depreciation, amortisation and impairment:		
Depreciation of tangible fixed assets	**8.7**	5.6
Amortisation of intangible assets	**21.7**	15.4
Impairment of intangible assets	**4.8**	-
	35.2	21.0
Total operating expenses	**355.9**	349.4

Average headcount

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

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

Retirement benefit obligations

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

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

Fees payable to the auditors

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

	2017 £m	2016 £m
Fees payable for the audit of the Company's current year Annual Report and Accounts	**0.2**	0.2
Audit of the subsidiaries pursuant to legislation	**1.1**	0.7
Total audit fees	**1.3**	0.9
Audit-related assurance services	**0.2**	0.2
Total audit and audit-related fees	**1.5**	1.1
Other non-audit fees:		
Other services	**0.1**	0.1
Total other non-audit fees	**0.1**	0.1
Total fees payable to the auditors by the Group	**1.6**	1.2

All amounts are shown exclusive of VAT.

The following types of services are included in the categories listed above:

Audit and audit-related fees

This category includes fees in respect of the audit of the Group's Annual Report and Accounts and other services in connection with regulatory filings and services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

Note 7: Share based payments

All share based payments charges relate to equity settled schemes. The scheme details are summarised below.

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

1 All awards have vesting conditions and therefore some may not vest.
2 Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme.

(A) Long-term incentive plan (LTIP)

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

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

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

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

(B) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short-term incentive plan for Executive Directors and other senior managers of the Group.

Share awards for the deferred element of 2017 bonuses will be granted under this scheme in 2018.

During 2017, selected senior employees of the Group were granted up to a maximum of 1,833,349 Ordinary Shares under the scheme. This number includes an award granted to senior employees who joined the Company in 2017 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Group. Awards granted under the scheme have service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2017 was £3.26 based on market prices at the date of grant.

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

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

Movement in share options and conditional shares

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

	Ordinary Shares						
	Interest in share options[1]	Long-term incentive plan	Deferred bonus share plan	Phantom share award	IPO incentive scheme	Recruitment award	IPO share award
Shares in existence at 1 January 2016	625,328	1,399,453	1,157,800	3,061,820	332,334	175,810	139,041
Granted in year	-	1,572,717	1,695,266	-	-	-	-
Exercised or vested in year	-	(98,349)	(754,417)	(950,550)	(305,676)	(175,810)	(68,885)

Forfeited in year	-	(222,483)	-	(66,790)	(26,658)	-	(1,236)
Outstanding 31 December 2016	625,328	2,651,338	2,098,649	2,044,480	-	-	68,920
Of which exercisable	625,328	-	-	-	-	-	-

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

Note 8: Allowance for impairment losses on loans and receivables

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

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

Note 9: Taxation

(A) Analysis of the tax charge for the year

	2017 £m	2016 £m
UK corporation tax		
Current tax on profit for the year	**(63.5)**	(40.3)
Adjustments in respect of prior years	**(0.6)**	0.4
Current tax charge	**(64.1)**	(39.9)
Deferred tax (refer note 21)		
Origination and reversal of temporary differences	**(6.9)**	(14.0)
Adjustments in respect of prior years	**0.9**	(0.2)
Reduction in UK corporation tax rate	**(0.4)**	(0.2)
Deferred tax charge to the income statement	**(6.4)**	(14.4)
Tax charge	**(70.5)**	(54.3)

Analysis of tax charge recognised in Other Comprehensive Income:

	2017 £m	2016 £m
Current tax		
Cash flow hedge reserve	**2.4**	4.9
Deferred tax		
Revaluation reserve in respect of available-for-sale financial assets	**(0.1)**	(1.7)
Cash flow hedge reserve	**(5.0)**	1.4
Total (charge)/credit	**(2.7)**	4.6

(B) Factors affecting the tax charge for the year

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

	2017 £m	2016 £m
Profit before tax	**262.6**	194.4
Tax charge at standard tax rate of 19.25% (2016: 20%)	**(50.5)**	(38.9)
Factors affecting charge:		
Disallowed items	**(1.0)**	(1.8)

Bank corporation tax surcharge	**(18.9)**	(12.5)
UK corporation tax rate change	**(0.4)**	(0.2)
Deferred tax charge in respect of share schemes	**-**	(1.1)
Adjustments in respect of prior years	**0.3**	0.2
Total tax charge	**(70.5)**	(54.3)

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

The charge in respect of the corporation tax surcharge for banks which was introduced from 1 January 2016 is £18.9 million in the year ended 31 December 2017. The surcharge imposes an 8% charge on the banking profits of the Group (less a £25 million allowance against those profits).

Note 10: Earnings per share

	2017 £m	2016 £m
Profit attributable to equity owners - basic and diluted	**192.1**	140.1
Distributions to Additional Tier 1 security holders (net of tax)	**(24.8)**	(10.1)
Profit attributable to equity shareholders for the purposes of basic and diluted EPS	**167.3**	130.0

	2017 Number of shares (million)	2016 Number of shares (million)
Weighted-average number of ordinary shares in issue - basic	**442.1**	442.8
Adjustment for share options and awards	**3.8**	4.7
Weighted-average number of ordinary shares in issue - diluted	**445.9**	447.5
Basic earnings per share (pence)	**37.8**	29.4
Diluted earnings per share (pence)	**37.5**	29.1

Basic earnings per share has been calculated after deducting 2.8 million (2016: 1.7 million) ordinary shares representing the weighted-average of the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 31 December 2017 none were anti-dilutive (2016: nil).

Note 11: Dividends

An interim dividend of 1.9 pence (2016: 1.6 pence) per Ordinary Share, amounting to £8.4 million (2016: £7.1 million), was paid in September 2017 and a final dividend in respect of the year ended 31 December 2016 of 3.5 pence (31 December 2015: 3.1 pence) per Ordinary Share amounting to £15.5 million (31 December 2015: £13.7 million), was paid in May 2017. These dividends were deducted from retained profits in the current year.

The Directors have recommended for approval at the 2018 AGM the payment of a final dividend in respect of the year ended 31 December 2017 of 4.1 pence per ordinary share, amounting to £18.1 million. If approved, this final dividend will be paid on 16 May 2018 to shareholders on the register at close of business on 6 April 2018. The financial statements for the year ended 31 December 2017 do not reflect this final dividend, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2018.

Under the trust deed of the Employee Benefit Trust (EBT), a standing waiver is in force in respect of any dividends declared on shares held by the EBT.

Note 12: Analysis of financial assets and financial liabilities by measurement basis

					Derivatives designated as hedging instruments		
	Held at amortised cost £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**
As at 31 December 2017							
Financial assets							
Cash and balances at central banks	-	2,579.0	-	-	-	-	2,579.0
Derivative financial instruments	-	-	-	11.9	11.5	55.4	78.8
Loans and receivables:							
– Loans and advances to banks	-	359.4	-	-	-	-	359.4
– Loans and advances to customers	-	36,740.2	-	-	-	-	36,740.2
– Debt securities	-	0.3	-	-	-	-	0.3
Available-for-sale financial assets	-	-	1,051.8	-	-	-	1,051.8
Other assets	-	55.0	-	-	-	-	55.0
Total financial assets	-	39,733.9	1,051.8	11.9	11.5	55.4	40,864.5

Non financial assets							**243.3**
Total assets							**41,107.8**
Financial liabilities							
Deposits from banks	**5,379.0**	**-**	**-**	**-**	**-**	**-**	**5,379.0**
Customer deposits	**30,808.4**	**-**	**-**	**-**	**-**	**-**	**30,808.4**
Derivative financial instruments	**-**	**-**	**-**	**10.7**	**82.5**	**0.3**	**93.5**
Debt securities in issue	**2,736.9**	**-**	**-**	**-**	**-**	**-**	**2,736.9**
Other liabilities	**215.1**	**-**	**-**	**-**	**-**	**-**	**215.1**
Total financial liabilities	**39,139.4**	**-**	**-**	**10.7**	**82.5**	**0.3**	**39,232.9**
Non financial liabilities							**50.0**
Total liabilities							**39,282.9**
Equity							**1,824.9**
Total liabilities and equity							**41,107.8**

	Held at amortised cost £m	Loans and receivables £m	Available-for-sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as hedging instruments		Total £m
					Fair value hedges £m	Cash flow hedges £m	
As at 31 December 2016							
Financial assets							
Cash and balances at central banks	-	786.3	-	-	-	-	786.3
Derivative financial instruments	-	-	-	18.5	21.0	64.7	104.2
Loans and receivables:							
– Loans and advances to banks	-	635.6	-	-	-	-	635.6
– Loans and advances to customers	-	32,367.1	-	-	-	-	32,367.1
– Debt securities	-	0.7	-	-	-	-	0.7
Available-for-sale financial assets	-	-	858.8	-	-	-	858.8
Other assets	-	68.8	-	-	-	-	68.8
Total financial assets	-	33,858.5	858.8	18.5	21.0	64.7	34,821.5
Non financial assets							234.1
Total assets							35,055.6
Financial liabilities							
Deposits from banks	2,132.5	-	-	-	-	-	2,132.5
Customer deposits	28,106.3	-	-	-	-	-	28,106.3
Derivative financial instruments	-	-	-	22.9	206.8	-	229.7
Debt securities in issue	2,600.0	-	-	-	-	-	2,600.0
Other liabilities	189.5	-	-	-	-	-	189.5
Total financial liabilities	33,028.3	-	-	22.9	206.8	-	33,258.0
Non financial liabilities							127.1
Total liabilities							33,385.1
Equity							1,670.5
Total liabilities and equity							35,055.6

Note 13: Derivative financial instruments

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

	As at 31 December 2017	As at 31 December 2016

	Contract / notional amount £m	Asset fair value £m	Liability fair value £m	Contract / notional amount £m	Asset fair value £m	Liability fair value £m
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges:						
Interest rate derivatives (gross)	**23,314.7**	**61.7**	**(91.0)**	21,584.8	34.7	(219.8)
Less: contracts centrally cleared	**(17,360.6)**	**(50.2)**	**8.5**	(8,194.1)	(13.7)	13.0
Interest rate derivatives (net)	**5,954.1**	**11.5**	**(82.5)**	13,390.7	21.0	(206.8)
Derivatives designated as cash flow hedges:						
Interest rate derivatives (gross)	**1,199.0**	**-**	**(2.9)**	1,287.0	3.5	(2.2)
Less: contracts centrally cleared	**(1,199.0)**	**-**	**2.9**	(1,287.0)	(3.5)	2.2
Interest rate derivatives (net)	**-**	**-**	**-**	-	-	-
Currency derivatives	**705.6**	**55.4**	**(0.3)**	520.3	64.7	-
Total derivative assets/(liabilities) - in accounting hedge relationships	**6,659.7**	**66.9**	**(82.8)**	13,911.0	85.7	(206.8)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives (gross)	**7,205.6**	**9.6**	**(10.4)**	7,549.6	15.7	(24.0)
Less: contracts centrally cleared	**(2,830.7)**	**(0.8)**	**2.8**	(3,665.1)	(2.5)	9.2
Interest rate derivatives (net)	**4,374.9**	**8.8**	**(7.6)**	3,884.5	13.2	(14.8)
Currency derivatives	**76.0**	**3.0**	**(3.1)**	56.0	3.4	(3.8)
Equity and other options	**25.7**	**0.1**	**-**	149.5	1.9	(4.3)
Total derivative assets/(liabilities) - in economic hedging relationship but not in accounting hedge relationships	**4,476.6**	**11.9**	**(10.7)**	4,090.0	18.5	(22.9)
Total recognised derivative assets/(liabilities)	**11,136.3**	**78.8**	**(93.5)**	18,001.0	104.2	(229.7)

The notional amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in the Risk Management Report on page 155.

The fair values and notional amounts shown in the line 'Total recognised derivative assets/(liabilities)' above reflect amounts relating only to contracts that are not centrally cleared. Centrally cleared interest rate derivatives are set off in the balance sheet as they meet the offsetting criteria under IAS 32 (refer note 33).

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will impact income:

	2017 £m	2016 £m
Within one year	**(7.2)**	(9.2)
In one to five years	**(15.5)**	(22.3)
Total	**(22.7)**	(31.5)

Fair value losses on financial instruments

	2017 £m	2016 £m
Fair value gains/(losses) from derivatives designated as fair value hedges	**104.8**	(69.9)
Fair value (losses)/gains from underlying hedged risk	**(99.4)**	81.8
Fair value gain from fair value hedge accounting[1]	**5.4**	11.9
Fair value losses from cash flow hedges	**(12.6)**	(13.6)
Fair value gains/(losses) from other derivatives[2]	**3.9**	(7.2)
Fair value losses on financial instruments	**(3.3)**	(8.9)

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

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

Note 14: Loans and advances to banks

	2017 £m	2016 £m
Balances within securitisation vehicles	**201.0**	354.3
Money market placements with banks	**13.8**	33.0
Cash collateral pledged to banks (refer note 17)	**93.0**	181.1
Other lending to banks	**51.6**	67.2
Total loans and advances to banks	**359.4**	635.6

Note 15: Loans and advances to customers

	2017 £m	2016 £m
Advances secured on residential property not subject to securitisation	**21,878.7**	19,375.2
Advances secured on residential property subject to securitisation	**5,438.5**	4,907.8
	27,317.2	24,283.0
Residential buy-to-let loans not subject to securitisation	**6,367.3**	5,468.4
Total loans and advances to customers secured on residential property	**33,684.5**	29,751.4
Unsecured receivables not subject to securitisation	**3,071.4**	2,486.6
Total loans and advances to customers before allowance for impairment losses	**36,755.9**	32,238.0
Allowance for impairment losses on loans and receivables (refer note 8)	**(59.4)**	(50.1)
Total loans and advances to customers excluding portfolio hedging	**36,696.5**	32,187.9
Fair value of portfolio hedging	**43.7**	179.2
Total loans and advances to customers	**36,740.2**	32,367.1

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

For collateral held in respect of the values included in the table above, refer to the Risk Management Report.

Note 16: Available-for-sale financial assets

	2017 £m	2016 £m
At 1 January	**858.8**	1,296.9
Additions	**690.9**	670.0
Disposals (sales and redemptions)	**(483.2)**	(1,111.1)
Exchange differences	**1.2**	0.1
Changes due to amortisation and accrued interest	**(5.0)**	(11.6)
Net (losses)/gains on changes in fair value	**(10.9)**	14.5
At 31 December	**1,051.8**	858.8

Gains on sale of available-for-sale securities amounted to £8.4 million (2016: £6.8 million).

Analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in the Risk Management Report on page 154. All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

Note 17: Collateral pledged and received

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

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

At 31 December 2017 cash collateral of £101.5 million had been pledged by the Group, comprising £93.0 million recognised within loans and advances to banks and £8.5 million within other assets (2016: £235.0 million, comprising £181.1 million recognised within loans and advances to banks and £53.9 million within other assets) and £53.9 million (2016: £14.0 million) has been received as cash collateral by the Group, of which £13.0 million is recognised within deposits from banks (2016: £14.0 million) and £40.9 million within other liabilities (2016: £nil).

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

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

Note 18: Securitisation

Securitisation programmes

Loans and advances to customers include loans securitised under the Group's Gosforth securitisation programmes, which have been sold by Virgin Money plc to bankruptcy remote SPVs. The transfers of the mortgage loans to the structured entities are not treated as sales by the Group. No gain or loss has been recognised on pledging the mortgages to the programmes.

The SPVs are principally engaged in providing long-term funding to the Group through the issue of amortising mortgage backed securities to investors on terms whereby the majority of the risks and rewards of the loans and advances are retained by Virgin Money plc. As a result, the SPVs are fully consolidated in these financial statements and all of the loans and advances are retained on the Group's balance sheet, with the related securities included within debt securities in issue.

	2017		2016	
	Loans and advances securitised £m	**Securities in issue £m**	Loans and advances securitised £m	Securities in issue £m
Residential mortgage loans	**5,438.5**	**5,132.7**	4,907.8	4,616.7
Less: securities held by the Group	**-**	**(2,698.6)**	-	(2,322.5)
Total securitisation programmes	**5,438.5**	**2,434.1**	4,907.8	2,294.2

The full liabilities associated with the securitisation programme (excluding the proportion relating to securities retained) are recognised within debt securities in issue. However, the Group's obligations are limited to the cash flows generated from the underlying securitised assets.

At the reporting date the Group had over-collateralised the securitisation transactions, as set out in the table above, to meet the terms of the transaction and to provide operational flexibility. In addition, the Group held cash deposits and permitted investments of £350.4 million (2016: £354.3 million) supporting the securities issued. To satisfy transaction requirements the Group may provide additional support to the SPV in the form of increased cash reserves funded by further subordinated loans.

Transfers of financial assets

There were no transactions in the year involving the transfer of financial assets that were derecognised by the Group but with ongoing exposure (2016: none). There were also no transactions in the year where the Group transferred assets that should have been derecognised in their entirety (2016: none).

As noted above, loans and advances transferred to SPVs do not represent transfers of financial assets by the Group as all of the SPVs are consolidated in these financial statements.

Note 19: Intangible assets

	Core deposit intangible £m	**Software £m**	**Banking platforms £m**	**Total £m**
Cost:				
At 1 January 2016	4.8	85.1	21.5	111.4
Additions	-	31.6	-	31.6
Disposals	-	(2.1)	-	(2.1)
At 31 December 2016	4.8	114.6	21.5	140.9
Additions	**-**	**36.0**	**38.3**	**74.3**
Disposals	**-**	**(5.7)**	**-**	**(5.7)**
At 31 December 2017	**4.8**	**144.9**	**59.8**	**209.5**
Accumulated amortisation and impairment:				
At 1 January 2016	3.4	40.7	2.9	47.0
Charge for the year	1.4	10.4	3.6	15.4
Disposals	-	(2.1)	-	(2.1)
At 31 December 2016	4.8	49.0	6.5	60.3
Charge for the year	**-**	**18.1**	**3.6**	**21.7**
Disposals	**-**	**(5.7)**	**-**	**(5.7)**
Impairment	**-**	**4.8**	**-**	**4.8**
At 31 December 2017	**4.8**	**66.2**	**10.1**	**81.1**
Balance sheet amount at 31 December 2017	**-**	**78.7**	**49.7**	**128.4**
Balance sheet amount at 31 December 2016	-	65.6	15.0	80.6

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

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

Note 20: Tangible fixed assets

	Land and buildings	**Plant, equipment, fixtures, fittings and vehicles**	**Total**

	£m	£m	£m
Cost:			
At 1 January 2016	63.3	39.5	102.8
Additions	1.8	6.8	8.6
Disposals	(0.6)	(3.0)	(3.6)
At 31 December 2016	64.5	43.3	107.8
Additions	**-**	**5.8**	**5.8**
Disposals	**-**	**(0.1)**	**(0.1)**
At 31 December 2017	**64.5**	**49.0**	**113.5**
Accumulated depreciation and impairment:			
At 1 January 2016	9.5	18.7	28.2
Depreciation charge for the year	0.1	5.5	5.6
Disposals	(0.5)	(2.9)	(3.4)
At 31 December 2016	9.1	21.3	30.4
Depreciation charge for the year	**2.4**	**6.3**	**8.7**
Disposals	**-**	**(0.1)**	**(0.1)**
At 31 December 2017	**11.5**	**27.5**	**39.0**
Balance sheet amount at 31 December 2017	**53.0**	**21.5**	**74.5**
Balance sheet amount at 31 December 2016	55.4	22.0	77.4

Note 21: Deferred tax

	2017 £m	2016 £m
Deferred tax assets/(liabilities):		
Accelerated capital allowances	**10.8**	12.9
Revaluation reserve in respect of available-for-sale financial assets	**(2.1)**	(2.6)
Cash flow hedge reserve	**0.2**	5.2
Change in accounting basis on adoption of IFRS	**(3.2)**	(4.0)
Tax losses carried forward	**0.6**	7.3
Other temporary differences	**5.2**	4.2
Total deferred tax assets	**11.5**	23.0

The Group has not recognised deferred tax assets in respect of gross unused tax losses of £31.2 million (2016: £31.2 million).

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

	2017 £m	2016 £m
At 1 January	**23.0**	38.0
Income statement (charge)/credit (refer note 9):		
Accelerated capital allowances	**(2.1)**	(2.2)
Tax losses carried forward	**(6.7)**	(10.7)
Other temporary differences	**2.4**	(1.5)
	(6.4)	(14.4)
Amounts (charged)/credited to equity:		
Available-for-sale financial assets	**(0.1)**	(1.7)
Cash flow hedges	**(5.0)**	1.4
Adjustments relating to share based payments	**-**	(0.3)
	(5.1)	(0.6)
At 31 December	**11.5**	23.0

Note 22: Other assets

	2017 £m	2016 £m
Trade debtors	**6.3**	17.7
Prepayments and accrued income	**40.2**	27.9
Other	**37.4**	76.3
Total other assets	**83.9**	121.9

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

Note 23: Deposits from banks

	2017 £m	2016 £m
Liabilities in respect of securities sold under repurchase agreements	**1,130.0**	850.0
Secured loans	**4,236.0**	1,268.0
Other deposits from banks	**13.0**	14.5
Total deposits from banks	**5,379.0**	2,132.5

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

Note 24: Customer deposits

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

Note 25: Debt securities in issue

	Securitisation programmes £m	Medium term notes £m	Total £m
At 1 January 2016	1,741.9	297.5	2,039.4
Repayments	(798.1)	-	(798.1)
Issues	1,278.9	-	1,278.9
Revaluations	73.0	-	73.0
Other movements	(1.5)	8.3	6.8
At 31 December 2016	2,294.2	305.8	2,600.0
Repayments	**(608.3)**	**-**	**(608.3)**
Issues	**746.2**	**-**	**746.2**
Revaluations	**1.5**	**-**	**1.5**
Other movements	**0.5**	**(3.0)**	**(2.5)**
At 31 December 2017	**2,434.1**	**302.8**	**2,736.9**

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

Securitisation programmes

On 25 September 2017, the Group raised £746.2 million from institutional investors through the issuance of Residential Mortgage Backed Securities (RMBS) in the Gosforth Funding 2017-1 transaction in US Dollars and Sterling.

In 2016, the Group also raised £1,278.9 million through the issue of RMBS in the Gosforth Funding 2016-1 and Gosforth Funding 2016-2 transactions in Euro, US Dollars and Sterling.

For all RMBS funding raised in currencies other than Sterling, the Group enters into cross-currency derivatives which swap the foreign currency liabilities into Sterling.

Medium term notes

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

Note 26: Other liabilities

	2017 £m	2016 £m
Trade creditors and accruals	**66.3**	59.0

Provisions	**7.5**	8.5
Deferred income	**2.3**	3.0
Accrued interest	**110.9**	127.2
Other liabilities	**54.5**	102.2
Total other liabilities	**241.5**	299.9

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

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

Note 27: Share capital and share premium

	2017 £m	2016 £m
Share capital	**0.1**	0.1
Share premium	**654.5**	654.5
Total share capital and share premium	**654.6**	654.6

Issued and fully paid share capital

	2017 Number of shares	**2017 £**	2016 Number of shares	2016 £
Ordinary Shares of £0.0001 each				
At 1 January	**444,942,008**	**44,494**	443,711,458	44,371
Issued during year	**-**	**-**	1,230,550	123
At 31 December	**444,942,008**	**44,494**	444,942,008	44,494
Deferred Shares of £0.001 each				
At 1 January and at 31 December	**10,052,161**	**10,052**	10,052,161	10,052

As permitted by the Companies Act 2006, the Company's Articles of Association do not contain any references to authorised share capital.

The following describes the rights attaching to each share class at 31 December 2017:

Ordinary Shares

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Group. 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. The shares represented 81.6 per cent of the total share capital at 31 December 2017 (2016: 81.6 per cent).

There are no restrictions in the transfer of Ordinary Shares in the Company other than:

- certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws);
- where Directors and certain employees of the Group require the approval of the Company to deal in the Company's Ordinary Shares; and
- pursuant to the rules of some of the Group's employee share plans where certain restrictions may apply while the Ordinary Shares are subject to the plan.

Deferred Shares

As set out in the Articles of Association adopted on listing (and pursuant to the provisions of the Companies Act in respect of shares held in own shares), the Deferred Shares have no voting or dividend rights and, on a return of capital on a winding up, have no valuable economic rights. No application has been made or is currently intended to be made for the Deferred Shares to be admitted to the Official List or to trade on the London Stock Exchange or any other investment exchange.

The Deferred Shares are held in treasury. This is to ensure that the aggregate nominal value of the Company's share capital will be not less than £50,000, which is the minimum level of nominal share capital required by the Companies Act for a company to be established as a public limited company. The shares represented 18.4 per cent of the total share capital at 31 December 2017 (2016: 18.4 per cent).

Note 28: Other equity instruments

	2017 £m	2016 £m
At 1 January	**384.1**	156.5
Additional Tier 1 securities issued in the year (net of issue costs)	**-**	227.6
At 31 December	**384.1**	384.1

The Company issued Fixed Rate Resettable Additional Tier 1 (AT1) securities on the Luxembourg Stock Exchange of £230.0 million on 10 November 2016 and £160.0 million on 31 July 2014. The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £5.9 million. Dividends and other returns to equity holders are treated as a deduction from equity.

The principal terms of the AT1 securities in issue are described below:

- the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;
- the securities bear a fixed rate of interest of 8.750% and 7.875% from their issue dates up to their first reset dates on 10 November 2021 and 31 July 2019 respectively;
- interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion

at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;

- the securities are perpetual with no fixed redemption date and are repayable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the AT1 securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and
- all AT1 securities will be converted into Ordinary Shares of the Company, at a pre-determined price, should the Common Equity Tier 1 ratio of the Group fall below 7.0% as specified in the terms.

Note 29: Other reserves

	2017 £m	2016 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**4.1**	(0.3)
Net gains from changes in fair value	**2.6**	52.8
Net gains on disposal transferred to income statement	**(13.5)**	(38.3)
Amounts transferred to income statement due to hedge accounting	**11.5**	(8.4)
Taxation	**(0.1)**	(1.7)
At 31 December	**4.6**	4.1

	2017 £m	2016 £m
Cash flow hedge reserve		
At 1 January	**(31.5)**	(15.3)
Amounts recognised in equity	**(1.2)**	(36.1)
Amounts transferred to income statement	**12.6**	13.6
Taxation	**(2.6)**	6.3
At 31 December	**(22.7)**	(31.5)

Note 30: Retained earnings

	2017 £m	2016 £m
At 1 January	**659.2**	544.8
Profit for the year	**192.1**	140.1
Dividends paid to ordinary shareholders	**(23.9)**	(20.8)
Distributions to Additional Tier 1 security holders (net of tax)	**(24.3)**	(10.1)
Purchase of own shares	**(8.5)**	(7.3)
Share based payments (including deferred tax)	**9.9**	12.5
Other distributions	**(0.2)**	-
As at 31 December	**804.3**	659.2

Other distributions represent distributions paid by certain SPVs currently in the process of liquidation.

Employee Benefit Trust (EBT)

Retained earnings are stated after deducting £8.0 million (2016: £6.9 million) representing 2,868,458 (2016: 2,922,220) own shares held in an EBT.

The Company established an EBT in 2011 in connection with the operation of the Company's share plans. The Company funded the EBT by means of a cash loan and is therefore considered to be the sponsoring entity. The EBT purchased shares in the Company using the cash loan which is accounted for as a purchase of own shares by the Company. The investment in own shares at 31 December 2017 is £8.0 million (2016: £6.9 million). The market value of the shares held in the EBT at 31 December 2017 was £8.2 million (2016: £8.8 million).

Note 31: Contingent liabilities and commitments

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 31 December 2017 (31 December 2016: none).

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

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

Loan commitments

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

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

Operating lease commitments - land and buildings

Minimum future lease payments under non-cancellable operating leases:

	2017 £m	2016 £m
Not later than 1 year	**7.5**	7.1
Later than 1 year and not later than 5 years	**26.0**	25.0
Later than 5 years	**18.7**	20.0
Total operating lease commitments - land and buildings	**52.2**	52.1

Operating lease commitments - other operating leases

Minimum future lease payments under non-cancellable operating leases:

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

Capital commitments

Capital commitments for the acquisition of fixed assets:

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

Note 32: Fair value of financial assets and financial liabilities

Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9 (j) sets out the key principles for estimating the fair values of financial instruments.

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

	Level 1	Level 2	Level 3	Total fair value	Total carrying value

	£m	£m	£m	£m	£m
At 31 December 2016					
Cash and balances at central banks	-	786.3	-	786.3	786.3
Loans and advances to banks	-	635.6	-	635.6	635.6
Loans and advances to customers	-	-	32,514.0	32,514.0	32,367.1
Debt securities classified as loans and receivables	0.7	-	-	0.7	0.7
Available-for-sale financial assets	-	-	0.3	0.3	0.3
Other assets	-	68.8	-	68.8	68.8
Total financial assets at fair value	0.7	1,490.7	32,514.3	34,005.7	33,858.8
Deposits from banks	-	2,132.5	-	2,132.5	2,132.5
Customer deposits	-	28,222.7	-	28,222.7	28,106.3
Debt securities in issue	2,610.8	-	-	2,610.8	2,600.0
Other liabilities	-	189.5	-	189.5	189.5
Total financial liabilities at fair value	2,610.8	30,544.7	-	33,155.5	33,028.3

Fair value hierarchy

The table above 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 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 Group 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 Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, the Group's policy is to hedge fixed rate loans in respect of interest rate risk, which limits the Group's exposure to this difference in value to be within the Group's risk appetite.

Loans and advances to customers are categorised as Level 3 as unobservable pre-payment rates are applied.

Debt securities classified as loans and receivables

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

Available-for-sale financial assets

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

Other assets and liabilities - trade debtors/creditors, accrued income and accrued interest

Fair value is deemed to approximate 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 Group for deposits of similar remaining maturities.

Debt securities in issue

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

Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9(j) sets out the key principles for estimating the fair values of financial instruments.

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

2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	-	104.2	-	104.2

Available-for-sale financial assets	850.9	-	7.6	858.5
Financial liabilities				
Derivative financial instruments	-	229.7	-	229.7

Level 1 Valuations

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

Level 2 Valuations

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

Level 3 Valuations

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

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

Note 33: Offsetting of financial assets and financial liabilities

				Related amounts where set off in the balance sheet not permitted[2]		
	Gross amounts of assets and liabilities £m	**Amounts offset in the balance sheet[1] £m**	**Net amounts presented in the balance sheet £m**	**Subject to master netting agreements £m**	**Collateral received/ pledged £m**	**Net amounts £m**
As at 31 December 2017						
Financial assets						
Derivative financial instruments	**129.8**	**(51.0)**	**78.8**	**(11.5)**	**(67.3)**	**-**
Loans and advances to banks	**359.4**	**-**	**359.4**	**-**	**(74.6)**	**284.8**
Financial liabilities						
Deposits from banks	**5,379.0**	**-**	**5,379.0**	**-**	**(8.4)**	**5,370.6**
Derivative financial instruments	**107.7**	**(14.2)**	**93.5**	**(11.5)**	**(63.6)**	**18.4**
Other liabilities	**251.9**	**(36.8)**	**215.1**	**-**	**-**	**215.1**

				Related amounts where set off in the balance sheet not permitted[2]		
	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Subject to master netting agreements £m	Collateral received/pledged £m	Net amounts £m
As at 31 December 2016						
Financial assets						
Derivative financial instruments	123.9	(19.7)	104.2	(25.4)	(78.8)	-
Loans and advances to banks	635.6	-	635.6	-	(168.1)	467.5
Other assets	72.0	(3.2)	68.8	-	-	68.8
Financial liabilities						
Deposits from banks	2,132.5	-	2,132.5	-	(10.7)	2,121.8
Derivative financial instruments	254.1	(24.4)	229.7	(25.4)	(168.1)	36.2
Other liabilities	188.0	1.5	189.5	-	-	189.5

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

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

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

Note 34: Cash flow statements

(a) Change in operating assets

	2017 £m	2016 £m
Change in loans and advances to customers	**(4,417.3)**	(5,295.7)
Change in derivative financial assets	**25.4**	(21.9)
Change in other operating assets	**34.1**	(69.7)
Change in operating assets	**(4,357.8)**	(5,387.3)

(b) Change in operating liabilities

	2017 £m	2016 £m
Change in deposits from banks	**3,247.1**	833.2
Change in customer deposits	**2,702.1**	2,961.4
Change in derivative financial liabilities	**(136.2)**	73.7
Change in other operating liabilities	**(6.4)**	89.0
Change in operating liabilities	**5,806.6**	3,957.3

(c) Non-cash and other items

	2017 £m	2016 £m
Depreciation, amortisation and impairment	**35.2**	21.0
Other non-cash items	**13.0**	39.3
Total non-cash and other items	**48.2**	60.3

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

	2017 £m	2016 £m
Cash and balances at central banks	**2,579.0**	786.3
Less: mandatory reserve deposits[1]	**(53.0)**	(49.1)
	2,526.0	737.2
Loans and advances to banks	**359.4**	635.6
Available-for-sale financial assets (with a maturity of less than 3 months)	**149.4**	-
Deposits from banks	**(5,379.0)**	(2,132.5)
Less: amounts not repayable on demand	**5,379.0**	2,131.9
	-	(0.6)
Total cash and cash equivalents	**3,034.8**	1,372.2

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

Note 35: Related party transactions

Key Management Personnel

Key Management Personnel refer to the Executive Committee of the Group, Non-Executive Directors and Directors of subsidiary companies.

	2017 £m	2016 £m
Compensation		
Salaries and other short-term benefits	6.7	7.4

Share based payments (refer note 7)	6.1	7.6
Post-employment benefits	0.9	0.8
Total compensation	13.7	15.8

Aggregate contributions in respect of Key Management Personnel to defined contribution pension schemes £0.9 million (2016: £0.8 million).

	2017 £m	2016 £m
Deposits		
At 1 January	1.4	2.2
Placed (includes deposits of appointed Key Management Personnel)	0.6	1.5
Withdrawn (includes deposits of former Key Management Personnel)	(0.9)	(2.3)
Deposits outstanding at 31 December	1.1	1.4

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

At 31 December 2017, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with Key Management Personnel included amounts outstanding in respect of loans and credit card transactions of £0.6 million with 7 Key Management Personnel (2016: £0.9 million with 7 Key Management Personnel).

Subsidiaries

Transactions and balances with subsidiaries have been eliminated on consolidation. A full list of the Company's subsidiaries and SPVs included within the consolidation is provided in note 2 to the parent company financial statements.

Other transactions

Transaction value at year end:	**2017 £m**	2016 £m
Trademark licence fees paid to Virgin Enterprises Limited	(8.0)	(7.0)
Commissions received and charges paid to Virgin Atlantic Airways Limited	0.5	0.4
Donations to The Virgin Money Foundation	(1.4)	(1.4)
Dividend payment to Virgin Group Holdings Limited	(8.4)	(7.3)
Other costs paid to Virgin Management Group Companies	(0.3)	(0.3)

Balance outstanding at year end:	**2017 £m**	2016 £m
Trademark licence fees to Virgin Enterprises Limited	(0.6)	(0.6)
Commissions received and charges paid to Virgin Atlantic Airways Limited	0.1	0.1
Asset recognised in relation to Virgin Atlantic Airways Limited agreement	10.0	-
Liability recognised in relation to Virgin Atlantic Airways Limited agreement	(10.0)	-
Donations to The Virgin Money Foundation	-	(0.2)
Other costs to Virgin Management Group Companies	-	(0.1)

Trademark licence fees paid to Virgin Enterprises Limited

Licence fees are payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark.

Virgin Atlantic Airways Limited

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

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

Donations to The Virgin Money Foundation (the Foundation)

The Group has made donations to the Foundation in both the current and prior year to enable the Foundation to pursue its charitable objectives. The Group has also provided a number of support services to the Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.4 million (2016: £0.3 million).

Dividend payment to Virgin Group Holdings Limited

The Group made dividend payments totalling £8.4 million to Virgin Group Holdings Limited in the year which represented that company's proportionate share of the total final 2016 dividend and the total interim 2017 dividend. In the prior year, the Group made dividend payments totalling £7.3 million to Virgin Group Holdings Limited which represented that company's proportionate share of the total final 2015 dividend and the total interim 2016 dividend.

Other costs paid to Virgin Management Group Companies

These costs include transactions with other companies in the Virgin Group.

Note 36: Events after balance sheet date

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

Note 37: Future accounting developments

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

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

Background

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

Classification and Measurement

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

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

Hedge Accounting

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

Impairment (Expected Credit Loss)

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

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

Key accounting judgements

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

Measurement of Expected Credit Loss

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

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

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

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

Definition of default (movement to stage 3)

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

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

Forward-looking information and multiple economic scenarios

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

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

IFRS 9 implementation programme and governance

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

The Group has developed and built new expected credit loss models for the key retail portfolios (secured and unsecured). The Group has run these models during the second half of 2017 in a period of parallel run to ensure full readiness in advance of implementation from 1 January 2018. The Group is in the process of completing the refinement and validation of these models. The Group's auditors have undertaken extensive audit procedures during the course of 2017 to provide proactive assurance over the new expected credit loss models and the Group's IFRS 9 accounting policies.

The Group continues to monitor the wider market developments in relation to IFRS 9, including evolving disclosure requirements and regulatory developments such as potential capital transitionary rules.

Impact of transition to IFRS 9

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

The Group estimates the transition to IFRS 9 will reduce shareholders' equity by approximately £35 million after deferred tax as at 1 January 2018. The impact on the Group's CET1 ratio will reflect the recently published capital transitional arrangements. This adjustment arises from the increase in the Group's balance sheet loan loss allowances as a result of the application of IFRS 9 requirements, with the Group's retail credit card portfolio being the most significantly impacted.

The Group continues to refine, monitor and validate certain elements of the impairment models and related controls ahead of full reporting of IFRS 9 impacts later in 2018.

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

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

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

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

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

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

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 activities of the Group are described in the Strategic Report.

All companies consolidated within the Group's financial statements are UK registered entities.

	UK
Number of employees (average FTE)	2,959
Turnover (total income)	£662.7m
Pre-tax profit	£262.6m
Corporation tax paid	£45.1m
Public subsidies received	£0.0m

The Group received no public subsidies during the year.

Alternative Performance Measures

The Group analyses its performance on an underlying basis, as described in the basis of preparation of the financial results on page 48, and reconciled to the statutory results in note 2 to the consolidated financial statements. These are consistent with the Board and the Executive's view of the Group's underlying performance without the distortions of items and timing differences which are not reflective of the Group's ongoing business activities.

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

Descriptions of alternative performance measures used throughout this Report, including their basis of calculation, are set out below.

Banking Net Interest Margin (NIM)	Net interest income, calculated on an underlying basis, as a percentage of simple average interest-earning banking assets.
Cost of funds (spread)	Funding costs divided by average funding balances less the average 3 month Libor interest rate for the period.
Cost of risk	Impairment charges, net of debt recoveries, divided by simple average gross loans for the period.
Cost:income ratio	Operating expenses divided by total income, calculated on an underlying basis.
JAWS	The difference between the period on period percentage change in total income less the period on period change in operating expenses calculated on an underlying basis.
Loan-to-deposit ratio	The ratio of loans and advances to customers, net of allowances for impairment, divided by customer deposits (each excluding adjustments for fair value of portfolio hedging).
Net interest margin (NIM)	Net interest income, calculated on an underlying basis, as a percentage of simple average interest-earning assets.
Return on assets	Profit attributable to equity owners divided by closing total assets.

Return on tangible equity (RoTE)	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by simple average tangible equity. Tangible equity is calculated as total equity less other equity instruments and intangible assets.
Tangible net asset value per share	Net assets excluding intangible assets and Additional Tier 1 securities divided by the closing number of Ordinary Shares (excluding own shares held).
Underlying basic earnings per share	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by the weighted-average number of Ordinary Shares outstanding during the period (excluding own shares held).
Underlying net interest income	Statutory net interest income adjusted for a subset of certain items as detailed on page 48.
Underlying profit/(loss) before tax	Statutory profit/(loss) before tax adjusted for certain items as detailed on page 48.
Underlying return on assets	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by simple average total assets.
Underlying total income	Statutory total income adjusted for a subset of certain items as detailed on pages 48.

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

Glossary

Advanced Internal Ratings Based (AIRB) Approach	A CRD IV approach for measuring exposure to credit risk. The method of calculating credit risk capital requirements uses internal probability of default (PD), loss given default (LGD) and exposure at default (EAD) models. AIRB approaches may only be used with Prudential Regulation Authority (PRA) permission.
Basel III	Global regulatory standard on Bank Capital Adequacy, Stress Testing and Market and Liquidity proposed by the Basel Committee on Banking Supervision in 2010. See also CRD IV.
Basis Point (bps)	One hundredth of a per cent (0.01%). 100 basis points is 1%. Used when quoting movements in interest rates or yields.
Capital at Risk (CaR)	Approach set out for the quantification of interest rate risk expressed as the impact to the present value of the Group's capital under interest rate sensitivity analysis.
CASS	Client Assets Sourcebook, included in the FCA Handbook and sets out the requirements with which firms must comply when holding or controlling client assets.
Certificates of Deposit	A certificate issued by a bank to a person depositing money for a specified length of time at a specified rate of interest.
Charge-Off	Charge-off occurs on outstanding credit card balances where in-house collections and recoveries have been exhausted. This involves the removal of the balance and associated provision from the balance sheet with any remaining outstanding balance recognised as a loss. Charged-off accounts may be subject to debt-sale, where by additional recoveries will be taken to profit or loss.
Common Equity Tier 1 Capital (CET1)	The highest quality form of capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
CRD IV	In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in.
Credit Enhancements	Risk reduction techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation.
Credit Valuation Adjustments (CVA)	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Cross-Currency Swaps	An arrangement in which two parties exchange specific principal amounts in different currencies at inception and subsequent interest payments on the principal amounts.
Debt Securities	Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Earnings at Risk (EaR)	Approach set out for the quantification of interest rate risk expressed as the impact to forecast net interest income under interest rate sensitivity analysis.
Expected Loss (regulatory)	Regulatory expected loss represents the anticipated loss, in the event of a default, on a credit risk exposure modelled under the Advanced Internal Ratings Based approach. Expected loss is determined by multiplying the associated PD, LGD and EAD.
Expected Credit Loss (IFRS 9)	Expected Credit Losses are a provision held on the balance sheet for all financial instruments. Expected Credit Losses may be recognised on either a 12 month or lifetime basis. The level will be determined by the performance of individual assets, and take into consideration associated credit risk attributes, including a significant increase in credit risk or any credit impairment. An expected credit loss may either be individual or collective as a result of the raising of a charge against profit for the expected loss inherent in the lending book. An expected credit loss may either be individual or collective.
Exposure at Default (EAD)	An estimate of the amount expected to be owed by a customer at the time of a customer's default.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties; or for where the contractual terms have been

	cancelled for credit cards. Forbearance options are determined by assessing the customer's personal circumstances.
Full Time Equivalent (FTE)	A full time employee is one that works a standard five day week. The hours worked by part time employees are measured against this standard and accumulated along with the number of full time employees and counted as full time equivalents.
Funding for Lending Scheme (FLS)	The Bank of England launched the Funding for Lending scheme in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to households and businesses by lowering interest rates and increasing access to credit.
Funding Risk	The inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.
Impaired Assets	Loans that are in arrears and where the carrying amount of the loan exceeds the expected recoverable amount. All mortgage expired terms, fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due.
Impairment Allowance (IAS 39)	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Impairment Losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determined that the asset's value is lower than its carrying value.
Interest Rate Risk	The risk of a reduction in the present value of the current balance sheet or earnings as a result of adverse movement in interest rates.
Interest Rate Risk in the Banking Book (IRRBB)	The risk of a reduction in the present value of the current balance sheet or earnings as a result of an adverse movement in interest rates arising as a consequence of carrying out and supporting core business activities.
Internal Capital Adequacy Assessment Process (ICAAP)	The part of the Pillar 2 assessment to be undertaken by a bank. The ICAAP allows financial institutions to assess the level of capital that adequately supports all relevant current and future risks in their business. In undertaking an ICAAP, a financial institution should be able to ensure that it has appropriate processes in place to ensure compliance with CRD IV.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The ILAAP provides comprehensive documentation of the Bank's Liquidity Risk Management framework, including: identifying the key liquidity and funding risks to which Virgin Money is exposed; describing how these risks are identified, monitored and measured and describing the techniques and resources used to manage and mitigate these risks.
Leverage Ratio	Total Tier 1 Capital expressed as a percentage of Total assets (adjusted in accordance with CRD IV).
Liquidity Coverage Ratio (LCR)	Stock of high quality liquid assets as a percentage of expected net cash outflows over the following 30 days according to CRD IV requirements.
Liquidity Risk	The inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet the Group's contractual obligations to make payments as they fall due.
Loan-to-Value Ratio	The amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of mortgage loan as a percentage of the property's value.
Loss Emergence Period (IAS 39)	Under IAS 39, the loss emergence period allows for the recognition of impairment in respect of losses that have been incurred but not reported. The emergence period is measured as time between the emergence of impairment triggers and the time at which the loss is incurred.
Loss Given Default (LGD)	The estimated loss that will arise if a customer defaults. LGD comprises the actual loss (the part that is not expected to be recovered), after taking account of credit risk mitigation, for example, any security held over collateral and the economic costs associated with the recovery process.
Master Netting Agreement	An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.
Mortgage Completion Spread	The balance weighted average effective interest rate on new mortgages advanced in the period less the cost of associated fixed to 3 month Libor interest rate swaps.
Net Interest Income	The difference between interest received on assets and interest paid on liabilities.
Net Promoter Score (NPS)	A measure of satisfaction that ranges between -100 and +100 and represents the likelihood of respondents recommending Virgin Money, its products or services to others. From a scale between 0 to 10, those scoring 9 to 10 are categorised as Promoters, those scoring 0 to 6 as Detractors and those scoring 7 to 8 as Passives. The NPS is calculated by subtracting the percentage of respondents who are Detractors from the percentage of respondents that are Promoters. Passives count towards the total number of respondents and thus decrease the percentage of Detractors and Promoters.
Net Stable Funding Ratio (NSFR)	The ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. The ratio is required to be 100% with effect from 2018. Available stable funding would include such items as equity capital, preferred stock with a maturity of over 1 year, or liabilities with a maturity of over 1 year.
Percentage Point (pp)	Unit for measuring the difference of two percentages. A change from 1% to 2% is 1 percentage point.
Pillar 1	The part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.
Pillar 2	The part of CRD IV that ensures financial institutions hold adequate capital to support the relevant risks in their business. It also encourages financial institutions to develop and use enhanced risk management techniques in monitoring and managing their risks.
Pillar 3	The part of CRD IV that sets out the information banks must disclose in relation to their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Probability of Default (PD)	The probability of a customer defaulting over a defined outcome period. Default occurs where a borrower has missed 6 months of mortgage repayments or 3 months of credit card repayments, or the borrower is deemed to be unlikely to repay their loan. The outcome period varies for assessment of capital requirements and for assessment of provisions.
Repurchase Agreements (Repos)	A form of short-term funding where one party sells a financial asset to another party with an agreement to repurchase at a specific price and date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).
Risk Appetite	The risk appetite sets limits on the amount and type of risk that the Group is willing to tolerate in order to meet its strategic objectives.
Risk-Weighted Assets	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules and are used to assess capital requirements and adequacy under Pillar 1.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities through an SPV.
Sovereign Exposures	Exposures to central governments and central government departments, central banks and entities owned or guaranteed by the aforementioned.
Standardised Approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings of obligors (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines.
Stress Testing	Techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital or liquidity resources which are required to be held.
Tier 1 Capital	A measure of banks financial strength defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to deductions including in respect of material holdings in financial companies.
Tier 1 Capital Ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 Capital	A further component of regulatory capital defined by the PRA for the Group. It comprises eligible collective assessed impairment allowances under CRD IV.
Term Funding Scheme (TFS)	The Bank of England launched the Term Funding Scheme in 2016 to allow banks and building societies to borrow from the Bank of England at rates close to Bank Base Rate.
Virgin	Virgin Group Holdings Limited.
Virgin Money Trademark Licence Agreement	The agreement under which Virgin Enterprises Limited (a subsidiary undertaking of Virgin Group Holdings Limited) grants perpetual licence to Virgin Money to use the 'Virgin' and 'Virgin Money' trademarks.

Abbreviations

AGM	Annual General Meeting	**GDPR**	General Data Protection Regulation	**MREL**	Minimum Requirements for Own Funds and Eligible Liabilities
AIRB	Advanced Internal Ratings Based	**GHG**	Greenhouse Gas	**NIM**	Net Interest Margin
AT1	Additional Tier 1	**HMRC**	Her Majesty's Revenue and Customs	**NPS**	Net Promoter Score
BOE	Bank of England	**HPI**	House Pricing Index	**NSFR**	Net Stable Funding Ratio
CET1	Common Equity Tier 1 Capital	**HQLA**	High Quality Liquid Assets	**PCA**	Personal Current Account
CRD	Capital Requirements Directive	**IAS**	International Accounting Standards	**PD**	Probability of Default
CRR	Capital Requirements Regulation	**IASB**	International Accounting Standards Board	**PRA**	Prudential Regulation Authority
CVA	Credit Valuation Adjustment	**ICAAP**	Internal Capital Adequacy Assessment Process	**PSD2**	Second Payment Services Directive
DTR	Disclosure Guidance and Transparency Rules	**IFRS**	International Financial Reporting Standards	**PwC**	PricewaterhouseCoopers LLP
EBO	Everyone better off	**ILAAP**	Individual Liquidity Adequacy Assessment Process	**RoTE**	Return on Tangible Equity
EAD	Exposure At Default	**IPO**	Initial Public Offering	**RMBS**	Residential Mortgage Backed Securities
EIR	Effective Interest Rate	**IRRBB**	Interest Rate Risk in the Banking Book	**RWAs**	Risk-weighted Assets
EPS	Earnings per share	**ISA**	Individual Savings Account	**SID**	Senior Independent Director
FCA	Financial Conduct Authority	**ISDA**	International Swaps and Derivatives Association	**SME**	Small or Medium-sized Enterprise
FLS	Funding for Lending Scheme	**LIBOR**	London Inter-Bank Offered Rate	**SPV**	Special Purpose Vehicle
FRC	Financial Reporting Council	**LCR**	Liquidity Coverage Ratio	**TFS**	Term Funding Scheme
FSCS	Financial Services Compensation Scheme	**LGD**	Loss Given Default	**TNAV**	Tangible Net Asset Value
FTE	Full Time Equivalent	**LTIP**	Long-Term Incentive Plan	**TSYS**	Total System Services, Inc
FTP	Funds Transfer Pricing	**LTV**	Loan-to-Value		

The information contained within this announcement is deemed by Virgin Money to constitute inside information as stipulated under the Market Abuse Regulation No 596/2014. Upon the publication of this announcement via a Regulatory Information Service, this inside information is now considered to be in the public domain.

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The company news service from the London Stock Exchange

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