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National Australia Bank

Monday, 16 November 2015

ASX Announcement

Clydesdale Bank background information

As announced to the market on 28 October 2015, NAB has made significant progress in relation to its intention to divest its UK retail bank Clydesdale Bank PLC, through a demerger and Initial Public Offering (IPO), in early February 2016.

The proposed transaction is in line with NAB's strategy to focus on the Australia and New Zealand franchise, and remains subject to a range of matters, including various court and regulatory approvals and NAB shareholder approval.

For informational purposes, please find attached:

- A copy of CYB Investments Limited's[1] audited Annual Report & Consolidated Financial Statements for the year ended 30 September 2015;
- A copy of CYB Investments Limited's 2015 Full Year Pillar 3 Report; and
- An update of the UK banking market overview that was released on the ASX as part of the Clydesdale Bank business update on 7 July 2015.

It is expected that shareholders will be provided with further information, including the Scheme Booklet and detailed financial information, in the week commencing 7 December 2015.

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[1] CYB Investments Limited, formerly known as National Australia Group Europe Limited, is the holding company of Clydesdale Bank PLC. As part of the proposed demerger and IPO, ownership of CYB Investments Limited would be transferred to CYBG PLC, the newly incorporated company which is proposed to be the listed entity and ultimate holding company of the Clydesdale Bank group.

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This announcement contains statements that are, or may be deemed to be, "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "believe", "estimate", "plan", "project", "anticipate", "expect", "intend", "likely", "may", "will", "could" or "should" or, in each case, their negative or other variations or other similar expressions, or by discussions of strategy, plans, objectives, targets, goals, future events or intentions. Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the company and its respective affiliates (the "Group"), which may cause actual results to differ materially from those expressed or implied in such statements. There can be no assurance that actual outcomes will not differ materially from these statements. Further information on important factors that could cause actual results to differ materially from those projected in such statements is contained in the Group's Annual Financial Report.

The Group expressly disclaims any obligation or undertaking to update, review or revise any of the forward-looking statement contained in this announcement whether as a result of new information, future developments or otherwise.

To the maximum extent permitted by law, the Group, its advisers, affiliates, related bodies corporate, directors, officers, partners, employees and agents:

- Exclude and disclaim all liability (including without limitation for negligence) for any expense, loss, damage or cost incurred as a result of the information in this announcement being inaccurate or incomplete in any way for any reason; and
- Make no representation or warranty, express or implied, as to the currency, accuracy, reliability or completeness of information in this announcement.

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

Annual report & consolidated financial statements

CYB Investments Limited
(Formerly known as National Australia Group Europe Limited)

For the year ended 30 September 2015

Company Number: 2108635

CYB Investments Limited

(Formerly known as National Australia Group Europe Limited)

Annual report and consolidated financial statements

For the year ended 30 September 2015

Contents

Overview

CYB Investments Limited ("the Company"), together with its subsidiary undertakings (which together comprise "the Group"), is the United Kingdom retail and commercial banking business of National Australia Bank Limited ("NAB"). The Group operates under both the Clydesdale Bank and Yorkshire Bank brands. It offers a range of banking services for both personal and business customers through retail branches, Business & Private Banking centres, direct and online banking and brokers.

All percentage movements noted in the document are calculated based on unrounded figures and may therefore not be able to be recalculated from the figures provided on the face of the document.

Forward looking statements

This document contains certain forward looking statements with respect to the expectations, plans and aims of the Group relating to future performance, financial position and results. The Group considers the expectations these forward looking statements reflect to be reasonable. However, we can give no assurance that these expectations will not differ materially from actual outcomes. All forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control. Factors beyond the Group's control include, amongst others, domestic UK and global economic, business and political conditions, the policies and actions of Governments and other regulatory bodies, changes in the tax regimes or other legislation in the jurisdictions the Group and its parent operate, market related risks such as interest or exchange rate movements, inflation, changes in customer preferences and the actions of competitors, the effect, timing and other uncertainties around future acquisitions or other combinations within relevant industries, delays in implementing proposals and risks affecting borrower credit quality. As a result, the Group recommends that readers of this document do not place undue reliance on such forward looking statements.

The Group undertakes no obligation to update any forward looking statements in light of any future events, new information or otherwise.

CYB Investments Limited

Officers and professional advisers

Directors	Chairman	Jim Pettigrew ^
	Non-executive	David Allvey * # David Bennett, Deputy Chairman (appointed 22 October 2015) David Browne * # ^ Adrian Grace (appointed 23 December 2014) ^ Richard Gregory OBE, Senior Independent Director * # ~ Barbara Ridpath # ~ Dr Teresa Robson-Capps (appointed 8 October 2014) * Alexander Shapland # ~
	Executive	David Duffy, Chief Executive Officer (appointed 5 June 2015) Debbie Crosbie, Chief Operating Officer Richard Sawers (National Australia Bank) Ian Smith, Chief Financial Officer (appointed 11 March 2015)
Clydesdale and Yorkshire Bank Leadership Team		David Duffy, Chief Executive Officer (appointed 5 June 2015) Debbie Crosbie, Chief Operating Officer Ian Smith, Chief Financial Officer (appointed 1 November 2014) David Gillespie, Customer Banking Director (appointed 18 February 2015) Derek Treanor, Acting Chief Risk Officer (appointed 1 July 2015) James Peirson, General Counsel (appointed 27 November 2014) Lynn McManus, People & Communications Director Helen Page, Customer Proposition Director
Company Secretary		Lorna McMillan James Peirson (appointed 16 February 2015)
Registered Office		20 Merrion Way Leeds, West Yorkshire, LS2 8NZ
Auditor		Ernst & Young LLP 25 Churchill Place London, E14 5RE

^ Member of the Boards' Remuneration Committee
* Member of the Boards' Audit Committee
# Member of the Boards' Risk Committee
~ Member of the Boards' Governance and Nomination Committee

CYB Investments Limited
Strategic Report

The Directors of the Company with its subsidiary undertakings (which together comprise "the Group") present their Strategic Report for the year ended 30 September 2015.

Highlights

- The Group's ultimate parent company, NAB, announced its intention to pursue a demerger of approximately 75% of its shares to NAB shareholders and a sale of the balance by way of an initial public offering ("IPO") to institutional investors. A detailed timetable was announced on 28 October 2015. In preparation for the transaction the Company changed its name from National Australia Group Europe Limited to CYB Investments Limited on 29 October 2015.
- In order to prepare for the demerger and IPO, the Group has made changes to senior management, most notably the appointments of David Duffy as Chief Executive Officer and Ian Smith as Chief Financial Officer. It has also incurred costs relating to separation, invested in the customer franchise and run off low yielding non-core business lending assets.
- On 7 May 2015, NAB publicly announced it intended to provide a Conduct Mitigation Package in respect of legacy conduct issues of £1.7bn (including the Group's risk share of £120m). The Conduct Mitigation Package will, from the point of separation, provide the Group with a capped indemnity in respect of certain historic conduct related liabilities including Payment Protection Insurance ("PPI") and Interest Rate Hedging Products ("IRHP") (1).
- On 30 September 2015, the Group acquired CYB Intermediaries Holdings Limited. CYB Intermediaries Holdings Limited operates through its subsidiary CYB Intermediaries Limited and acts as an intermediary for third party providers of insurance and investment products. The Group distributes these products through its retail mortgage and retail banking advisors (note 21).
- In order to use capital more efficiently and improve returns on risk-weighted assets, the Group has grown its mortgage book by 11.2% from £18,444m as at 30 September 2014 to £20,504m as at 30 September 2015. The principal source of gross new mortgage lending has been intermediary mortgage lending (74% of gross new lending). The use of the intermediary channel enables the Group to compete effectively and efficiently outside of its core regions, and facilitates diversification across the mortgage book.
- On a management basis, the profit before tax was 28% lower at £159m, driven by an increase in investment in the business with expenditure focusing on revenue generation, regulatory and compliance activities. On a statutory basis, the loss on ordinary activities before tax increased to £285m for the year ended 30 September 2015, as a result of the aforementioned investment as well as an increase in PPI and IRHP redress expenses.
- In line with its stated strategy, the Group's business lending portfolio reduced by 11.4% to £7,061m in the year to 30 September 2015. This has been driven by the managed run-off of lower yielding assets to improve overall returns, the subdued demand for business credit and competitive pressures. The Group continues to reshape its business lending portfolio, focusing principally on small and medium sized businesses ("SME") in its core regional markets.
- The Group continues to diversify and improve its funding with 10% growth in customer deposits, from £23,989m to £26,349m, and issuance of external term funding. £709m was raised in December 2014 and a further £498m in August 2015 through the Lanark residential mortgage backed securities programme. As a result, the Group's loan to deposit ratio improved to 109% and funding from NAB reduced by £1,679m.
- The impact of dealing with legacy conduct related issues continues to have an impact on the Group's results. The Group incurred a Financial Conduct Authority ("FCA") fine of £21m in the year in relation to its historic PPI complaint handling following an FCA review and enforcement action. Further provisions for PPI of £390m and IRHP of £75m were also raised in the year. As the result of these and other factors, the Group's loss after tax increased to £225m (2014: £190m).
- The Group has continued to reshape and strengthen its balance sheet. Asset quality has improved and the bad and doubtful debt charges to average customer loans ratio was 0.21% as at 30 September 2015, a 9bp year-on-year improvement. Capital has been strengthened. The Common Equity Tier 1 ("CET1") Ratio was 13.2% as at 30 September 2015 (up from 9.4% as at 30 September 2014) and leverage ratio of 7.1% as at 30 September 2015 (up from 5.2% as at 30 September 2014). The Group's balance sheet is resilient and strongly capitalised which, together with the capital protection expected to be provided by the Conduct Mitigation Package from the point of separation, provides a strong foundation to support the Group's future growth.

(1) References to "IRHP" incorporate: (i) standalone hedging products identified in the Financial Services Authority ("FSA") 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan ("TBL") products; and (iii) the Group's secondary review of all fixed-rate tailored business loans ("FRTBLs") complaints which were not in scope for the FSA notice.

Key performance indicators

12 months to:	30 Sep 2015	30 Sep 2014	2015 v 2014
Profitability:			
Net interest margin [1]	2.20%	2.30%	(10)bp
Return on tangible equity ("ROTE") [2]	(10.3)%	(9.4)%	(90)bp
Management basis ROTE [3] [4]	5.1%	7.7%	(260)bp
Cost to income ratio [5]	120%	116%	(400)bp
Management basis cost-to-income ratio [6]	75%	70%	(500)bp
Return on assets [7]	(0.58)%	(0.51)%	(7)bp
Management basis return on assets [8]	0.36%	0.46%	(10)bp

As at:	30 Sep 2015	30 Sep 2014	2015 v 2014
Asset Quality:			
Bad and doubtful debt charge to average customer loans [9]	0.21%	0.30%	9bp
90+ days past due ("DPD") to customer loans [10]	0.50%	0.66%	16bp
Gross impaired assets to customer loans [11]	0.91%	1.35%	44bp
Specific provision to gross impaired assets [12]	39.2%	37.3%	190bp
Total provision to customer loans [13]	0.93%	1.15%	22bp
Indexed loan-to-value ("LTV") of mortgage portfolio [14]	55.3%	58.8%	350bp
Regulatory Capital:			
Common Equity Tier 1 ratio [15]	13.2%	9.4%	380bp
Tier 1 ratio [16]	15.7%	11.0%	470bp
Total capital ratio [17]	18.9%	17.7%	120bp
Leverage ratio [18] [22]	7.1%	5.2%	190bp
Funding and Liquidity:			
Loan to deposit ratio [19]	109%	115%	600bp
Liquidity coverage ratio ("LCR") [20] [22]	136%	110%	2,600bp
Net stable funding ratio ("NSFR") [21] [22]	120%	108%	1,200bp

Key performance indicators (continued)

(1) Net interest margin is defined as net interest income divided by average interest earning assets for a given period.

(2) ROTE is defined as profit/(loss) after tax less preference share and non-controlling interest distributions as a percentage of average tangible equity (total equity less intangible assets excluding minorities, Additional Tier 1 and preference shares) for a given period. Average tangible equity has been calculated using tangible equity spot balances at each of the month ends of the applicable period.

(3) Management basis ROTE is defined as underlying profit after tax (as defined in footnote 4) less preference share and other distributions as a percentage of average tangible equity (total equity less intangible assets excluding minorities, Additional Tier 1 and preference shares) for a given period.

(4) Underlying profit after tax is defined as underlying profit before tax less tax charge (or plus tax credit, as the case may be), less dividends and distributions and was equal to £121m (2014: £163m). The management basis tax credit/(charge) is calculated by applying the statutory tax rate for the relevant period (30 September 2015: 20.5%; 30 September 2014: 22.0%) to the taxable items adjusted on the management basis. The taxable items are calculated with reference to the underlying profit before tax (including items such as PPI redress expense and IRHP redress expense), adjusted for items such as the non-taxable pension increase exchange gain, net gain on capital and debt restructuring and non-deductible separation costs and restructuring expenses. The Group had an unrecognised deferred tax asset of £16m (representing trading losses with a gross value of £80m) at the balance sheet date, reflecting the uncertainty of projections towards the end of the period over which such differences might be expected to reverse. Average tangible equity has been calculated using the tangible equity spot balances at each of the month ends of the applicable period.

(5) Cost to income ratio is defined as total operating expenses as a percentage of total operating income for a given period.

(6) Management basis cost-to-income ratio is defined as management basis total operating expenses as a percentage of management basis total operating income for a given period.

(7) Return on assets is defined as profit/(loss) after tax as a percentage of average assets for a given period.

(8) Management basis return on assets is defined as underlying profit after tax (as defined in footnote 4) as a percentage of average assets for a given period. Average assets have been calculated using the asset spot balances at each of the month ends in the applicable period.

(9) Bad and doubtful debt charge to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances) is defined as impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans.

(10) 90+ DPD to customer loans is defined as customer loans that are more than 90 days overdue as a percentage of total customer loans.

(11) Gross impaired assets to customer loans is defined as gross impaired assets as a percentage of total customer loans at a given date.

(12) Specific provision to gross impaired assets is defined as the specific impairment provision on credit exposures as a percentage of gross impaired assets at a given date.

(13) Total provision to customer loans is defined as total impairment provision on credit exposures as a percentage of total customer loans at a given date.

(14) Indexed LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the Halifax house price index at a given date.

(15) Common Equity Tier 1 ratio is defined as Common Equity Tier 1 capital divided by risk-weighted assets at a given date.

(16) Tier 1 ratio is defined as Tier 1 capital resources divided by risk-weighted assets at a given date.

(17) Total capital ratio is defined as total capital resources divided by risk-weighted assets at a given date.

(18) Leverage ratio is defined as Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

(19) Loan to deposit ratio is defined as customer loans as a percentage of customer deposits at a given date.

(20) The Group monitors the LCR based on its own interpretations of current guidance available for CRD IV LCR reporting. Therefore, the reported LCR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

(21) The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

(22) New regulatory standard ratio proposed by the Basel III reforms.

Our business model

The Group has over 175 years of history and operates a full service UK-focused retail and commercial banking business under the brand names “Clydesdale Bank” and “Yorkshire Bank” across its core regional markets (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. The Group delivers these services through a network of 275 retail branches, 40 Business & Private Banking centres (including 28 sites co-located with retail branches), strong and well-established relationships with leading third-party mortgage intermediaries, a rapidly evolving digital platform (including proprietary website and mobile offerings as well as participation in third-party aggregator sites), access to certain banking services through over 11,800 Post Office branches, telephony and voice services, and an ATM network. The Group's distribution platform continues to develop to allow customers to complete their Retail and SME banking needs seamlessly across multiple distribution channels with an emphasis on digital and non-branch channel usage, reflecting changing customer behaviour and preferences to interact in an omni-channel way. The Group employs 7,244 staff as at 30 September 2015. The Group is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Prudential Regulation Authority (“PRA”) and FCA.

Through both the Clydesdale Bank and Yorkshire Bank, the Group offers strong local community brands which provide a full range of banking products and services, including mortgages, current accounts, deposits, term lending, personal loans, working capital solutions, overdrafts, credit cards and payment and transaction services. The Group is also one of only a small number of banks in the world that issues banknotes.

The Group's long established Retail and SME franchises have significant scale and strong market shares in personal current accounts (“PCA”), business current accounts (“BCA”), SME business lending and mortgages in its core regions. As at 30 September 2015, the Group had 2.8 million retail and business customers, with £26,349m of customer deposits and a £28,783m customer loan portfolio, of which £20,504m was mortgage loans, £7,061m was business lending and the remainder was unsecured personal lending (including credit cards and overdrafts).

The principal strengths of the Group's business model are built around a number of key components;

- a long established franchise in core regional and selected national markets;
- strong local community brands;
- standalone, scalable and full service operating platform;
- resilient and strongly capitalised balance sheet;
- clear strategy to drive growth and returns; and
- an experienced leadership team.

Our strategic priorities

As announced on 7 May 2015, NAB intends to pursue a demerger and IPO of the Group and its subsidiaries. The target date for completion of the transaction is early in February 2016. The Group’s business model and strategic direction will not be impacted by the separation from NAB, with the Group committed to delivering a strong, customer-centric banking proposition in the UK.

Following separation from NAB, the Group will have more freedom to pursue the following strategic aims:

- leverage its capabilities in existing core regional markets;
- continue its successful national growth strategy focusing on selected products and sectors where it has strong history and established capabilities;
- deliver a consistently superior experience to its customers underpinned by local community brands and a customer driven omni-channel strategy; and
- deliver enhanced shareholder returns.

The Group’s goal is to be a strong, customer-centric bank that proactively responds to changes in its customers' needs and builds long-standing customer relationships. The Group plans to build on its existing strengths to continue the delivery of customer-driven product and service propositions across both Retail and SME banking in addition to leveraging its position as a strong regional bank with established Retail and SME franchises. The Group plans to continue to take advantage of national opportunities by focusing on growth in selected products and sectors.

Our strategic priorities (contined)

In order to support the development of sustainable, multi-product customer relationships, the Group aims to deliver a customer experience that makes it the first choice for a customer to operate their main bank account. Due to the nature of the PCA product and the relationship developed with customers, the Group believes that growth in this area will provide valuable opportunities to meet customers' needs for other banking products with a particular focus on unsecured lending and savings and mortgage products.

The Group has introduced product offerings targeted at increasing the number of PCA customers outside of its core regions, including the Group's £150 current account switching bonus which resulted in 25,000 switches in FY 2015. The Group also intends to increase the retail customer base nationally through continued development of its digital distribution capability. Digital distribution will be supported by access to telephony channels providing personal interaction as required by customers seeking support for advice or service requirements.

The Group has grown its mortgage book during the year and will continue to do so, increasing market share while maintaining its prudent risk appetite. The Group originates mortgages through both the proprietary channels in its core regions and via third party broker channels, primarily in the South East of England. During the year, the majority of mortgages originated were through the broker channel. The Group offers both owner occupied loans and buy to let mortgages. During the year, the Group also continued to see a modest run off within the mortgage tracker portfolio.

The Group aims to deepen its relationships with existing SME customers, grow its BCA customer base, and develop its business lending in selected products and sectors. The Group targets the acquisition of new micro customers, Business Direct customers and small business customers principally through digital and direct channels, including marketing campaigns specifically aimed at these customer segments, such as the BCA free day-to-day banking offer. The Group aims to further develop small business relationships and believes this presents an opportunity to leverage its existing relationships and product offerings to capitalise on growth opportunities within the small business segment. Through the provision of a full suite of banking products, the Group seeks to meet the working capital and longer-term funding requirements of all business customers, as well as their cash management and payment services needs. The Group is also in the process of running-off its low yielding non-core portfolio which is releasing capital to be redeployed into higher yielding activities.

In October 2014, the Group embarked on a programme to further digitise the customer experience for retail and SME banking and to provide improved solutions for customers to manage their finances. The Group intends for the digital proposition to be an important part of its growth agenda and to drive efficiency, process simplification and customer acquisitions. The digital proposition is expected to appeal to a more affluent demographic that may have little or no association with the Group's brands, as well as our current customer base.

The Group commenced a programme in 2015 to reshape and optimise its physical network. As part of the programme, the Group closed 24 branches and in addition to this spent £10m on various improvements to the network including the relocation of 4 branches, the extensive refurbishment of 15 branches as well as minor improvements to a number of other branches during the year.

The Group also aims to deliver a consistently superior experience to customers underpinned by its local community brands and a customer driven omni-channel strategy. Progress is monitored through a number of metrics including staff surveys, customer surveys, the level of and satisfaction with the resolution of complaints and net promoter scores ("NPS"). The principal metrics used by the Group are NPS which it monitors for both the Clydesdale and Yorkshire Bank brands.

Our strategic priorities (continued)

The Board identified four overarching goals against which to regularly monitor progress during the year through the use of management information supported by key performance indicators ("KPI").

The Customer *Risk & Control* *Sustainable Returns* *People*

The Customer – The primary metric used to monitor the Bank's progress in meeting customer expectations is NPS. NPS is monitored separately for the Clydesdale and Yorkshire Bank brands. It showed an overall change of +12 in new to bank customers over 2015. Secondary metrics include the level of customer complaints, which (excluding PPI) fell year on year, and industry awards. Clydesdale Bank was crowned best provider for branch customer service and rated as having the best switching service and mobile banking app by uSwitch. For the second year running, Clydesdale Bank also won the 'Best First Time Buyer Mortgage Provider' accolade at the 2015 Moneyfacts Awards.

Risk & Control – The Group has a formal risk appetite approved by the Board. Each risk appetite statement is monitored by reference to management and Board (breach) thresholds. Risk appetite is formally monitored by management monthly and all amber metrics and any red breaches are reported to the Board as part of monthly reporting. The Group's overall risk profile remained within the Board's risk capacity limits at all points in 2015.

Sustainable Returns – The Group uses a series of KPIs to support its analysis of returns. The key performance measures used are disclosed on page 3. In order to ensure that returns are sustainable the Group also monitors capital, liquidity and funding, further detail on these are included on pages 17 to 23.

People – A motivated and engaged workforce is a prerequisite for a customer focused, well controlled and sustainable business. The Group uses a range of measures in addition to a formal people management and leadership framework to support its employees and understand their engagement with the Group. The primary tool is SUSU – Speak Up Step Up, the Group's engagement survey. There was an increase in employee engagement in the 2015 survey, both compared to the previous year and to the global average benchmark. Clydesdale Bank won the Best Employer Award at the S1 Jobs Recruitment Awards which provides external corroboration of the results of SUSU.

Business model challenges and top and emerging risks

The principal areas of risk to the Group's business model are outlined below. Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the Group's risk appetite statement ("RAS") process. The RAS places an overall limit on the total amounts and types of risk that the Group is prepared to take within its capacity to achieve its strategic objectives and business plan. The position against the various RAS settings is monitored and reported to the Group's various management and Board Governance Committees as set out in note 40 to the financial statements.

- *Credit risk*: is the potential that a customer or counterparty will fail to meet its obligations to the Group in accordance with agreed terms and arises from both the Group's lending activities and markets and trading activities. Further detail on the Group's approach to the management of credit risk is included in note 39 to the financial statements.
- *Conduct risk*: is the risk that the Group's operating model, culture or actions result in unfair outcomes to customers. The treatment of customers and the management of customers impacts on all core activities. This is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, customer expectations are met and complaints are dealt with effectively and fairly. Consideration of customer outcomes is embedded within the Group's operating processes, and metrics are regularly monitored to help ensure outcomes are appropriate. Further detail on the Group's approach and exposures to conduct risk related matters can be found in notes 3, 27, 33, 40 and 43 to the financial statements.
- *Operational risk (excluding conduct risk)*: is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and arises from the day to day operational activities of the Group, which may result in direct or indirect losses and could adversely impact the Group's financial performance and position. These losses may result from both internal and external events, and risks, including, but not limited to, process error or failure, inadequate process design, poor product development and maintenance, poor change management, ageing infrastructure and systems, system failure, security and physical protection, fraud, deficiencies in employees' skills and performance or human error, operational failures by third party providers (including offshored and outsourced providers), natural disasters, extreme weather events, political, security and social events and failings in the financial services industry or other idiosyncratic components of operational risk that are related to the Group's particular size, nature and complexity.
- *Regulatory risk:* this represents regulatory strategy and change risk and regulatory relationship risk. Regulatory strategy and change risk is the risk of failing to identify and monitor changes in the regulatory environment and of failing to take opportunities to help shape the development of emerging legislative frameworks and/or to effectively implement the required changes. Regulatory relationship risk is the risk of damaging the Group's relationship with regulators through non-compliance with regulatory requirements, failing to inform regulators of relevant issues impacting (or which may potentially impact) the Group, and not meeting the information requests and review findings of regulators, by providing incorrect or inadequate information, not meeting regulatory deadlines or obstructing the regulator from fulfilling its role.
- *Compliance risk*: is the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives, as well as internal policies, standard procedures and frameworks. Compliance risk incorporates financial crime risk, which includes risks relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes.
- *Balance sheet and liquidity risk:* is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments:
  - *Market risk:* is the risk associated with adverse changes in the fair value of positions held by the Group as a result of movement in market factors such as interest rates and foreign exchange rates, volatility and credit spreads.
  - *Structural interest rate risk:* is the risk which comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.
  - *Foreign exchange risk*: is the risk arising as a result of future cashflows being converted to pounds sterling ("GBP") at a rate different to that prevailing at the time of the original transaction.

Business model challenges and top and emerging risks (continued)

- *Defined benefit pension risk*: is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. Further detail on the Group's pension scheme (including the actuarial assumptions) is included in note 29 to the financial statements.
- *Strategic risk*: is the risk of significant loss or damage arising from business decisions that impact the long-term interests of the Group's stakeholders or from an inability to adapt to external developments.

Further detail on the risks the Group faces and how these are managed is included in note 40 to the financial statements.

The Group monitors the environment in which it operates to identify those emerging risks that can have an impact on how it operates from a strategic, operational and financial perspective.

As part of its separation from NAB, the Group has developed and restructured its own functions and processes in a range of areas, including making its risk systems independent from NAB's, enhancing or streamlining certain of its back office processes, separating knowledge and education management systems, separating human resource processes as well as introducing shareholder services and investor relations platforms. Some of these functions and processes will in some respects continue to be supported by various services under a transitional services agreement ("TSA") and others have been developed as standalone functions. In addition to the TSA, the Group's ongoing contractual relationship with NAB will include NAB acting as the Group's sole clearing provider for central clearing of derivative transactions and the Group providing certain operational support services to NAB's London branch. There is a possibility that these functions and processes may not operate as intended or the execution of the separation process and the creation of new processes may not have been properly completed. Consequently, there is a risk that the Group could suffer operational difficulties which, either directly or as a result of the need for further financial investment or through the depletion of management resources in developing, monitoring and/or rectifying these new services and functions, could have an adverse effect on the Group's business, financial condition, results of operations and prospects.

In addition to the potential separation risks referred to above, the Group currently considers its top emerging risks to be:

- Risks relating to the macro-economic environment in which the Group operates: These include risks arising from macro-economic conditions in the UK, risks related to volatility in UK house prices and to the supply and affordability of property in the UK, risks associated with interest rate levels and volatility, risks relating to higher levels of unemployment, principally in the UK, risks from the macro-economic conditions in the Eurozone and globally and risks relating to a proposed referendum on the UK's continued membership of the European Union ("EU").

  Key mitigating actions

  The Group has comprehensive credit risk management policies. Concentration of risk is managed by client/counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to limit exposure to a single entity/counterparty. The Group has no material operations outside the UK and has no direct sovereign exposure to any Eurozone countries.

- Risks relating to the operation of the Group businesses: These include risks associated with compliance with a wide range of laws and regulations, risks associated with the implementation of its strategy, the risk that the reputation of the Group and its brands may be damaged by the actions, behaviour or performance of the Group, its employees, affiliates, suppliers, counterparties, regulators or customers or the financial services industry generally, risks relating to the cost and availability of liquidity and funding, the amount and quality of the Group's capital and risks associated with complaints and redress issues from historic sales of financial products, risks from the highly competitive market in which the Group operates, its relationships with mortgage intermediaries and with customer and counterparty non-performance, dependence on third party service providers for certain functions, cyber-crime and fraud, the Group's hedging and treasury operations including potential negative fair value adjustments, actual or perceived deterioration in the soundness of other financial institutions and counterparties, a significant reduction or withdrawal of the Funding for Lending Scheme or other funding schemes increasing competition for other sources of funding, and risks related to inadequate or failed internal processes, people and systems.

Business model challenges and top and emerging risks (continued)

Key mitigating actions

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events. The Group has an established Operational Risk Framework which operates across the Group. It is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes.

- Risks relating to pension schemes: Clydesdale Bank PLC is the sponsoring employer of the Yorkshire and Clydesdale Bank Pension Scheme, a defined benefit scheme. Risk arises as from time to time there may be insufficient assets to cover the defined benefit liabilities of the scheme and Clydesdale Bank PLC and any other employers from time to time in the Group are obliged by legislation and the governing documents of the scheme to fund the liabilities.

  Key mitigating actions

  The Group has implemented a number of reforms to the scheme to manage the liability. A recovery plan was agreed on 7 May 2014 to eliminate the deficit. The Pension Risk Management Committee has been established under the authority of the Chief Executive Officer UK.

- Regulatory risks: The Group is subject to substantial and changing prudential regulation, conduct regulations, the potential impacts of UK and European banking financial services reform initiatives and to the substantial and increasing industry-wide regulatory and governmental oversight.

  Key mitigating actions

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

The risks and challenges identified in the Strategic Report do not represent an exhaustive list of the risks and issues associated with the Group. Other risks and issues not specifically referenced may adversely impact the future financial position and performance of the Group. Accordingly, no assurances or guarantees of future performance, profitability or returns on capital are given by the Group.

Operating environment

UK economic environment

Overall UK banking performance is correlated with the health of the UK economy. UK GDP growth, which has been increasing ahead of European peers, grew by 2.8% in 2014, and real GDP is forecast to grow 2.6% in 2015 (Source: Office for National Statistics).

Other key UK macro-economic indicators are also strong. In the quarter to August 2015 the unemployment rate fell to a seven year low of 5.4% and the employment rate rose to 73.6% which is the highest rate since records began in 1971. Also, in the quarter to August 2015 workers' total earnings were up 3% from a year earlier. Inflation, as measured by the Consumer Prices Index fell to (0.1)% in September 2015. Core inflation, which strips out volatile elements like food and energy, remained weak at 1.0%. The British Chambers of Commerce expect inflation to remain at or below 0% for the remainder of the year and remain below the Monetary Policy Committee target of 2% until well into 2017.

The Bank of England bank rate has remained at 0.5% since March 2009, and the spread between bank rate and 3 month London Interbank Offered Rate ("LIBOR") has remained relatively narrow throughout the year.

Regulatory and political environment

The regulatory and political environment in which the Group operates continues to evolve. Key changes, all of which the Group is responding to, include:

- Under the Capital Requirements Directive ("CRD IV"), Financial Reporting ("FinRep") was mandated by the European Banking Authority ("EBA") as a standardised financial reporting framework on 1 July 2014. The intention of FinRep is to harmonise financial reporting, and significantly increases the level of reporting of financial information to the EBA. The Group currently complies with the inforce measures, with the first quarterly reporting (as at September 2014) submitted to the Regulator in November 2014.

Regulatory and political environment (continued)

- The PRA, published Policy Statement 11/15 on "CRD IV: Liquidity" on 8 June 2015. In this the PRA confirmed that the Liquidity Coverage Ratio ("LCR") will be phased in from 1 October 2015 at a level of 80% until the end of 2016. The PRA also clarified that firms with a balance sheet total above £5bn should be able to produce the Common Reporting ("CoRep") LCR return on a daily basis. The Group is currently compliant with an LCR in excess of 100% (30 September 2015: 136%). As a subsidiary of NAB, under Australian Prudential Regulatory Authority ("APRA") rules, the Group was required to meet a 100% LCR from 1 January 2015.
- On 22 December 2014, the Basel Committee on Banking Supervision ("BCBS") published proposals to revise the standardised approach to credit risk. They form part of the BCBS' broader work on reducing variability in risk-weighted assets, increasing risk sensitivity, reducing national discretions and enhancing comparability of capital requirements across banks. If the proposals were to be implemented, prior to mitigation, there would be a significant increase in the Group's capital requirements.
- In June 2014, the recast Deposit Guarantee Schemes Directive was finalised and published in the Official Journal. It introduced harmonised funding requirements, protection for certain types of temporary high balances, a reduction in pay-out deadlines, harmonisation of eligibility categories and new disclosure requirements. The PRA set out its near final rules on 1 April 2015 to implement the Directive by the implementation date of 3 July 2015. However, on the implementation date, the PRA also announced that the depositor protection limit was being reduced from £85,000 to £75,000 from 1 January 2016, reflecting the increased value of the pound against the euro. The Group has already implemented a number of the changes but as a result of this announcement, a number of new disclosure requirements originally scheduled for implementation on 3 July have been revised and implementation is now postponed until 1 January 2016.
- The PRA published its near final rules on the implementation of ring-fencing in Policy Statement 10/15 on 27 May 2015. It published Consultation Paper ("CP") 33/15 on 18 September 2015 and CP 37/15 on 15 October 2015 on additional aspects of the ring-fencing regime and the Group is monitoring developments closely. The Government has stated that its intention is for ring-fencing to be implemented from 1 January 2019. On 19 June 2015 the Council of the EU issued a press release stating that it has agreed its negotiation stance on structural measures to improve the resilience of the EU credit institutions. The Presidency will start negotiations with the European Parliament as soon as it has adopted its position.
- The Mortgage Credit Directive ("the Directive") was published in the Official Journal on 28 February 2014. The FCA issued policy statements in March 2015 (2nd charge mortgages) and June 2015 (buy-to-let mortgages). These policy statements outlined the key changes that will be required to be made regarding the mortgage sales process, documentation, and regulatory reporting. The UK is required to implement these rules by March 2016, and the Group has mobilised a project to assess their impact.
- The EBA has developed liquidity metrics in addition to those used to report liquidity coverage and stable funding requirements, with a view to providing supervisors with an adequate toolkit to assess liquidity risk, and to facilitate their work in performing their reviews of Internal Liquidity Adequacy. The Group has a project in place to deliver Additional Monitoring Metrics ("AMM") reporting from 1 January 2016.
- On 6 November 2014, the Competition and Markets Authority ("CMA") announced that it would carry out an in-depth investigation into the supply of personal current accounts and banking services to small and medium-sized enterprises. The Group has been an active participant by providing data and written submissions and attending a panel hearing. In late October 2015 the CMA issued its provisional findings and a notice of possible remedies which the Group is currently considering. The CMA has stated that it will reach a preliminary decision on remedies in February 2016 and issue their final report by May 2016.
- On 2 October 2015, the FCA announced its intention to issue a consultation, before the end of the calendar year, in relation to the introduction of a deadline by which consumers would need to make their PPI complaints and also on how firms should handle PPI complaints in light of a recent Supreme Court decision ("Plevin"). The Group will consider the implications of the FCA's consultation once it has been published. Further detail is included in note 33.

CYB Investments Limited
Strategic Report (continued)

Financial analysis

Management basis

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

Consolidated income statement – management basis	2015 £m	2014 £m	2015 vs 2014 %
Net interest income	787	785	0.2%
Non-interest income	177	197	(10.2%)
Total operating income	964	982	(1.9%)
Total operating and administrative expenses	(727)	(686)	(6.0%)
Operating profit before impairment losses	237	296	20.0%
Impairment losses on credit exposures (1)	(78)	(74)	(5.2%)
Underlying profit on ordinary activities before tax	159	222	28.4%
PPI redress expense	(390)	(420)	
PPI complaint handling fine	(21)	-	
IRHP redress expense	(75)	-	
Other conduct expenses	-	(13)	
Restructuring expense	(17)	-	
Separation costs	(10)	-	
Net gain on capital and debt restructuring (2)	61	-	
Pension increase exchange gain	18	-	
Loss on impairment of intangible assets	(10)	(23)	
Statutory loss on ordinary activities before tax	(285)	(234)	
Tax credit	60	44	
Statutory loss for the year	(225)	(190)	

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

(2) Includes gains of £61m, and a loss of £2m, in relation to capital restructuring and a further £2m gain on debt restructuring (refer to notes 6, 7 and 11 to the financial statements).

The Group made a statutory loss after tax of £225m in the current year compared to a statutory loss after tax of £190m for the year to September 2014. This was primarily due to increased conduct provisions, restructuring expenses, costs associated with separation activities, investment costs to support growth of the franchise, and lower fees and commissions. These impacts were partially offset by a one off gain arising from a capital restructure in December 2014 and a one off pension scheme gain. In the year ended 30 September 2015, the conduct redress expense of £465m was offset by a capital contribution by NAB which forms part of the conduct mitigation package.

In the year ended 30 September 2015, underlying profit on ordinary activities before tax decreased to £159m from £222m in the year ended 30 September 2014. This was primarily due to a decrease in non-interest income, reflecting the Group's strategy to reduce fees on customer accounts and an increase in marketing to support balance sheet growth, and franchise investment.

Net interest income remained relatively flat in 2015 compared to 2014, primarily due to the reduction in interest rates on lending and deposits which largely offset each other.

Income statement analysis – management basis

Net interest income – management basis

	2015 £m	2014 £m	*2015 vs 2014 %*
Gross interest income and similar income	1,110	1,135	(2.2%)
Gross interest expense and similar charges	323	350	7.6%
Total net interest income	787	785	0.2%

Net interest income increased by £2m (0.2%). The key drivers in this increase were higher mortgage lending income and lower funding costs driven by an improved customer deposit mix. This was partially offset by lower business lending income driven by a reduction in business lending balances due to the managed run-off of lower yielding assets and subdued demand for business credit. There was also lower income from the structural hedging of non-interest bearing deposits and capital as a result of the on-going low interest rate environment.

The net interest margin reduced by 10bps to 2.20% (2014: 2.30%). Lower lending margins due to competitive pressures and lower deferred fee income due to a reduction in business lending balances were partially offset by lower funding costs. There was also lower income from hedging derivatives.

Non-interest income – management basis

	2015 £m	2014 £m	*2015 vs 2014 %*
Gains less losses on financial instruments at fair value	2	(8)	large
Fees and commission	144	164	(12.1%)
Gain on disposal of tangible fixed assets	-	7	(100.0%)
Other income	31	34	(7.6%)
Total non-interest income	177	197	(10.2%)

Non-interest income reduced by £20m (10.2%). The key driver in the reduction was lower fees and commissions as a result of our decision to reduce current account fees to improve the customer proposition. This was largely offset by a reduction in the credit risk adjustment on loans accounted for at fair value as asset quality improved.

Operating and administrative expenses – management basis

	2015 £m	2014 £m	2015 vs 2014 %
Personnel expenses	282	287	1.8%
Depreciation and amortisation expense	83	78	(6.3%)
Other operating and administrative expenses:	362	321	(12.9%)
of which operating lease rentals	32	31	(2.5%)
of which other occupancy charges	38	39	1.7%
of which related entity charges	18	8	large
of which other operating and administrative expenses	274	243	(12.7%)
Total operating and administrative expenses	727	686	(6.0%)

Operating and administrative expenses increased by £41m (6.0%) primarily due to an increase in marketing and investment costs to support growth of the franchise. These increases were partially offset by lower personnel expenses primarily due to a reduction in performance related remuneration and restructuring benefits.

Balance sheet

	2015 £bn	2014 £bn	2015 vs 2014 %
Customer loans [1][2]	28.2	26.9	4.8%
Interest earning assets [1]	35.8	34.1	4.9%
Total assets [1]	38.7	36.9	4.9%
Customer deposits [1][3]	25.1	23.4	7.3%

(1) Average volume.

(2) Customer loans include gross loans and advances to customers, loans designated at fair value through profit or loss and amounts due from customers on acceptances.

(3) Customer deposits include both interest and non-interest bearing accounts and deposits.

Balance sheet analysis

	2015			2014		
	Average balance £m	Interest income/ expense £m	Average yield/ rate %	Average balance £m	Interest income/ expense £m	Average yield/ rate %
Interest earning assets:						
Mortgages	19,576	647	3.31%	17,155	584	3.40%
Business lending	7,339	278	3.78%	8,337	324	3.89%
Unsecured personal lending	1,274	138	10.83%	1,295	155	11.99%
Liquid assets	6,781	36	0.53%	6,180	33	0.54%
Due from related entities	810	3	0.40%	1,102	4	0.33%
Swap income / other	-	8	n/a	-	35	n/a
Total average interest-earning assets	35,780	1,110	3.10%	34,069	1,135	3.33%
Interest bearing liabilities:						
Current accounts	10,416	12	0.11%	9,741	12	0.12%
Savings accounts	7,171	54	0.75%	5,911	35	0.59%
Term deposits	5,500	129	2.35%	5,975	165	2.77%
Other wholesale deposits	96	1	0.85%	171	1	0.69%
Bonds and notes	3,868	82	2.11%	3,280	81	2.47%
Due to related entities	1,956	40	2.07%	2,961	50	1.69%
Liquid liabilities	978	5	0.54%	808	6	0.72%
Total average interest-bearing liabilities	29,985	323	1.08%	28,847	350	1.21%
Total average equity attributable to equity holders of the parent	3,029			2,324		
Net interest margin	2.20%			2.30%		

Balance sheet analysis (continued)

Customer loans [1]	2015 £m	2014 £m
Mortgages	20,504	18,444
Business lending	7,061	7,970
Unsecured personal lending	1,218	1,282
Total customer loans	28,783	27,696
Loans and advances to customers	27,687	26,121
Other financial assets at fair value	1,092	1,570
Due from customers on acceptances	4	5
Total customer loans	28,783	27,696

(1) Spot balances excluding accrued interest receivable.

Customer loans increased by £1,087m (3.9%) from £27,696m at 30 September 2014 to £28,783m at 30 September 2015, with growth in mortgages partially offset by a reduction in business lending.

Mortgages

Mortgages comprise the Group's largest asset portfolio and have a significant impact on its overall financial performance. The mortgage portfolio increased by 11.2% from £18,444m at 30 September 2014 to £20,504m at 30 September 2015. While the Group is focused on growing its mortgage portfolio through all distribution channels, this increase was primarily driven by an increase in mortgage lending via intermediaries. The balance of mortgage lending through the intermediary channel increased by £2,142m to £10,910m at 30 September 2015, enabling the Group to access customers across the UK including regions where the Group does not have a large branch network.

Additionally, the growth in the year reflects an increase in the level of fixed rate mortgages of £3,256m (34.4%) to £12,710m driven by a customer preference for securing fixed rates in a macroeconomic environment where base rates are expected to increase. This was offset in part by a reduction in the base rate tracker book, which was withdrawn from sale to the general public in 2008, and a decrease in the variable rate mortgage portfolio.

Business lending

Business lending comprises term business loans, overdrafts and other lending - predominantly asset and invoice finance. The business lending portfolio reduced by 11.4%, from £7,970m at 30 September 2014 to £7,061m at 30 September 2015. This was primarily due to the managed run-off of lower yielding assets, coupled with the impacts of subdued business credit demand. The core business lending portfolio is now showing signs of stabilising.

Unsecured personal lending

The Group's unsecured personal lending portfolio comprises credit cards, personal loans and overdrafts originated through branches or by way of digital or other direct channels. Unsecured personal lending balances decreased by 5.0% from £1,282m at 30 September 2014 to £1,218m at 30 September 2015. This was primarily due to a managed reduction in personal loan volumes via the web-based digital platform, after competitive pressures reduced margins to unattractive levels. This impact offset an increase in origination via the branch network and direct (telephone) channel in the year.

Balance sheet analysis (continued)

Customer deposits [1]	2015 £m	2014 £m
Current accounts	12,982	12,031
Variable rate savings accounts	7,790	6,165
Fixed rate term deposits	5,483	5,674
Other wholesale deposits	94	119
Total customer deposits	26,349	23,989
Due to customers	26,282	23,901
Other financial liabilities at fair value	67	88
Total customer deposits	26,349	23,989

(1) Spot balances excluding accrued interest payable.

Customer deposits increased by £2,360m (9.8%), from £23,989m at 30 September 2014 to £26,349m at 30 September 2015, primarily due to an increase in current accounts and variable rate savings accounts.

Current accounts

Funding provided by current accounts increased by £951m (7.9%) from £12,031m at September 2014 to £12,982m at September 2015, with growth in customer numbers and customers retaining higher instant access balances in response to falling market rates of interest on savings products.

Savings accounts

Variable rate savings account balances increased by £1,625m (26.4%) from £6,165m at 30 September 2014 to £7,790m at 30 September 2015 primarily driven by a substantial increase in ISAs due to attractive pricing.

Fixed rate term deposits

Fixed rate term deposits decreased by £191m (3.4%) from £5,674m at 30 September 2014 to £5,483m at 30 September 2015 in line with the Group's ongoing strategy to proactively run-off the higher rate part of the book originated in 2012. This was driven by a decline in business term deposits partially offset by growth in the retail term deposit book.

Bonds and notes

	2015 £m	2014 £m
Retail mortgage backed securities ("RMBS")	3,031	2,370
Covered bonds	721	1,063
Ultimate parent	382	410
Total bonds and notes	4,134	3,843
Bonds and notes	3,752	3,433
Related party transactions	382	410
Total bonds and notes	4,134	3,843

Bonds and notes increased by £291m (7.6%) from £3,843m at 30 September 2014 to £4,134m at 30 September 2015, primarily due to the issuance of residential mortgage backed securities of €550m and £275m through Lanark 2014-2 in December 2014, a further issuance of £300m and €280m through Lanark 2015-1 in August 2015 and offset by the redemptions of Lanark 2012-1 of €615m and £400m covered bond 2012-1.

Capital position

The Group's CET1 ratio increased from 9.4% in September 2014 to 13.2% in September 2015. In December 2014, a capital restructure was completed to strengthen the Group's capital base and ensure that the PRA's prudential capital requirements continue to be met. As part of this restructure, the Group repaid £650m of Tier 2 capital in the form of subordinated loan debt and issued £350m of ordinary shares and £150m of CRD IV compliant Additional Tier 1 ("AT1") Perpetual Capital Notes to NAB Group. Between June and September 2015, the Group issued 2 ordinary shares at their nominal value of £0.10 per share and a premium of £670m as part of the preparation for the demerger and IPO. These actions led to a strengthening of the CET1 ratio. Further capital benefits from balance sheet optimisation resulted in a reduction in credit risk-weighted assets. These actions were partially offset by the impact of conduct charges incurred in the year.

The Group's capital position at 30 September 2015 is summarised below. This table shows the capital position on a CRD IV "transitional" basis and includes grandfathered legacy Tier 2 instruments under the transitional rules implemented by the PRA.

Regulatory capital

	CRD IV 2015 £m	CRD IV 2014 £m
CET1 capital		
Capital instruments	223	1,882
Share premium account	670	-
Retained earnings and other reserves [1]	2,097	346
Structured entities reserves [1]	-	(4)
Prudent valuation adjustment [2]	(5)	(2)
Intangible assets [3]	(265)	(213)
Deferred tax asset ("DTA") relying on future profitability [4]	(273)	(223)
Defined benefit pension fund assets (net of deferred tax liabilities)	(42)	(39)
	2,405	1,747
Tier 1 capital		
Additional Tier 1 capital instruments	450	300
	450	300
Total Tier 1 capital	2,855	2,047
Tier 2 capital		
Subordinated loans [5]	460	1,125
Credit risk adjustments [6]	138	135
	598	1,260
Total capital	3,453	3,307

(1) Under Capital Requirements Regulation ("CRR") the cash flow hedge, available for sale and asset revaluation reserves now form part of regulatory capital resources. The inclusion of the available for sale asset reserve became a requirement under CRR with effect from 1 January 2015. Structured entities reserves are also excluded for regulatory capital purposes.

(2) A prudent valuation adjustment is applied in respect of fair valued instruments as required under regulatory capital rules.

(3) Intangible assets do not qualify as capital for regulatory purposes.

(4) Under CRD IV, deferred tax assets that rely on future profitability are deducted from CET1 capital.

(5) Subordinated loans reflect the principal outstanding and do not include accrued interest.

(6) The collective provision add back is limited for regulatory capital purposes.

Capital position (continued)

Risk-weighted assets [1]	2015 £m	2014 £m
Retail mortgages	7,526	6,917
Business lending	7,044	7,961
Other retail lending	951	1,030
Other lending	773	855
Credit risk	16,294	16,763
Credit valuation adjustment	206	137
Operational risk	1,589	1,564
Counterparty risk	138	181
	18,227	18,645

Capital ratios		
CET1 ratio [2]	13.2%	9.4%
Tier 1 ratio	15.7%	11.0%
Total capital ratio	18.9%	17.7%

[1] Risk-weighted assets ("RWAs") are calculated under the standardised approach.

[2] CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.

Regulatory capital to statutory total equity reconciliation	2015 £m	2014 £m
Regulatory Tier 1 capital	2,855	2,047
Reverse pension regulatory adjustments	42	39
Reverse deductions from capital	270	215
Share option reserve	3	2
Available for sale reserve	-	8
DTA relying on future profitability	273	223
Structured entities reserves	-	4
Statutory total equity	3,443	2,538

Minimum Pillar 1 capital requirements	2015 £m	2014 £m
Credit risk	1,304	1,341
Operational risk	127	125
Counterparty risk	11	14
Credit valuation adjustment	16	11
Tier 1 regulatory capital requirements	1,458	1,491

Capital position (continued)

Regulatory capital flow of funds	CRD IV 2015 £m	CRD IV 2014 £m
CET1 capital		
CET1 capital at 1 October	1,747	1,901
Share capital: ordinary share new issuance	350	300
Share premium	670	-
Retained earnings and other reserves (including structured entities)	1,755	(193)
Prudent valuation adjustment	(3)	1
Intangible assets	(52)	2
DTA relying on future profitability	(50)	(223)
Defined benefit pension fund assets	(3)	(39)
Nominal share value reduction	(2,009)	-
Pension fund deficit adjustment	-	(2)
	2,405	1,747
Tier 1 capital		
Tier 1 capital at 1 October	300	300
Share capital redeemed: perpetual non-cumulative preference shares	-	(100)
Share capital redeemed: Hybrid Tier 1 capital	-	(200)
Capital instruments issued: Additional Tier 1 Perpetual Capital Notes	150	300
	450	300
Total Tier 1 capital	2,855	2,047
Tier 2 capital		
Tier 2 capital at 1 October	1,260	1,255
Credit risk adjustments	3	(20)
Subordinated debt redemption	(665)	-
Asset revaluation reserve	-	(2)
Excess Tier 2 capital	-	24
Qualifying and material holding Tier 2 deductions	-	3
	598	1,260
Total capital	3,453	3,307

Risk-weighted assets flow statement	2015 £m	2014 £m
Risk-weighted assets at 1 October	18,645	19,817
Book size	(103)	(382)
Book quality	(180)	(399)
Methodology and policy	(130)	(391)
Other	(5)	-
Risk-weighted assets at 30 September	18,227	18,645

Capital position (continued)

Capital requirements for calculating RWAs	At 30 September 2015			At 30 September 2014		
	Capital required £m	RWA £m	Exposure £m	Capital required £m	RWA £m	Exposure £m
Central Governments or Central Banks	-	-	6,477	-	-	5,105
Regional Governments or Local Authorities	2	22	108	2	22	112
Public Sector Entities	-	3	3	-	3	3
Multilateral development banks	-	-	100	-	-	50
Financial Institutions	18	222	871	18	224	1,006
Corporates						
Term lending – Business	150	1,872	1,909	134	1,676	1,715
Other lending	62	772	840	110	1,373	1,419
Overdrafts	23	287	335	25	315	363
Lease	27	333	364	26	328	355
	262	3,264	3,448	295	3,692	3,852
Retail						
Term lending – Retail	43	539	718	46	577	769
Credit cards	21	263	350	21	263	355
Other unsecured including overdrafts	10	128	172	12	154	213
	74	930	1,240	79	994	1,337
Secured by mortgages on residential property						
Mortgages	590	7,371	20,921	541	6,761	18,872
Term lending – Business	50	626	1,081	64	795	1,345
	640	7,997	22,002	605	7,556	20,217
Secured by mortgages on commercial real estate						
Term lending – Business	178	2,230	2,468	189	2,356	2,585
Overdrafts	51	635	727	51	640	723
	229	2,865	3,195	240	2,996	3,308
Exposures in default	34	427	356	49	611	493
Claims in the form of CIU	-	-	-	-	3	15
Collective investments undertakings	-	3	3	-	3	3
Equity exposures	1	16	10	1	12	8
Other items	44	545	1,905	52	647	1,991
	1,304	16,294	39,718	1,341	16,763	37,500
Operational risk	127	1,589		125	1,564	
Counterparty risk	11	138		14	181	
Credit valuation adjustment	16	206		11	137	
	1,458	18,227		1,491	18,645	

The 'Exposure' amounts disclosed above are post Credit Risk Mitigation and Credit Conversion Factors having been applied where applicable. The tables above reflect the Group's interpretation of the revised capital calculation required by CRD IV.

Funding and liquidity

The Group strengthened its funding and liquidity position in the year. The mix of funding was improved by increasing customer deposits and secured funding whilst further reducing parental funding. The loan to deposit ratio reduced from 115% to 109% with growth in the customer deposit portfolio exceeding growth in customer loans. This was primarily due to growth in lower cost current accounts and in cash ISAs. In addition to this, there were two issuances of RMBS in the year of €550m and £275m through Lanark 2014-2 in December 2014, and £300m and €280m through Lanark 2015-1 in August 2015. The Group repaid subordinated debt from its parent as part of the capital restructure and reduced deposits from its parent.

The Group's liquid asset portfolio is managed by diversifying the mix to reduce basis risk and optimise the yield on liquid assets whilst remaining at a prudent level above PRA liquidity requirements. Core liquidity is held predominantly in deposits with central banks. Total unencumbered liquid assets increased by £1,399m from £4,143m to £5,542m. This is primarily due to a higher balance with the Bank of England which is a result of the funding actions described above and a lower level of sale and repurchase agreements at 30 September 2015.

The Group obtained credit ratings from Standard & Poor's and Fitch for the first time in 2015. Standard & Poor's assigned a long-term credit rating of "BBB" to the Group which is one notch below that of Clydesdale Bank PLC reflecting Standard & Poor's non-operating holding company methodology. Fitch assigned an issuer default rating of "A", which is in line with that of Clydesdale Bank PLC. As with Clydesdale Bank PLC, the outlook for both ratings is negative.

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

	Outlook as at 13 November 2015 [1]	2015	2014
Fitch	Rating Watch Negative	A	n/a
Standard & Poor's	Credit Watch Negative	BBB	n/a

(1) For detailed background on the latest Credit Opinions, including commentary on the impact of the demerger and IPO, by Fitch and Standard & Poor's please refer to the respective rating agency websites.

Liquid asset reserve	2015 £m	2014 £m
Cash and balances with central banks	6,431	5,986
Encumbered cash balances	(2,301)	(2,133)
	4,130	3,853
Financial assets available for sale	1,462	1,168
Encumbered available for sale securities	(50)	(878)
	1,412	290
Total unencumbered liquid assets	5,542	4,143

In addition to the above, as at 30 September 2015, the Group has £3.9bn (2014: £3.6bn) of gross eligible collateral pre-positioned with the Bank of England for potential use in its liquidity facilities.

Funding and liquidity (continued)

	At 30 September 2015		
	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,301	4,130	6,431
Due from related entities	624	162	786
Due from other banks	3	125	128
Financial assets available for sale	50	1,412	1,462
Loans and advances to customers	7,398	20,084	27,482
	10,376	25,913	36,289

Encumbered cash and balances with central banks	
Note cover	2,033
Cash ratio deposit	44
EU payment system pre-funding	5
UK payment system collateral	219
	2,301
Encumbered balances due from related entities	
Structured funding - GIC account balances	380
Cash collateral supporting derivatives transactions	244
	624
Encumbered balances due from other banks	
Cash collateral supporting derivative transactions	1
Cash margin supporting repurchase ("repo") transactions	2
	3
Encumbered investments – financial assets available for sale	
Payment system collateral (1)	50
Repo transaction collateral (1)	-
	50
Encumbered loans and advances to customers	
Structured Programme collateral – Lanark Master Trust	4,275
Structured Programme collateral – Regulated Covered Bond	1,475
Structured Programme collateral – Lannraig Master Trust	1,648
	7,398

(1) Market value of securities posted as collateral.

Funding and liquidity (continued)

	At 30 September 2014		
	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,133	3,853	5,986
Due from related entities	1,073	414	1,487
Due from other banks	6	7	13
Financial assets available for sale	878	290	1,168
Loans and advances to customers	6,770	19,131	25,901
	10,860	23,695	34,555

Encumbered cash and balances with central banks	
Note cover	2,088
Cash ratio deposit	42
EU payment system pre-funding	3
UK Payment system collateral	-
	2,133
Encumbered balances due from related entities	
Structured funding - GIC account balances	757
Cash collateral supporting derivatives transactions	316
	1,073
Encumbered balances due from other banks	
Cash collateral supporting derivative transactions	-
Cash margin supporting repurchase ("repo") transactions	6
	6
Encumbered investments - financial assets available for sale	
Payment system collateral (1)	232
Repo transaction collateral (1)	646
	878
Encumbered loans and advances to customers	
Structured Programme collateral – Lanark Master Trust	3,211
Structured Programme collateral – Regulated Covered Bond	2,007
Structured Programme collateral – Lannraig Master Trust	1,552
	6,770

(1) Market value of securities posted as collateral.

Liquid assets	2015 £bn	2014 £bn
UK Government Treasury Bills and Gilts	1.3	1.1
Interbank lending	0.1	0.1
Cash and cash at central bank	4.4	3.9
Note cover (1)	2.0	2.0
Liquid assets	7.8	7.1

(1) Note cover is excluded from PRA regulatory liquidity.

The Group continues to hold £100m of floating rate notes issued by the European Investment Bank and has no direct exposure to any Eurozone Sovereigns as part of its liquidity portfolio.

Asset Quality

Provisions on credit exposures (£m)	2015	2014
Specific provision for doubtful debts	92	110
Collective provision for doubtful debts	138	135

Credit risk adjustments on loans at fair value (£m)	2015	2014
Individually assessed credit risk adjustments on loans at fair value	11	30
Collectively assessed credit risk adjustments on loans at fair value	27	44

Past due and impaired assets (£m)	2015	2014
90+ Days Past Due ("DPD") assets	143	182
Gross impaired assets [(1)]	263	375

Asset Quality measures (%)	2015	2014
90+ DPD plus gross impaired assets to gross loans and acceptances [(1)]	1.41%	2.01%
Specific provision to gross impaired assets [(1)]	39.2%	37.3%
Net write-offs to gross loans and acceptances	0.35%	0.43%
Total provision as a percentage of net write-offs [(2)]	268%	279%
Total provision to gross loans and acceptances [(2)]	0.93%	1.15%
Impairment losses on credit exposures to credit risk-weighted assets [(3)]	0.48%	0.45%

Impairment provisions on credit exposures (£m)	2015	2014
Business lending (including lease finance)	168	187
Retail lending	62	58
	230	245

Impairment losses on credit exposures (£m)	2015	2014
Business lending (including lease finance)	45	46
Retail lending	33	28
	78	74
Of which:		
Specific	73	95
Collective	5	(21)
	78	74

(1) Gross impaired assets for September 2015 and September 2014 include £25m and £56m gross impaired fair value assets respectively.

(2) Total provision to gross loans and acceptances/net write-offs includes the credit risk adjustments on loans at fair value through profit or loss.

(3) Impairment losses on credit exposures to credit risk-weighted assets excludes credit risk adjustments on loans at fair value.

A number of key Asset Quality measures improved in the period as the impacts of management actions in prior years and improvement in the UK economy took effect. Retail asset quality remains strong and lower default rates continue to be observed. Housing lending impaired loan levels have remained subdued against a growing portfolio supported by the prolonged period of low interest rates and recovery in residential property prices. The 90+ DPD levels for both housing lending and the unsecured portfolios show a steady reduction through the 12 months to 30 September 2015.

While the non-retail portfolio remains sensitive to economic conditions, the recent improvement in the environment, combined with management actions, has had a positive impact on asset quality metrics. The overall collective provision for doubtful debts, including credit risk adjustments on loans at fair value, continues to decrease, reflecting the reduction in the business lending portfolio and stabilisation in non-retail asset quality. The personal lending collective provision also continues to reduce, driven by the improved delinquency profile of these portfolios.

CYB Investments Limited

Strategic Report (continued)

Asset Quality (continued)

The ratio of total provisions to gross loans and acceptances decreased by 22 basis points to 0.93% at 30 September 2015. The movement in the ratio reflects the reduction in the level of specific provisions recognised in the period, resulting from the improvement in economic conditions and improving Asset Quality trends, combined with the lower risk profile of the book, with a reduced business lending portfolio and growth in the mortgage portfolio which has a lower provisioning requirement.

Investment spend

The Group has increased its investment in the business with expenditure focused on regulatory and compliance, revenue generation activities and refreshing the infrastructure landscape in preparation for being a standalone entity.

Significant progress has been made during the year including the development of our new digital offering to further enhance our customer proposition. The Group has also delivered mandatory reporting capabilities for our Automated Anti Money Laundering Transaction Screening and Mortgage Product Sales Data requirements.

The second half of the year saw the implementation of our new mortgage processing platform and a refresh of the call centre infrastructure as part of the Unified Telephony Programme. This year also saw the launch of the People Programme, investing in the cross enterprise employee proposition.

Community

The Group continues to support the communities it serves.

The Yorkshire and Clydesdale Bank Foundation provides financial support to a large number of charities. In the last 12 months the Foundation has distributed over £864,000 to 350 worthy causes. The third year of the annual Spirit in the Community Awards saw £150,000 being donated to 24 charities in June 2015. The charity relationship with Help the Hospices is now in its eighth year and over £4.5m has been raised in this time, including matching and donations from the Group. In addition, 19% of employees currently donate to their chosen charities through Payroll Giving and the Group's Employee Volunteering Policy offers all employees the opportunity to take two days paid leave to work in the local community.

The Group has received the HM Government Payroll Giving Platinum Award for the third consecutive year.

Employee engagement

We can only deliver our strategy if our people are motivated and equipped to do their best. Key to this is determining and understanding what they think about the Group as an employer and as a place to work. To do this, we undertake an annual "Speak Up Step Up" ("SUSU") survey, that asks a range of questions to gauge how engaged our employees are with the business and what the Group can do to enable our people going forward.

The recent SUSU results were positive and we have seen an increase in our employee engagement index compared to last year and to the global average benchmark. 84% of employees responded to the voluntary survey. Employee advocacy, pride and commitment to making the Group successful continue to improve year on year. Furthermore, our employees responded favourably to understanding how they can contribute to meeting the needs of our customers, something which has been a key focus for the Group. The results indicate a strong customer focus, a risk and compliance culture that aligns with our strategy and brand and also provide a good indicator of where improvements can be made to strengthen our employee proposition. We will continue to work proactively on the insights that are derived from SUSU to ensure we understand and act on areas where improvements can be made.

The Strategic Report was approved by the Board of Directors on 13 November 2015 and was signed on its behalf by:

David Duffy

Chief Executive Officer

CYB Investments Limited
Report of the Directors

The Directors of the Company with its subsidiary undertakings (which together comprise "the Group") submit their report and consolidated financial statements for the year ended 30 September 2015. On 29 October 2015 the Company name was changed from National Australia Group Europe Limited to CYB Investments Limited.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2015 amounted to £285m (2014: loss of £234m). The loss attributable to the shareholders for the year ended 30 September 2015 amounted to £225m (2014: loss of £198m). No dividends were paid on the ordinary shares during the year ended 30 September 2015 (2014: £Nil). The Directors do not recommend the payment of a dividend in respect of this financial year (2014: £Nil).

The Group's strategic highlights and business developments are set out in the Strategic Report on pages 2 to 25.

Financial instruments

The Group's risk management objectives and policies are discussed in note 40.

Directors and Directors' interests

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

Directors' interests

No Director had any interest in the shares of the Company or its subsidiaries at any time during the year. As the Group is a wholly-owned subsidiary of NAB, any interest which the Directors may have in NAB does not need to be notified to the Group, and therefore is not disclosed in this report.

Appointments

Dr Teresa Robson-Capps was appointed as a Non-executive Director of the Company on 8 October 2014.

Adrian Grace was appointed as a Non-executive Director of the Company on 23 December 2014.

Ian Smith was appointed as a Director of the Company on 11 March 2015.

David Duffy was appointed as a Director of the Company on 5 June 2015.

David Bennett was appointed as a Non-executive Director of the Company on 22 October 2015.

Resignations

John Hooper resigned as a Director of the Company on 31 October 2014.

David Thorburn resigned as a Director of the Company on 28 February 2015.

Directors' liabilities

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

Employee involvement

The Group regularly communicates with staff to keep them informed of business objectives and results using methods including the intranet site and all employee telephone calls with the Clydesdale and Yorkshire Bank Leadership Team ("CYB Leadership Team").

Employee involvement (continued)

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,800 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on the open market or issue shares which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

An offer of NAB shares is not being made for the 2015 financial year due to the planned demerger and IPO. In respect of the 2014 financial year, NAB gifted ordinary shares of A$1,000 in total to each eligible employee based on Group performance under the UK National Share Incentive Plan.

Equality of employment opportunities

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

The staff network group and membership of the Business Disability Forum provides an ongoing opportunity for progress by identifying and implementing improvements.

The Group is authorised as a “two tick” symbol user by Jobcentre Plus. The disability symbol is a recognition given by Jobcentre Plus to employers who have agreed to take action to meet five commitments regarding the employment, retention, training and career development of disabled employees, and to continually review progress and improve on what they do. Employers who wish to become a symbol user have to evidence they can achieve those commitments in their application.

Political donations

No political donations were made during the year (2014: £Nil).

Corporate governance

The Group confirms that it complies with the PRA’s General Organisational Requirements 5.8 and the Financial Conduct Authority’s Senior Management Arrangements, Systems and Controls sourcebook (“SYSC”) 4.3A.11R. These rules require a firm that maintains a website to explain on the website how it complies with certain of the General Organisational Requirements and SYSC rules relating to governance. Statements of compliance are included in the Corporate Governance section of the Group's websites at www.cbonline.co.uk/corporategovernance and www.ybonline.co.uk/corporategovernance.

To demonstrate compliance with certain of the General Organisational Requirements and SYSC rules the Group has published a Corporate Governance Statement. It is the Group's policy not to include all of the disclosures in respect of voluntary corporate governance Codes of Practice as it is a wholly owned subsidiary of NAB. The NAB Group's Annual Financial Report details the full Corporate Governance framework applicable to the Group and its subsidiaries. These disclosures are made after consideration of authoritative pronouncements on Audit Committees and associated disclosures in Australia and the UK. Whilst the Group remains part of the NAB Group, Remuneration policy is not the responsibility of the Board. The remuneration policy that applies to employees and Directors of the Group is decided at the NAB Group level.

Management of risk

The Group has a well-established Boards’ Risk Committee for the consideration of risks. The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals.

Additional risk and capital related disclosures can be found in the Group’s Pillar 3 Report, https://secure.cbonline.co.uk/debtinvestors/clydesdale-bank-update/, and also within the Strategic Report on pages 17 to 20. Further information on the Group’s risk management structure is included in note 40.

CYB Investments Limited

Report of the Directors (continued)

Management of risk (continued)

The Group also continues to report on the Enhanced Disclosure Task Force ("EDTF") recommendations taking a measured and proportionate approach to the disclosures provided. Further information on the EDTF disclosures can be found on page 142.

The information contained in these qualitative disclosures has not been audited by the Group's external auditors except to the extent that they are equivalent to those made under accounting requirements.

Going concern

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

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

Events after the balance sheet date

On 28 October 2015, NAB confirmed its intention to divest the Group to CYBG PLC ("CYBG") through a demerger and subsequently list CYBG by IPO in February 2016. CYBG will be the newly created holding company for the Group. The proposed demerger is subject to a range of matters including various court and regulatory approvals and NAB shareholder approval.

In order to achieve the proposed CYBG demerger and IPO the PRA requires capital support for CYBG of £1.7bn in relation to potential future legacy conduct costs. The provisions of £465m recognised in the year ended September 2015 will form part of the £1.7bn support package.

Auditors

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

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

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

By order of the Board

Lorna McMillan
Company Secretary
13 November 2015

CYB Investments Limited
Statement of Directors' responsibilities

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

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

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

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

Lorna McMillan
Company Secretary
13 November 2015

Independent auditor's report to the members of CYB Investments Limited on the Group's financial statements

We have audited the financial statements of CYB Investments Limited for the year ended 30 September 2015 which comprise the Consolidated Income Statement, the Group Statement of Comprehensive Income, the Group Balance Sheet, the Group Statement of Changes in Equity, the Group Statement of Cash Flows and the related notes 1 to 43. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 29, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's affairs as at 30 September 2015 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Group financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

CYB Investments Limited

Independent auditor's report to the members of CYB Investments Limited on the Group's financial statements (continued)

Matters on which we are required to report by exception

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

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

Ernst & Young LLP

Andrew Gilder (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
13 November 2015

CYB Investments Limited

Consolidated financial statements

Contents

CYB Investments Limited
Consolidated income statement
for the year ended 30 September 2015

	Note	2015 £m	2014 £m
Interest income and similar income		1,110	1,135
Interest expense and similar charges		(323)	(350)
Net interest income	5	787	785
Gains less losses on financial instruments at fair value		2	(8)
Other operating income		238	205
Non-interest income	6	240	197
Total operating income		1,027	982
Personnel expenses		(266)	(287)
Restructuring expenses		(17)	-
Depreciation and amortisation expense		(83)	(78)
Other operating and administrative expenses		(868)	(777)
Total operating and administrative expenses before impairment losses	7	(1,234)	(1,142)
Operating loss before impairment losses		(207)	(160)
Impairment losses on credit exposures	16	(78)	(74)
Loss on ordinary activities before tax		(285)	(234)
Analysed as:			
Profit before tax, PPI, IRHP redress expense, other conduct expenses, restructuring expense, separation costs, net gain on capital and debt restructure, pension increase exchange gain and loss on impairment of intangible assets		159	222
PPI redress expense	27	(390)	(420)
PPI complaint handling fine	7	(21)	-
IRHP redress expense	27	(75)	-
Other conduct expenses	7	-	(13)
Restructuring expense	7, 27	(17)	-
Separation costs	7	(10)	-
Net gain on capital and debt restructure	6, 11	61	-
Pension increase exchange gain	29	18	-
Loss on impairment of intangible assets	22	(10)	(23)
Loss on ordinary activities before tax		(285)	(234)
Tax credit	8	60	44
Loss for the year		(225)	(190)
Attributable to			
Equity holders of the parent		(225)	(198)
Non-controlling interest		-	8
		(225)	(190)

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

The notes on pages 39 to 130 form an integral part of these financial statements.

CYB Investments Limited

Group statement of comprehensive income

for the year ended 30 September 2015

	Note	2015 £m	2014 £m
Loss for the year		(225)	(190)
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
Gains during the year		21	1
Transfers to the income statement		(18)	(50)
Tax thereon		-	10
		3	(39)
Change in available for sale reserve			
Gains during the year		5	4
Taxation thereon		(1)	(1)
		4	3
Total items that may be reclassified to the income statement		7	(36)
Items that will not be reclassified to the income statement			
Change in asset revaluation reserve			
Tax thereon		-	1
		-	1
Remeasurement of defined benefit pension plans	29	(36)	24
Tax thereon		7	(2)
		(29)	22
Total items that will not be reclassified to the income statement		(29)	23
Other comprehensive losses, net of tax		(22)	(13)
Total comprehensive losses for the year		(247)	(203)
Attributable to:			
Equity holders of the parent		(247)	(211)
Non-controlling interest		-	8
		(247)	(203)

The notes on pages 39 to 130 form an integral part of these financial statements.

CYB Investments Limited
Group balance sheet
as at 30 September 2015

	Note	2015 £m	2014 £m
Assets			
Cash and balances with central banks	10	6,431	5,986
Due from related entities	11	786	1,487
Due from other banks		128	13
Financial assets available for sale	12	1,462	1,168
Other financial assets at fair value	13	1,097	1,583
Derivative financial instruments	14	285	220
Loans and advances to customers	15	27,482	25,901
Due from customers on acceptances		4	5
Current tax assets		4	-
Property, plant and equipment	18	109	121
Investment properties	19	32	44
Property inventory	20	-	2
Investments in controlled entities and associates	21	2	2
Intangible assets	22	265	213
Deferred tax assets	23	389	349
Defined benefit pension assets	29	52	49
Other assets	24	177	249
Total assets		38,705	37,392
Liabilities			
Due to other banks	25	393	914
Other financial liabilities at fair value	13	67	91
Derivative financial instruments	14	534	548
Due to customers	26	26,407	24,073
Liabilities on acceptances		4	5
Current tax liabilities		-	32
Provisions	27	1,006	952
Due to related entities	11	998	2,677
Bonds and notes	28	3,766	3,453
Retirement benefit obligations	29	4	4
Deferred tax liabilities	23	10	10
Other liabilities	30	2,073	2,095
Total liabilities		35,262	34,854
Equity			
Share capital	31, 32	223	1,882
Other equity instruments	32	450	300
Share premium	32	670	-
Other reserves	32	4	96
Retained earnings	32	2,096	260
Total equity		3,443	2,538
Total liabilities and equity		38,705	37,392

The notes on pages 39 to 130 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 13 November 2015 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Ian Smith
Chief Financial Officer

Company number: 2108635

CYB Investments Limited

Group statement of changes in equity

for the year ended 30 September 2015

Group

	Note	Share capital £m	Share premium account £m	Capital redemption reserve £m	Other equity instruments £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total parent entity interest £m	Non-controlling interest £m	Total equity £m
As at 1 October 2013		1,682	-	-	-	2	2	5	23	535	2,249	200	2,449
(Loss)/profit for the year		-	-	-	-	-	-	-	-	(198)	(198)	8	(190)
Other comprehensive income/(losses), net of tax		-	-	-	-	-	-	3	(39)	23	(13)	-	(13)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	3	(39)	(175)	(211)	8	(203)
Dividend paid		-	-	-	-	-	-	-	-		-	(8)	(8)
Capital redemption		-	-	-	-	-	-	-	-	-	-	(200)	(200)
Capital note issued		-	-	-	300	-	-	-	-	-	300	-	300
Shares repurchased		(100)	-	-	-	-	-	-	-	-	(100)	-	(100)
Shares issued		300	-	-	-	-	-	-	-	-	300	-	300
Transfer to capital redemption reserve		-	-	100	-	-	-	-	-	(100)	-	-	-
Share options expensed		-	-	-	-	6	-	-	-	-	6	-	6
Share options settled		-	-	-	-	(6)	-	-	-	-	(6)	-	(6)
As at 30 September 2014	31, 32	1,882	-	100	300	2	2	8	(16)	260	2,538	-	2,538
Loss for the year		-	-	-	-	-	-	-	-	(225)	(225)	-	(225)
Other comprehensive income/(losses), net of tax		-	-	-	-	-	-	4	3	(29)	(22)	-	(22)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	4	3	(254)	(247)	-	(247)
AT1 distribution paid	9	-	-	-	-	-	-	-	-	(18)	(18)	-	(18)
Nominal share value reduction		(2,009)	-	-	-	-	-	-	-	2,009	-	-	-
Capital note issued		-	-	-	150	-	-	-	-	-	150	-	150
Shares issued		350	670	-	-	-	-	-	-	-	1,020	-	1,020
Transfer from capital redemption reserve		-	-	(100)	-	-	-	-	-	100	-	-	-
Transfer to share option reserve		-	-	-	-	1	-	-	-	(1)	-	-	-
Share options expensed		-	-	-	-	7	-	-	-	-	7	-	7
Share options settled		-	-	-	-	(7)	-	-	-	-	(7)	-	(7)
As at 30 September 2015	31, 32	223	670	-	450	3	2	12	(13)	2,096	3,443	-	3,443

The notes on pages 39 to 130 form an integral part of these financial statements.

CYB Investments Limited

Group statement of cash flows

for the year ended 30 September 2015

	Note	2015 £m	2014 £m
Operating activities			
Loss on ordinary activities before tax		(285)	(234)
Adjustments for:			
Non-cash or non-operating items included in loss before tax	34	(679)	(615)
Changes in operating assets	34	(1,494)	(1,177)
Changes in operating liabilities	34	1,983	562
Interest received		1,257	1,134
Interest paid		(418)	(257)
Tax repayment received		5	-
Tax (paid)/received - group relief		(20)	18
Net cash provided by/(used in) operating activities		349	(569)
Cash flows used in investing activities			
Interest received		8	8
Proceeds from sale or maturity of investments		-	50
Proceeds from sale of tangible fixed assets [1]		17	41
Purchase of tangible fixed assets [1]		(19)	(23)
Purchases of investments		(269)	(251)
Purchase and development of intangible assets		(119)	(75)
Net cash used in investing activities		(382)	(250)
Cash flows from financing activities			
Interest received		3	4
Interest paid		(122)	(131)
Proceeds from ordinary shares issued	31	1,020	300
Proceeds from other capital issued		150	300
Redemption of preference shares		-	(100)
Redemption of non-controlling interest		-	(200)
Redemption of medium term notes	11	(427)	-
Redemption of subordinated debt	11	(591)	-
Redemption, principal repayment and other movements on residential mortgage backed securities and covered bonds	17	(921)	(216)
Issuance of residential mortgage backed securities and covered bonds	17	1,207	601
Net decrease/(increase) in amounts due from related entities		686	(91)
Net decrease in amounts due to related entities		(512)	(295)
Amounts paid to non-controlling interest		-	(8)
AT1 distributions		(18)	-
Net cash provided by financing activities		475	164
Net increase/(decrease) in cash and cash equivalents		442	(655)
Cash and cash equivalents at the beginning of the year		5,895	6,550
Cash and cash equivalents at the end of the year	34	6,337	5,895

[1] Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

The notes on pages 39 to 130 form an integral part of these financial statements.

CYB Investments Limited
Notes to the consolidated financial statements

1. Basis of preparation

Reporting entity

The Company is incorporated in the UK and registered in England and Wales. The consolidated financial statements comprise the Company and its controlled entities (together the "Group"). The Group's controlled entities are listed in note 46.

The ultimate parent undertaking, and ultimate controlling party is NAB, a company incorporated in the State of Victoria, Australia. NAB also heads the largest group in which the results of the Group are consolidated. The results of the Group are not consolidated in the accounts of any other NAB Group company. The immediate parent of the Company is National Equities Limited, a company incorporated in the State of Victoria, Australia.

Statement of compliance

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

The consolidated financial statements of the Group for the year ended 30 September 2015 were authorised for issue by the Board of Directors on 13 November 2015.

Basis of measurement

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

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. In addition, note 40 to the financial statements includes the Group's risk management objectives and note 41 to the financial statements includes the Group's objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2015, the Directors have considered a number of factors including the Group's capital structure, its funding and liquidity position and its future financial performance. This assessment also took into consideration the impact of the intention to pursue a demerger and IPO as a result of the separation from NAB as announced on 7 May 2015 and confirmed on 28 October 2015. The assessment concluded that, for the foreseeable future, the Group has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that performance will improve as the economy continues to recover.

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

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. An assessment of control is performed on an ongoing basis. For details of controlled structured entities refer to note 21. For details of investments in subsidiaries and associates refer to note 46.

Controlled entities are consolidated from the date on which control is established by the Group until the date that control ceases. The acquisition method of accounting is used to account for business combination other than those under common control. Balances and transactions between entities within the Group and any unrealised gains and losses arising from those transactions are eliminated in full upon consolidation. The consolidated financial statements have been prepared using uniform accounting policies and are based on the same accounting period as NAB.

New accounting standards and interpretations adopted during the year

The Group has adopted the following IASB pronouncements in the current financial year. Except where otherwise stated, these amendments to standards and interpretations did not have a material impact on the Group's consolidated financial statements:

- *IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting – Narrow Scope Amendment'*, issued June 2013 and effective for financial years beginning on or after 1 January 2014. This amends IAS 39 to permit the continuation of hedge accounting in specified circumstances where a derivative, which has been designated as a hedging instrument, is novated from one counterparty to a central counterparty as a consequence of laws or regulations.
- *Amendments to IAS 32 'Financial Instruments – Presentation'*, issued December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment adds application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria of IAS 32, including clarifying the meaning of 'currently has a legally enforceable right of set—off' and that some gross settlement systems may be considered equivalent to net settlement.
- *Amendments to IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets'* issued May 2013 and effective for financial years beginning on or after 1 January 2014. This amends the disclosure requirements of IAS 36 to include additional information about the fair value measurement where the recoverable amount of the impaired asset is based on fair value less costs of disposal.

The Group has elected to early adopt the following IASB pronouncements in the current year. Except where otherwise stated, these amendments to standards and interpretations did not have a material impact on the Group's consolidated financial statements:

- *'Annual Improvements to IFRS 2010-2012 Cycle'*, issued December 2013 and effective for financial years beginning on or after 1 July 2014 (with the mandatory application date for EU entities being financial years beginning on or after 1 February 2015). The IASB have made amendments to the following standards that are relevant to the Group: IFRS 2 'Share Based Payments', *IFRS 3 'Business Combinations', IFRS 8 'Operating Segments', IFRS 13 'Fair Value Measurement', IAS 16 'Property, Plant and Equipment', IAS 24 'Related Party Disclosures' and IAS 38 'Intangible Assets'.*
- *'Annual Improvements to IFRS 2011-2013 cycle'*, issued December 2013 and effective for financial years beginning on or after 1 July 2014 (with the mandatory application date for EU entities being financial years beginning on or after 1 January 2015). The IASB have made amendments to the following standards that are relevant to the Group: *IFRS 3 'Business Combinations', IFRS 13 'Fair value measurement' and IAS 40 'Investment Property'.*
- *'Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)'*, issued November 2013 and effective for financial years beginning on or after 1 July 2014 (with the mandatory application date for EU entities being financial years beginning on or after 1 February 2015). This amendment to IAS 19 permits certain contributions from employees or third parties (only those contributions that are independent of the number of years of service) to be recognised as a reduction in the service cost in the period in which the employee's services are rendered, rather than being attributed to periods of service as a 'negative benefit'.

There were no other standards or interpretations relevant to the Group's operations which were adopted during the year.

New accounting standards and interpretations not yet adopted

The following IASB pronouncements are relevant to the Group but were not available for adoption in the EU and have not been applied by the Group in the 30 September 2015 reporting year. The impact of these pronouncements is still being assessed by the Group. Except where otherwise stated, the Group does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the financial statements:

- IFRS 15 'Revenue from Contracts with Customers', issued May 2014 and effective for financial years beginning on or after 1 January 2018. This standard establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard provides a single, principles based five step model to be applied to all contracts with customers. The expected impact on the Group is being evaluated.
- Amendments to IAS 16 and IAS 38: 'Clarification of Acceptable Methods of Depreciation and Amortisation', issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation are not appropriate.
- Amendments to IAS 27: 'Equity Method in Separate Financial Statements', issued August 2014 and effective for financial years beginning on or after 1 January 2016. The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.
- 'Annual Improvements to IFRS 2012-2014 Cycle', issued September 2014 and effective for financial years beginning on or after 1 January 2016. The IASB have made amendments to the following standards that are relevant to the Group and Company: IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'.
- Amendments to IAS 1: 'Disclosure Initiative', issued December 2014 and effective for financial years beginning on or after 1 January 2016. Narrow scope amendments providing clarification to existing IAS 1 'Presentation of Financial Statements' requirements.
- Amendments to IFRS 11: 'Accounting for Acquisitions of Joint Ventures and Associates', issued May 2014 and effective for financial years beginning on or after 1 January 2016. The amendments address how a joint operator should account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.
- Amendments to IFRS 10 and IAS 28 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture', issued in September 2014 and effective for financial years beginning on or after 1 January 2016. The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture.
- IFRS 9 'Financial Instruments', issued July 2014 and effective for financial years beginning on or after 1 January 2018. This standard replaces IAS 39 'Financial Instruments: Recognition and Measurement' and contains new requirements for the classification and measurement of financial assets and liabilities, the recognition of impairment, and hedge accounting. This standard is expected to have a significant impact on the Group in line with the wider industry.

  Classification and measurement

  The revised classification and measurement approach will lead to the Group's financial assets being classified as either amortised cost, fair value through other comprehensive income ("FVOCI"), or fair value through the income statement, dependant on the business model and cash flow characteristics of the financial asset. Financial liabilities will in most cases be accounted for as at present. One exception is where the Group opts to fair value a financial liability, where the movement in fair value due to own credit risk would be directly recognised in other comprehensive income. The Group is currently assessing the impact of these requirements.

  Recognition of impairment

  The impairment of financial assets under IFRS 9 will be based on an expected credit loss ("ECL") model, replacing the incurred loss methodology model under IAS 39.

New accounting standards and interpretations not yet adopted (continued)

Recognition of impairment (continued)

The key changes in the Group's accounting policy for impairment of financial assets expected as a result of the implementation of IFRS 9 are listed below. The Group will apply a three-stage approach to measuring ECL on debt instruments accounted for at amortised cost and FVOCI. Assets migrate through the following three stages based on the change in credit quality since initial recognition:

i) Stage 1: 12 months ECL: for exposures where there has not been a significant increase in credit risk since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised

ii) Stage 2: Lifetime ECL – not credit impaired: for credit exposures where there has been a significant increase in credit risk since initial recognition but that are not credit impaired, a lifetime ECL is recognised

iii) Stage 3: Lifetime ECL – credit impaired: financial assets will be assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the Group's methodology for specific provisions is expected to remain unchanged. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest revenue is calculated by applying the effective interest rate to the amortised cost (net of provision) rather than the gross carrying amount.

At each reporting date, the Group will assess whether there has been a significant increase in credit risk for financial assets since initial recognition by comparing the risk of default occurring over the expected life between the reporting date and the date of initial recognition. In determining whether credit risk has increased significantly since initial recognition, the Group expects to use its internal credit risk grading system, external risk ratings and forecast information to assess deterioration in credit quality of a financial asset.

Consistent with the current impairment policy, the Group will assess whether the credit risk on a financial asset has increased significantly on an individual or collective basis. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of shared credit risk characteristics, taking into account instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry and other relevant factors.

The amount of ECL is measured as the probability weighted present value of all cash shortfalls over the expected life of the financial asset discounted at its original effective interest rate. The cash shortfall is the difference between all contractual cash flows that are due to the Group and all the cash flows that the Group expects to receive. In calculating the ECL the Group will consider its historical loss experience and adjust this for current observable data. In addition, the Group intends to uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. IFRS 9 introduces the use of macroeconomic factors which include, but are not limited to, unemployment, interest rates, gross domestic product, inflation and commercial property prices, and requires an evaluation of both the current and forecast direction of the economic cycle. Incorporating forward looking information increases the level of judgement as to how changes in these macroeconomic factors will affect ECL. If, in a subsequent period, credit quality improves and reverses any previously assessed significant increase in credit risk since origination, then the provision for doubtful debts reverts from lifetime ECL to 12 months ECL.

Overall, impairment under IFRS 9 will increase the complexity of the Group's impairment modelling and result in earlier recognition of credit losses than under IAS 39 which is likely to lead to an increase in total provisions.

The Group's ultimate parent, NAB, early adopted IFRS 9 in relation to the impairment of credit exposures from 1 October 2014. NAB produces impairment models for the Group on an IFRS 9 basis for NAB consolidated reporting. The Group does not plan to early adopt any of the requirements of IFRS 9. Prior to adoption by the Group, the methodology and models developed by NAB in relation to the Group are being developed and assessed for consistency with emerging European guidance and market practice.

The Group's governance processes and controls are being developed to integrate the revised ECL requirements into the Group's risk management and financial reporting processes.

New accounting standards and interpretations not yet adopted (continued)

Recognition of impairment (continued)

NAB has produced an impairment provision calculation for the Group using an IFRS 9 ECL model, which is included in the NAB consolidated results from 1 October 2014. The day one impact of adopting the NAB ECL approach was to increase the Group's total impairment provisions on assets measured at amortised cost by £59m (unaudited). The collective impairment provision release for amortised cost assets in the current period calculated by the NAB ECL model was £16.5m (unaudited). These figures do not capture the impact of economic overlays which are applied at the NAB consolidated level, consequently they are not necessarily indicative of the expected adoption impact of the IFRS 9 ECL model on the Group.

As part of the planned demerger and IPO the Group will cease to book provisions on an IFRS 9 basis for NAB consolidated reporting, applying only the currently applicable credit loss standard, IAS 39. Accordingly, the Group will not report an IFRS 9 outcome in future periods until it has developed its own IFRS 9 ECL model closer to the EU adoption date of the standard.

Hedge accounting

The revised hedge accounting requirements are designed to create a stronger link with financial risk management. Accounting for dynamic risk management (macro hedge accounting) has been decoupled from IFRS 9 and is now subject to a separate IASB project. IFRS 9 allows for the option to continue to apply the existing hedge accounting requirements of IAS 39 until this separate project is completed. The Group are currently assessing the impact of these requirements.

Foreign currency

Functional and presentation currency

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

Transactions and balances

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

Subsequently, at each reporting date, the Group translates foreign currency monetary items at the closing rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the year in which the gains or losses arise. Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction. Foreign currency non-monetary items measured at fair value will be translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby the associated gains or losses are recognised in the income statement, are also recognised in the income statement.

Revenue recognition

Net interest income

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

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

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses.

Revenue recognition

The calculation of the effective interest rate includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Where it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

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

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

Fees and commissions

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

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

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

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

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

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

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

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

Dividend income

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

Taxation

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

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

Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Taxation (continued)

Deferred tax

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise to utilise those temporary differences and losses.

Deferred tax liabilities are not recognised for temporary differences arising from investments in subsidiaries and associates where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Deferred tax assets are not recognised for temporary differences arising from investments in subsidiaries and associates where it is probable that the difference will not reverse in the foreseeable future, and it is not probable that taxable profit will be available against which the temporary difference can be utilised.

The effects of income taxes arising from asset revaluation adjustments are recognised directly in the asset revaluation reserve where relevant.

Deferred tax assets and liabilities related to fair value re-measurement of cash flow hedges, which are charged or credited directly to equity, are also credited or charged directly to equity. The tax associated with these transactions will be recognised in the income statement at the same time as the underlying transaction.

Cash and cash equivalents

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

Repurchase and reverse repurchase agreements

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

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

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

Financial instruments

Recognition and derecognition of financial instruments

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

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

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

Financial instruments (continued)

The Group derecognises a financial asset when the contractual cash flows from the asset expires or it transfers the right to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred.

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

Offsetting financial instruments

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

Financial instruments designated at fair value through profit or loss

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

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

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

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

Financial assets held for trading

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

Financial assets available for sale

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

Consistent with financial assets classified as fair value through profit or loss, the Group applies trade date accounting to purchases and sales of financial assets available for sale.

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

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise. Financial assets available for sale are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

2. Accounting policies (continued)

Financial instruments (continued)

Financial liabilities

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

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

Fair value measurement

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

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

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

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

Derivative financial instruments and hedge accounting

All derivatives are recognised on the balance sheet at fair value on trade date and are classified as trading except where they are designated as part of an effective hedge relationship. The carrying value of a derivative is measured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The method of recognising the resulting fair value gain or loss on a derivative depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge); or hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge). Hedge accounting is used for derivatives designated in this way providing certain criteria are met.

The Group makes use of derivative instruments to manage exposures to interest rates and foreign currency, including exposures arising from forecast transactions and firm commitments. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria.

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

Derivative financial instruments and hedge accounting (continued)

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in the fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective interest rate basis over the remaining life of the asset or liability.

Cash flow hedge

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

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

Derivatives that do not qualify for hedge accounting

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

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

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

Loans and advances

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

Loans and advances are initially recognised at fair value including direct and incremental transaction costs. They are subsequently recorded at amortised cost, using the effective interest method, adjusted for impairment losses and unearned income. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where the inherent market risks (principally interest rate and option risk) are individually hedged using appropriate interest rate derivatives. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement and therefore avoid accounting mismatch. When this option is applied the asset is included within other financial assets at fair value, and not within loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Impairment of financial assets other than fair value loans

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

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

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

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

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

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

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

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

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off reduce the amount of the expense in the income statement.

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

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

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

Equity and debt instruments – classed as available for sale

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

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

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

Leases

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

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

As lessee

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

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

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

As lessor

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

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

Property, plant and equipment

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

Property, plant and equipment (continued)

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

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

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

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

- buildings - 2%;
- leases (leasehold improvements) - the lower of the expected lease term and the assets useful life; and
- fixtures and equipment - 10% to 33.33%.

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

Intangible assets

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

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

Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount.

The recoverable amount of an asset is the higher of its fair value less costs of disposal or its value in use.

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

Investments in controlled entities and associates

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

2. Accounting policies (continued)

Investment properties

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

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

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

Property inventory

Property acquired or being constructed for sale in the ordinary course of business, rather than to be held for rental or capital appreciation, is held as inventory and is measured at the lower of cost and net realisable value.

Provisions

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

Pension and post retirement costs

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

Defined contribution pension scheme

The defined contribution scheme receives fixed contributions from Group companies and the Group's obligation for contributions to these plans is recognised as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings for benefits accruing after 1 April 2006. A liability or asset in respect of the defined benefit scheme is recognised on the balance sheet and is measured as the present value of the defined benefit obligation less the fair value of the defined benefit scheme assets at the reporting date. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the Group's defined benefit obligation.

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

The Group also provides post-retirement health care for certain retired employees. The calculation of the post-retirement health care liability is calculated in the same manner as the defined benefit pension obligation.

Subordinated liability and related entity balances

Subordinated liabilities and related entity balances, other than derivatives, are recorded at amortised cost. Subordinated liabilities comprise undated and dated loan capital which is exclusively provided to the Group by NAB. Subordinated liabilities are included within amounts due to related entities on the balance sheet.

Debt issues

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

Financial guarantees

The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

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

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

Contingent liabilities

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

Equity

Share option reserve

The share option reserve records the outstanding balance payable to NAB for equity benefits provided to employees and Directors as part of their remuneration including deferred tax.

Cash flow hedge reserve

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

Other equity instruments

Other equity instruments represent Additional Tier 1 (“AT1”) notes. These are perpetual capital notes with no fixed maturity or redemption date and are classified as equity instruments. Distributions of interest on the AT1 notes will be due and are deducted from equity on the interest payment date. 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.

2. Accounting policies (continued)

Preference shares

Preference shares are classified as an equity instrument if the instrument includes no contractual obligation to:

- deliver cash or another financial asset to another entity; or
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

Where preference shares do not satisfy the above conditions, they are classified as a financial liability. The Company's preference shares which were repurchased on 20 December 2013 met the criteria for classification as equity.

Dividends on ordinary shares

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

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

Equity based compensation

The Group engages in share-based payment transactions in respect of services received from certain of its employees and to provide long term incentives. The fair value of the services received is measured by reference to the fair value of the NAB shares or share options granted on the date of the grant. This is recognised as an expense in the income statement over the relevant vesting period and results in an increase in the share option reserve which is reduced on repayment to the ultimate parent company.

The grant date fair value of shares is generally determined by reference to the weighted average price of the NAB shares in the week up to, and including, the date on which the shares are granted. Employee share plans are linked to internal performance, market performance and/or service conditions. The fair value of shares with a market performance condition is determined using a Monte Carlo simulation. The grant date fair value of the performance options and performance rights is determined using a simulated version of the Black-Scholes model. The key assumptions and inputs used in the valuation model are the exercise price of the performance options or performance rights, the expected volatility of the share price, the risk-free interest rate and the expected dividend yield on the shares for the life of the performance options and performance rights. The simulation takes into account both the probability of achieving market performance conditions and the potential for early exercise of vested performance options or performance rights.

While market performance conditions are incorporated into the grant date fair values, non-market conditions are not taken into account when determining the fair value and expected time to vesting of shares, performance options and performance rights. Instead, non-market conditions are taken into account by adjusting the number of shares, performance options and performance rights included in the measurement of the expense so that the amount recognised in the income statement reflects the number of shares, performance options or performance rights that actually vest.

Securitisation

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

Business combinations and disposals

i) Combination of businesses

The acquisition method of accounting is used for business combinations other than those under common control. Consideration is measured at fair value and is calculated as the sum of the acquisition date fair value of assets transferred, liabilities incurred to former owners of the acquiree and equity instruments issued. Any excess of the sum of the consideration and the amount of any non-controlling interest in the acquiree over the fair value of the identifiable assets acquired less liabilities assumed, is recognised as goodwill. Acquisition related costs are expensed as incurred.

2. Accounting policies (continued)

Business combinations and disposals (continued)

i) Combination of businesses (continued)

When a non-controlling interest is present in an entity over which the Group gains control, the non-controlling interest is measured at either fair value or at the proportionate share of the acquiree's identifiable net assets. This choice of accounting treatment is applied on a transaction by transaction basis. Any put and call instruments transacted concurrently with a business combination to acquire the remaining non-controlling interest are assessed to determine whether there is creation of a forward purchase agreement to acquire the remaining outstanding equity at a future date.

Any contingent consideration to be transferred is recognised at fair value at the acquisition date. Subsequent changes to the carrying amount of contingent consideration are recognised either in the income statement or in equity depending on the nature of the payment.

ii) Combination of businesses under common control

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

Post-acquisition, income received and expenses incurred by the entity or entities acquired are included in the consolidated income statement on a line-by-line basis in accordance with the accounting policies set out herein.

A non-controlling interest is recognised by the Group in respect of any portion of the total assets less total liabilities of an acquired entity or entities that is not owned by the Group.

3. Critical accounting estimates and judgements

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. Sensitivity analysis indicating the impact of reasonable possible changes in this input on the fair value is included within note 38.

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

Impairment losses on loans and advances

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

Impairment losses on loans and advances (continued)

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate price indices, country risk and the performance of different individual groups). If the probabilities of default were to improve from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £4m. Alternatively, if probabilities of default deteriorate by 5%, the impairment provision on loans and advances would increase by £4m. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £10m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £19m. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

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

Payment Protection Insurance redress provision and other conduct related matters

Disclosures in relation to the Group's PPI redress provision can be found in note 27 with the Group holding a provision of £774m at 30 September 2015 (2014: £515m). Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes, (both historic and estimated future complaint volumes), uphold rates (how many claims are, or may be, upheld in the customer's favour) and redress costs (the average payment made to customers). Also factored into the estimate is the effect of the past business review and the judgements required around customer mailing response rates. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2015. Consequently, the provision calculated may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. Sensitivity analysis indicating the impact of reasonable possible changes in key assumptions on the PPI provision is included within note 27.

There are similar uncertainties and judgements for other conduct risk related matters, including the Group's IRHP provision, disclosed in note 27 however the level of liability is materially lower.

Retirement benefit obligations

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Further details on the assumptions used and sensitivity analysis on the key assumptions are provided in note 29.

Carrying value of investments

In accordance with the requirements of IAS 36, an impairment test was performed on the carrying value of Clydesdale Bank PLC in the Company at the Group's standard annual impairment test date in August 2015. The results of this test highlighted a reduction in the current carrying value of Clydesdale Bank PLC to £3,071m following an impairment charge of £416m (2014: charge of £377m) which has been recognised in these financial statements.

The key assumptions and sensitivities involved in these calculations are discussed further in note 46 of the Company financial statements.

Deferred tax assets

Disclosures in relation to the Group's deferred tax assets of £389m (2014: £349m) can be found in note 23. The Group has assessed the recoverability of these deferred tax assets and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The Group has made this assessment with reference to the latest available profit forecasts. The largest deferred tax asset held within the Group relates to trading losses carried forward. These tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses; the Group expects the assets to be recovered in the reasonably foreseeable future.

4. Segment information

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

The Group's business is organised into two principal operating segments: SME Banking (formally referred to as "Business and Private") and Retail Banking. The Central Functions of the Group consist of: Customer Trust & Confidence, Finance, Risk, Operations & IT, Legal & Governance, CEO Office Support, Customer Experience, Products & Marketing, Strategy & Transformation, Treasury and People & Communications.

'Other' (which in previous years was incorporated into Central Functions) reflects certain elements of expenditure that are not recharged to the Group's two principal operating segments such as conduct related provisions and restructuring costs.

SME Banking

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

The Group's SME franchise is comprised of micro businesses (which the Group defines as businesses with no lending outstanding and turnover of less than £120,000), Business Direct (which the Group defines as businesses with outstanding lending of less than £0.1m and turnover of less than £750,000), small businesses (which the Group defines as businesses with lending of £0.1m to £0.25m and greater than £750,000 but less than £2.0m in turnover) and commercial businesses (which the Group defines as businesses with lending of higher that £0.25m and greater than £2.0m in turnover). Across all business segments, the Group provides working capital solutions to business customers through asset finance, invoice finance, international trade, merchant acquiring and treasury services.

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

- Term lending: the Group offers a wide variety of term loans, both secured and unsecured, and offers customers a range of repayment and interest rate options. The majority of the Group's business term lending is LIBOR based.
- Overdrafts: business overdrafts are the primary type of revolving variable rate credit facility offered by the Group to business customers.
- Invoice finance: the Group advances funds against the customer's trade receivables.
- Asset finance: these products provide a method of financing capital equipment purchases.
- International trade services: these products facilitate transactions between a buyer and seller located in different countries. The Group offers import loans, export loans, documentary collections and currency guarantees, together with letters of credit for securing trade.
- Private banking: a fee based service targeted at higher net worth customers, primarily business owners, providing tailored solutions to meet their financial requirements.

4. Segment information (continued)

Retail Banking

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

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

Major customers

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

Geographical areas

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

Operating segments 2015	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Net interest income	274	461	52	-	787
Non-interest income	77	94	6	63	240
Operating income	351	555	58	63	1,027
Operating and administrative expenses	(82)	(116)	(529)	(507)	(1,234)
Impairment losses on credit exposures [1]	(45)	(33)	-	-	(78)
Segment operating profit/(loss) before tax	224	406	(471)	(444)	(285)
Average interest-earning assets	10,908	17,400	7,472	-	35,780

[1] The impairment losses on credit exposures figure of £33m (2014: £28m) for Retail Banking includes losses on certain retail products attributable to SME (private banking) customers.

4. Segment information (continued)

Operating segments 2014	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Net interest income	308	453	24	-	785
Non-interest income	75	105	17	-	197
Operating income	383	558	41	-	982
Operating and administrative expenses	(80)	(138)	(468)	(456)	(1,142)
Impairment losses on credit exposures	(46)	(28)	-	-	(74)
Segment operating profit/(loss) before tax	257	392	(427)	(456)	(234)
Average interest-earning assets	12,200	14,984	6,888	-	34,072

The presentation and allocation of impairment losses on credit exposures between segments has been amended from prior years to allocate impairment losses previously included for central functions to SME and Retail Banking. Prior year comparatives have been amended to conform with the current year's presentation.

Comparative disclosures have been amended to conform with current year's presentation by reclassifying the 30 September 2014 Financial Services Compensation Scheme ("FSCS") levy of £13m from net interest income to operating and administrative expenses.

The components of the 'Other' segment are £390m for PPI redress expense (2014: £420m), £21m for PPI handling fine (2014: £Nil), £75m for IRHP redress expense (2014: £Nil), other conduct expenses £Nil (2014: £13m), £17m for restructuring expenses (2014: £Nil), £10m for separation costs (2014: £Nil), £63m for gains on capital and debt restructure (2014: £Nil), £18m for pension increase exchange gain (2014: £Nil), £10m of Impairment of intangible assets (2014: £23m) and £2m for loss on capital restructure (2014: £Nil).

5. Net interest income

	2015 £m	2014 £m
Interest income and similar income		
Loans and advances to other banks	28	25
Financial assets available for sale	8	8
Loans and advances to customers	1,033	1,052
Financial assets at fair value through profit or loss	37	45
Due from related entities (note 11)	3	4
Other interest income	1	1
Total interest income and similar income	1,110	1,135
Less: Interest expense and similar charges		
Due to other banks	5	5
Financial liabilities at fair value through profit or loss	1	1
Due to customers	195	212
Bonds and notes	82	81
Due to related entities (note 11)	40	50
Other interest expense	-	1
Total interest expense and similar charges	323	350
Net interest income	787	785

Comparative disclosures have been amended to conform with current year's presentation by reclassifying the 30 September 2014 FSCS levy of £13m from other interest expense to operating and administrative expenses.

6. Non-interest income

	2015 £m	2014 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	29	47
Other assets and liabilities at fair value	(29)	(64)
Ineffectiveness arising from fair value hedges (note 14)	1	7
Ineffectiveness arising from cash flow hedges (note 14)	1	2
	2	(8)
Other operating income		
Fees and commission	144	164
Margin on foreign exchange derivative brokerage	19	19
Net fair value movement on investment properties	(1)	-
Gain on disposal of tangible fixed assets [1]	-	7
Other income	76	15
	238	205
Total non-interest income	240	197

[1] Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

Margin on foreign exchange derivative brokerage has been included within other operating income. ATM fees have been moved from other income to fees and commission. Comparative disclosures have been amended to conform with the current year's presentation.

In December 2014, £650m of Tier 2 subordinated debt issued was redeemed. These instruments would have become progressively ineligible for Tier 2 treatment under CRD IV's transitional rules from 1 January 2015 as well as being impacted by the introduction of a 25% capital limit under Pillar 2A. These instruments were replaced by an issue of £350m of ordinary shares an issue of Additional Tier 1 capital instruments of £150m to the Company's ultimate parent. As a result of the redemptions in the year ended 30 September 2015, other income includes gains of £61m arising on capital restructures during the year and a further gain of £2m on early redemption of medium term funding on 30 September 2015, resulting in total gains of £63m. A loss of £2m arising on a capital restructure is included in related entity charges (notes 7 and 11).

The movement in fair value of assets incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans which are measured at fair value. The movements in fair value are taken through the income statement as part of non-interest income. The fair value of these loans is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. In general, as interest rates fall, the carrying value of the loan portfolio increases. Similarly, as interest rates increase, the carrying value of the loan portfolio decreases. The valuation technique used is reflective of current market practice.

7. Operating and administrative expenses

	2015 £m	2014 £m
Personnel expenses		
Salaries, wages and non-cash benefits	175	173
Related personnel expenses	22	22
Defined contribution pension expense	16	14
Defined benefit pension expense	11	29
Equity based compensation	7	7
Other personnel expenses	35	42
	266	287
Restructuring		
Restructuring expense (note 27)	17	-
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (note 18)	26	24
Amortisation of intangible assets (note 22)	57	54
	83	78
Other operating and administrative expenses		
Operating lease rental	32	31
Other occupancy charges	38	39
Related entity charges (note 11)	20	8
Impairment losses on software (note 22)	10	23
Payment Protection Insurance redress expense (note 27)	390	420
IRHP redress expense (note 27)	75	-
Other conduct expenses (note 27)	-	13
Other operating and administrative expenses	303	243
	868	777
Total operating and administrative expenses	1,234	1,142

Other operating and administrative expenses include the FSCS levy charge of £14m (2014: £13m). Comparative disclosures have been amended to conform with the current year's presentation.

On 14 April 2015, the FCA issued Clydesdale Bank PLC with a fine of £21m (2014: £Nil) for failings in its PPI complaint handling processes between May 2011 and July 2013. This amount is recorded within other operating and administrative expenses.

Related entity charges includes a loss on capital restructuring of £2m (2014: £Nil) (note 11).

During the year ended 30 September 2015, the Group's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After taking independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change has resulted in a credit to the income statement of £18m, resulting in a reduction in the defined benefit pension expense to £11m (2014: £29m).

Separation costs of £8m and £2m (2014: £Nil and £Nil) are included within other operating and administrative expenses and personnel expenses respectively.

Auditor's remuneration

Included within other operating and administrative expenses:	2015 £'000	2014 £'000
Audit of the financial statements	242	242
Other fees to the auditor:		
Audit of the Group pension scheme	75	75
Local statutory audits for subsidiaries	1,139	1,453
Other assurance including regulatory compliance based work	1,982	141
	3,438	1,911

Included within other assurance is £1,926k in respect of assurance work related to the proposed demerger and IPO (2014: £Nil) which has been paid by NAB.

8. Taxation

	2015	2014
Current tax	£m	£m
UK corporation tax:		
Current year	(2)	21
Adjustment in respect of prior years	(21)	(1)
	(23)	20
Deferred tax (note 23)		
Current year	(43)	(60)
Adjustment in respect of prior years	6	(4)
	(37)	(64)
Tax credit for the year	(60)	(44)

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

	2015	2014
	£m	£m
Loss on ordinary activities before tax	(285)	(234)
Tax credit based on the standard rate of Corporation Tax in the UK of 20.5% (2014: 22%)	(58)	(51)
Effects of:		
Expenses not deductible for tax purposes	8	3
AT 1 distribution paid	(4)	-
Non-deductible FCA fine	4	-
Regulatory capital and debt restructure	(12)	-
Deferred tax on losses not recognised	16	-
Chargeable gains	-	3
Rate differences	1	6
Adjustments in respect of prior years	(15)	(5)
Tax credit for the year	(60)	(44)

The net gain on capital and debt restructuring of £61m for the year to 30 September 2015 is not subject to taxation and has reduced the Group's effective tax rate for the year.

On 26 October 2015, legislation was substantively enacted to limit the tax-deductibility of payments by banks for compensation for mis-selling. The restrictions apply from 8 July 2015. The Finance Bill was not substantively enacted at the balance sheet date and therefore the restriction cannot be reflected in calculating the current period corporation tax credit. Had the legislation been substantively enacted, it is estimated that the impact of the non-deductibility of PPI and conduct charges incurred after 8 July 2015 would result in a reduction in the tax credit of approximately £17m.

9. Distributions paid

	2015	2014
	£m	£m
AT1 distribution paid	18	-

10. Cash and balances with central banks

	2015 £m	2014 £m
Cash assets	1,452	1,317
Balances with central banks (including EU payment systems)	4,979	4,669
	6,431	5,986
Less mandatory deposits with central banks [1]	(44)	(42)
Included in cash and cash equivalents (note 34)	6,387	5,944

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

11. Related party transactions

During the year there have been transactions between the Group, its ultimate parent, controlled entities of the ultimate parent, controlled entities of the Group, and other related parties.

The Group provides a range of services to related parties on an arm's length basis, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, foreign exchange and interest cover.

The Group receives a range of services from the ultimate parent and related parties, including loans and deposits, foreign exchange and interest rate cover and various technical and administrative services.

Amounts due from related entities	2015 £m	2014 £m
Loans		
Ultimate parent	672	1,104
Controlled entities of the ultimate parent	1	-
	673	1,104
Other receivables		
Ultimate parent	110	368
Controlled entities of the ultimate parent	3	15
	113	383
Total amounts due from related entities	786	1,487
Interest income on the above amounts was as follows:		
Ultimate parent (note 5)	3	4

11. Related party transactions (continued)

Amounts due to related entities	2015 £m	2014 £m
Deposits		
Ultimate parent	24	987
Controlled entities of the ultimate parent	101	110
	125	1,097
Bonds and notes		
Ultimate parent	382	410
Subordinated liabilities		
Ultimate parent	478	787
Immediate parent	-	344
	478	1,131
Other payables		
Ultimate parent	3	36
Controlled entities of the ultimate parent	10	3
	13	39
Total amounts due to related entities	998	2,677
Interest expense on the above amounts was as follows (note 5)		
Ultimate parent	36	43
Immediate parent	1	4
Controlled entities of ultimate parent	3	3
	40	50

On 30 September 2015, the Bank redeemed £429m of medium term notes with NAB early, resulting in a gain of £2m. The gain is included within other income (note 6) along with other capital restructuring gains of £61m.

Derivatives

The following derivative positions are held with the ultimate parent:

	2015 £m	2014 £m
Derivative financial assets		
Designated as hedging instruments	86	13
Designated as held for trading	60	75
	146	88
Derivative financial liabilities		
Designated as hedging instruments	173	245
Designated as held for trading	263	278
	436	523

11. Related party transactions (continued)

Subordinated liabilities

Subordinated liabilities comprise undated and dated loan capital which is provided to the Group by NAB. Interest on the loans is payable at rates related to the LIBOR. The undated loans are subject to five years and one day's notice of redemption by the lenders and are repayable at par. Early repayment is at the option of the borrower, subject to the prior consent of the PRA. The loans are subordinated to the claims of other creditors and are unsecured. The loans are employed in the general business of the Group.

Details of subordinated liabilities in excess of 10% of the total balance of the subordinated loans of the Group are disclosed below.

The rates of interest stated below apply at 30 September:	2015 £m	2014 £m
10-year, non-call 5-year with a final maturity of 20 December 2023 - LIBOR +3.41%	300	300
10-year, non-call 5-year with a final maturity of 25 January 2021 - LIBOR + 4.42%	175	250
Undated subordinated notes - LIBOR + 0.25%	-	285
Undated subordinated notes - LIBOR + 0.48%	-	258
	475	1,093
Other subordinated debt	-	32
Accrued interest payable	3	6
Total subordinated liabilities	478	1,131

On 29 December 2014, the Group repaid £232m of subordinated liabilities to its ultimate parent at a market value of £206m, resulting in a gain on capital restructure of £26m included within other income. A further £343m was repaid to the immediate parent at a market value of £308m, resulting in a gain of £35m. The combined gain on capital restructures of £61m is reflected in note 6. The Group also repaid £75m subordinated liabilities to the ultimate parent at a market value £77m, resulting in a loss on capital restructure of £2m included within other operating and administrative expenses – ultimate parent (note 7).

Securitisation

The Group has securitised part of its residential mortgage portfolio, and the cash raised from the issue of RMBS through structured entities forms part of the Group's medium term funding. A portfolio of buy to let mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £382m (2014: £410m) of the securities issued are held by the Group's ultimate parent.

Other transactions with related entities	2015 £m	2014 £m
Gain on debt and capital restructures		
Controlled entities of the ultimate parent	63	-
Non-interest income received		
Ultimate parent	5	5
Controlled entities of the ultimate parent	5	6
	10	11
Administrative expenses (note 7)		
Ultimate parent	11	5
Controlled entities of the ultimate parent	9	3
	20	8

Offset within administrative expenses paid to the ultimate parent are amounts received by the Group in relation to expenses incurred in the provision of services to the NAB UK Commercial Real Estate ("CRE") portfolio. The amount received is reducing as the portfolio reduces.

11. Related party transactions (continued)

Compensation of key management personnel ("KMP")

For the purposes of IAS 24 'Related Party Disclosures' KMPs comprise Directors of the Company, members of the CYB Leadership Team and PRA approved persons with a control function of 1 to 29.

	2015 £m	2014 £m
Salaries and other short-term benefits	10	10
Share based payments	1	2
	11	12

Directors' emoluments are analysed in note 37.

Transactions with key management personnel

KMPs, their close family members and any entities controlled or significantly influenced by the KMPs have undertaken the following transactions with the Group in the normal course of business. The transactions were made on the same terms and conditions as applicable to other Group employees, or on normal commercial terms.

	2015 £m	2014 £m
Loans and advances	11	1
Deposits	1	-

No provisions have been recognised in respect of loans provided to KMPs (2014: £Nil). There were no debts written off or forgiven during the year to 30 September 2015 (2014: £Nil). Included in the above are ten (2014: twelve) loans totalling £9.5m (2014: £0.1m) made to Directors.

In addition to the above, there are guarantees of £0.4m (2014: £Nil) made to Directors and their related parties.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.6m in the year ended 30 September 2015 (2014: £0.5m) were charged to the Group sponsored Scheme. The Group has deposits of £2.1m (2014: £3.4m) at the year end placed by the Scheme at market rates.

Pension contributions of £51m (2014: £252m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (see note 29).

As announced on 7 May 2015 and confirmed on 28 October 2015, NAB intends to pursue a demerger and IPO of the Group (note 43).

Related party balances with non NAB related entities

In addition to the balances with NAB related entities, the Group also has a £3m (2014: £Nil) term deposit balance due to the Group's associated entity (note 21) on normal commercial terms. The balance is disclosed within due to customers (note 26).

12. Financial assets available for sale

	2015 £m	2014 £m
Listed securities	1,447	1,161
Unlisted securities	8	7
Other financial assets	7	-
	1,462	1,168

Included in the available for sale ("AFS") listed securities are £1.3bn (2014: £1.1bn) in UK Government Gilts and £0.1bn (2014: £0.1bn) in other banks' debt securities.

The other AFS financial asset of £7m represents deferred consideration receivable following the acquisition of CYB Intermediaries Holdings Limited from the ultimate parent on 30 September 2015 and consists of the rights to future commission. Further detail on the acquisition can be found in note 21.

The listed AFS investments are classified as Level 1 in the fair value hierarchy, with the unlisted AFS investments and other AFS financial assets classified as Level 3 (note 38).

Credit quality of investments	2015 £m	2014 £m
Available for sale		
Senior investment grade	1,447	1,161
Other	15	7
	1,462	1,168

13. Other financial assets and liabilities at fair value

	2015 £m	2014 £m
Other financial assets at fair value through profit or loss		
Loans and advances	1,097	1,583
Other financial liabilities at fair value through profit or loss		
Due to customers – term deposits	67	91

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

Loans and advances

Included in other financial assets at fair value is a portfolio of loans. Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £1,097m (2014: £1,583m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £38m (2014: £74m) and the change for the current year is a decrease of £36m (2014: decrease of £3m).

The Group ceased further sales of this suite of loan products with effect from 30 April 2012 with the loans being classified as Level 3 in the fair value hierarchy (note 38).

Due to customers - term deposits

Included in other financial liabilities at fair value are fixed rate deposits which have been hedged with interest rate derivative contracts with matching cash flows.

The change in fair value attributable to changes in the Group credit risk is £Nil (2014: £Nil). The Group is contractually obligated to pay £4m (2014: £8m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as Level 3 in the fair value hierarchy (note 38).

14. Derivative financial instruments

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

	2015 £m	2014 £m
Fair value of derivative financial assets		
Designated as hedging instruments	103	13
Designated as held for trading	182	207
	285	220
Fair value of derivative financial liabilities		
Designated as hedging instruments	244	245
Designated as held for trading	290	303
	534	548

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

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

14. Derivative financial instruments (continued)

Total derivative contracts as at 30 September 2014	Notional contract amount	Fair value of assets	Fair value of liabilities
Derivatives designated as hedging instruments	£m	£m	£m
Cash flow hedges			
Interest rate swaps	29,355	13	86
Cross currency swaps	251	-	18
	29,606	13	104
Fair value hedges			
Interest rate swaps	1,458	-	91
Cross currency swaps	982	-	50
	2,440	-	141
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	2,423	55	40
Cross currency swaps	457	38	3
Options	520	4	4
	3,400	97	47
Interest rate related contracts			
Swaps	3,306	101	236
Swaptions	128	1	1
Options	601	4	15
	4,035	106	252
Commodity related contracts	120	4	4
Total derivative contracts	39,601	220	548

Certain derivative financial assets and liabilities have been booked in consolidated structured entities.

Derivative financial assets and liabilities include those designated as foreign currency hedges for the Group securitisations and interest rate hedges for covered bond programmes. The Group also macro hedges its interest rate exposure using cash flow hedges. The carrying value of the currency liabilities issued through securitisation entities fluctuates as a result of foreign exchange rate movements. There is a corresponding (and offsetting) movement in the value of the hedging derivatives.

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

Nominal values per time period	2015	2014
	£m	£m
0 to 6 months	4,310	14,305
6 to 12 months	1,448	1,133
1 to 2 years	8,318	6,165
2 to 5 years	3,330	8,003
Greater than 5 years	92	-
	17,498	29,606

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

	Forecast receivable cash flows 2015 £m	Forecast payable cash flows 2015 £m	Forecast receivable cash flows 2014 £m	Forecast payable cash flows 2014 £m
Within 1 year	47	112	56	68
Between 1 and 2 years	38	235	71	95
Between 2 and 3 years	26	319	67	242
Between 3 and 4 years	21	57	15	23
Between 4 and 5 years	9	68	2	10
Greater than 5 years	-	96	-	-
	141	887	211	438

	2015 £m	2014 £m
Gain/(loss) arising from fair value hedges (note 6)		
Hedging instrument	109	14
Hedged item attributable to the hedged risk	(108)	(7)
	1	7

	2015 £m	2014 £m
Gain from cash flow hedges due to hedge ineffectiveness (note 6)	1	2

15. Loans and advances to customers

	2015 £m	2014 £m
Overdrafts	1,563	1,767
Credit cards	376	364
Lease finance	426	417
Mortgages	20,504	18,444
Other term lending – business	4,025	4,272
Other term lending – retail	763	824
Other lending	30	33
Gross loans and advances to customers	27,687	26,121
Accrued interest receivable	75	79
Unearned income	(26)	(27)
Deferred and unamortised fee income	(24)	(27)
Impairment provisions on credit exposures (note 16)	(230)	(245)
	27,482	25,901

The Group has transferred £5,923m (2014: £4,763m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 17). The mortgages do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements, the Group continues to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £3,413m (2014: £2,780m) (note 17).

15. Loans and advances to customers (continued)

Included within Group loans and advances to customers are £1,475m (2014: £2,007m) of mortgages assigned to a bankruptcy remote structured entity, Clydesdale Covered Bonds No. 2 LLP (note 17). These loans provide security for covered bond issuances made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2015 there were £721m (2014: £1,063m) of covered bonds in issue under the covered bond programme (note 17).

The Group also has a portfolio of fair valued business loans and advances (note 13). Combined with the above this is equivalent to total loans and advances of £28,579m (2014: £27,484m).

Lease finance

The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The cost of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £2m (2014: £2m) and £297m (2014: £269m) respectively. The total receivables from finance leases and hire purchase contracts were £6m (2014: £8m) and £395m (2014: £384m) respectively.

Finance lease and hire purchase receivables	2015 £m	2014 £m
Gross investment in finance lease and hire purchase receivables		
Due within 1 year	183	196
Due within 1 to 5 years	241	216
Due after more than 5 years	2	5
	426	417
Unearned income	(25)	(25)
Net investment in finance lease and hire purchase receivables	401	392

Comparative disclosures have been amended to conform with the current year's presentation.

There are specific provisions of £1m (2014: £2m) in relation to finance lease and hire purchase receivables, with a collective provision of £1m (2014: £Nil) as at 30 September 2015 (note 16).

Maximum exposure to credit risk

The maximum exposure to credit risk in relation to loans and advances to customers is disclosed in note 39.

Distribution of loans and advances by credit quality

As at 30 September 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [(1)] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	70	363	418	20,170	5,277	668	26,966
Past due but not impaired	9	13	6	268	172	15	483
Impaired	-	-	2	66	170	-	238
	79	376	426	20,504	5,619	683	27,687

As at 30 September 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [(1)] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	84	349	405	18,045	5,577	713	25,173
Past due but not impaired	10	15	6	335	246	17	629
Impaired	-	-	6	64	249	-	319
	94	364	417	18,444	6,072	730	26,121

(1) Business lending includes business overdrafts.

Comparative disclosures have been amended to conform with the current year's presentation.

15. Loans and advances to customers (continued)

Credit quality of loans and advances

The Group has an internally developed credit rating system that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the probability of default ("PD") for each customer and can be broadly mapped to external agencies rating scales. Impaired assets consist of business lending and secured personal lending where current circumstances indicate that losses of loan principal and/or interest may be incurred.

Distribution of loans and advances neither past due nor impaired

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

The table below presents the analysis of business lending (including lease finance) credit quality of loans and advances that are neither past due nor impaired:

	2015 £m	2014 £m
Senior investment grade	1,174	1,225
Investment grade	1,615	1,721
Sub-investment grade	2,906	3,036
	5,695	5,982

Comparative disclosures have been amended to conform with the current year's presentation.

For the business lending analysis, investment grades are determined by the Customer Rating System ("eCRS") as defined under the Group's Credit Risk Management policy:

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

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

Loan to value ratio	2015 %	2014 %
Less than 50%	34	27
50% to 75%	51	49
76% to 80%	5	6
81% to 85%	4	5
86% to 90%	2	4
91% to 95%	1	1
96% to 100%	-	1
Greater than 100%	-	1
Unknown	3	6
	100	100

Gross loans and advances past due but not impaired

Gross loans and advances that are past due but not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility. Unsecured retail lending and credit cards are written off when they reach 180 days past due and are not designated as impaired.

Gross loans and advances past due but not impaired (continued)

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

2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	6	6	77	110	5	212
30 to 59 days past due	-	2	-	57	17	3	79
60 to 89 days past due	-	2	-	36	9	2	49
Past due 90 days and over	1	3	-	98	36	5	143
	9	13	6	268	172	15	483

2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	7	6	113	161	7	302
30 to 59 days past due	1	2	-	76	15	3	97
60 to 89 days past due	-	2	-	37	7	2	48
Past due 90 days and over	1	4	-	109	63	5	182
	10	15	6	335	246	17	629

[1] Business lending includes business overdrafts.

Comparative disclosures have been amended to conform with the current year's presentation.

16. Impairment provisions on credit exposures

2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	8	10	2	27	185	13	245
Charge for the year	(2)	5	1	18	44	12	78
Amounts written off	(4)	(10)	(1)	(6)	(63)	(16)	(100)
Recoveries of amounts written off in previous years	3	2	-	-	5	2	12
Other [2]	-	-	-	-	(5)	-	(5)
Closing balance	5	7	2	39	166	11	230
Specific	-	-	1	22	69	-	92
Collective	5	7	1	17	97	11	138
	5	7	2	39	166	11	230

2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	10	12	3	31	218	15	289
Charge for the year	2	9	2	6	44	11	74
Amounts written off	(8)	(14)	(3)	(10)	(79)	(17)	(131)
Recoveries of amounts written off in previous years	4	3	-	-	5	4	16
Other [2]	-	-	-	-	(3)	-	(3)
Closing balance	8	10	2	27	185	13	245
Specific	-	-	2	16	92	-	110
Collective	8	10	-	11	93	13	135
	8	10	2	27	185	13	245

[1] Business lending includes business overdrafts.

[2] Other includes the unwind of net present value elements of specific provisions and other minor movements.

	2015 £m	2014 £m
Amounts included in		
Loans and advances to customers (note 15)	230	245
Non-accrual loans		
Loans and advances to customers	238	319
Specific provisions	(92)	(110)
	146	209

17. Securitisations and covered bonds

Securitisations

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

The loans do not qualify for derecognition because the Group remains exposed to the majority of the risks and rewards of the mortgage portfolio, principally the credit risk associated with the underlying mortgage portfolio. The securitisation structured entities are consolidated and the securitised mortgage loans retained on the Group's balance sheet. The securitised notes in issue are included within bonds and notes (note 28).

Covered bonds

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

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

The balances of assets and liabilities in relation to securitisation and covered bonds in issue at 30 September 2015 within the Group balance sheet are as follows:

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

2014	Securitisation £m	Covered bonds £m	Total £m
At 1 October 2013	2,030	1,041	3,071
Issuance of debt	601	-	601
Repayments	(216)	-	(216)
Other movements	(45)	22	(23)
At 30 September 2014	2,370	1,063	3,433
Securitised assets	4,763	2,007	6,770

Further information on the liabilities relating to the Group's securitisation and covered bond programmes can be found in note 28.

17. Securitisation and covered bonds (continued)

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

In addition to the securitisation notes disclosed above, there are £382m (2014: £410m) of Lannraig debt securities (including accrued interest) which are held by NAB and disclosed as a related party transaction (note 11). Assets which support the Lannraig debt are disclosed in the table above.

The following table sets out the carrying amount of financial assets that do not qualify for derecognition and their associated liabilities. Where relevant, the table also sets out the net position of the fair value of financial assets where the counterparty to the associated liabilities has recourse only to the financial assets:

	2015		2014	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Carrying amount of transferred assets	5,923	1,475	4,763	2,007
Carrying amount of associated liabilities	3,413	721	2,780	1,063

For those liabilities that have recourse only to the transferred assets:

	2015		2014	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Fair value of transferred assets	5,923	-	4,763	-
Fair value of associated liabilities	3,413	-	2,780	-
	2,510	-	1,983	-

There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

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

Securitisation vehicles

The Group provides credit support to the structured entities via reserve funds through subordinated loan arrangements. Exposures totalled £Nil at the reporting date (2014: £17m). The Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities as at the reporting date of £1,308m (2014: £690m).

The Group has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Group has made no such repurchases in the current year (2014: none).

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

Covered bonds

The Group has a regulated covered bond programme. A Limited Liability Partnership was established and a ring fenced mortgage portfolio assigned to provide a guarantee under the terms of the covered bonds. At the reporting date the nominal level of over-collateralisation was £855m (2014: £1,249m) of the outstanding covered bonds. From time-to-time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

The Group has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Group has made no such repurchases in the current year (2014: none).

18. Property, plant and equipment

	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2013	19	3	156	135	313
Additions	-	-	11	12	23
Disposals	(8)	-	(6)	(33)	(47)
At 30 September 2014	11	3	161	114	289
Additions	-	-	10	9	19
Disposals	(1)	-	(7)	(11)	(19)
Transfers	-	-	7	(7)	-
At 30 September 2015	10	3	171	105	289
Accumulated depreciation					
At 1 October 2013	1	-	83	96	180
Charge for the year	-	-	13	11	24
Disposals	-	-	(4)	(32)	(36)
At 30 September 2014	1	-	92	75	168
Charge for the year (note 7)	-	-	14	12	26
Disposals	-	-	(4)	(10)	(14)
Transfers	-	-	3	(3)	-
At 30 September 2015	1	-	105	74	180
Net book value					
At 30 September 2015	9	3	66	31	109
At 30 September 2014	10	3	69	39	121

Valuations

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Group's own Directors' valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors, including adjustments to observable market inputs reflecting any specific characteristics of the land and buildings (Level 3 of the fair value hierarchy as defined in note 38). Valuations are performed annually in July.

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

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

	2015 £m	2014 £m
Carrying value as included under the revaluation basis	12	13
Carrying value if the historical cost basis had been used	10	11

19. Investment properties

	2015 £m	2014 £m
At 1 October	44	63
Disposals	(11)	(19)
Revaluation	(1)	-
At 30 September	32	44

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

Investment property is compared to property for which there is observable market data about its realisable value on disposal. Adjustments to this observable data are applied for specific characteristics of the property such as the nature, location or condition of the specific asset. Investment properties are classified in Level 3 of the fair value hierarchy as defined in note 38. There has been no change to the valuation technique during the year. There were no transfers between levels of the fair value hierarchy during the year.

During the year 99% (2014: 99%) of the investment properties generated total rental income of £2m (2014: £2m) and incurred operating and administrative expenses of £1m (2014: £2m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2014: £Nil).

20. Property inventory

	2015 £m	2014 £m
At 1 October	2	6
Disposals	(2)	(4)
At 30 September	-	2

All properties within property inventory are complete and available for sale. No properties are under construction (2014: none).

21. Investments in controlled entities and associates

	Group 2015 £m	2014 £m
At 30 September	2	2

Associates

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

The controlled entities of the Group and Company are provided in note 46.

Structured entities

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

Detail of the Group's interests in consolidated structured entities is set out in note 17.

The following companies are consolidated structured entities:

Other controlled entities as at 30 September 2015	Nature of business	Country of incorporation
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

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

Common control business combinations

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

On 30 September 2015 the Group acquired CYB Intermediaries Holdings Limited for a purchase price of £4m from its ultimate parent. CYB Intermediaries Holdings Limited is an insurance intermediary business, operated through its subsidiary CYB Intermediaries Limited. It acts as an intermediary for a number of third party providers of insurance and investment products. The Group distributes these products through its retail mortgage and retail banking advisers to its customers.

As at 30 September 2015, CYB Intermediaries Holdings Limited had total tangible assets of £8m and total tangible liabilities of £4m. The purchase price paid to the Group's ultimate parent of £4m represented the full net book value of the company's tangible net assets with no subsequent adjustment to equity required.

The main impacts of the transaction on the Group balance sheet is the addition of £7m of deferred consideration (note 12), with £1m of other receivables along with £3m of tax liabilities and £1m of other payables. The effect on the Group's results had the acquisition taken place on 1 October 2014 would have been an increase to the income statement before tax of £16m.

Significant restrictions

As is typical for a Group of its size, there are restrictions on the ability of certain subsidiary entities to make distributions of cash or other assets to the parent company. These are considered below:

Contractual requirements – asset encumbrance

The Group uses its financial assets to raise finance in the form of securitisations and through the sale of securities subject to repurchase agreements. Once encumbered, the assets are not available for transfer around the Group. The assets encumbered are disclosed in the Strategic Report and note 17.

22. Intangible assets

Capitalised software costs	2015 £m	2014 £m
Cost		
At 1 October	354	421
Additions	119	75
Disposals	(41)	(103)
Write-off	(5)	(39)
At 30 September	427	354
Accumulated amortisation		
At 1 October	141	206
Disposals	(41)	(103)
Charge for the year (note 7)	57	54
Write-off	(5)	(39)
Impairment (note 7)	10	23
At 30 September	162	141
Net book value at 30 September	265	213

Additions of £119m (2014: £75m) relate predominantly to the Group's continuing investment in new systems to meet the requirements of the business. To the extent that the systems are in use within the business, amortisation has been charged at the rates set out in note 2. Comparative disclosures have been amended to conform with the current year's presentation.

Management perform impairment testing of capitalised software assets in accordance with IAS 36. The impairment charge follows a detailed review of the recoverable amount of the various assets. Where the benefits associated with the software were substantially reduced from what had originally been anticipated, the software has been written down to its recoverable amount. An impairment charge of £10m has been recognised in the year to 30 September 2015 (2014: £23m).

23. Deferred tax

Movement in net deferred tax asset

	2015 £m	2014 £m
At 1 October	339	266
Recognised in the income statement (note 8)	37	64
Recognised directly in equity	3	3
Other	-	6
At 30 September	379	339

The Group recognises deferred tax attributable to the following items:

	2015 £m	2014 £m
Deferred tax assets		
Impairment provision on credit exposures	3	8
Employee equity based compensation	1	1
Tax losses carried forward	273	223
Provisions	-	25
Accelerated capital allowances	108	87
Cash flow hedge reserve	4	4
Other	-	1
	389	349
Deferred tax liabilities		
Defined benefit pension asset	10	10
Net deferred tax asset	379	339

23. Deferred tax (continued)

In addition to the deferred tax assets recognised above, the Group has an unrecognised deferred tax asset in respect of losses of £80m gross (£16m tax). A deferred tax asset has not been recognised in respect of these losses as the Directors have less certainty over their recoverability in the foreseeable future.

The statutory rate of UK corporation tax reduced to 20% on 1 April 2015 (Finance Act 2013). Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Accordingly, the deferred tax balances at 30 September 2015 have been reflected at the tax rates they are expected to be realised or settled.

On 8 July 2015 the Chancellor announced the introduction of a Bank Surcharge, being an 8% charge on taxable profits above £25m before the offset of brought forward losses or group relief. Additionally, it was announced that the mainstream UK rate of corporation tax would fall from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020. The legislation incorporating these changes is contained in Finance Bill 2015-2016 which was not enacted until after the balance sheet date, and accordingly the impact is not reflected in the charges or balances above. It is estimated that the changes would result in an overall reduction in the value of the deferred tax asset of approximately £20m.

From 1 April 2015, a maximum of 50% of taxable profits in an accounting period can be covered by tax losses brought forward from earlier periods. The utilisation of the deferred tax assets referred to above takes account of all substantively enacted legislation as at 30 September 2015 including the new loss utilisation rules.

24. Other assets

	2015 £m	2014 £m
Prepayments and accrued income	35	31
Other (including items in the course of collection)	142	218
	177	249

25. Due to other banks

	2015 £m	2014 £m
Transaction balances with other banks	-	4
Securities sold under agreements to repurchase *	-	644
Deposits from other banks	393	266
	393	914

* The underlying securities sold under agreements to repurchase have a fair value of £Nil (2014: £646m).

26. Due to customers

	2015 £m	2014 £m
Non-interest bearing demand deposits	1,986	1,849
Interest bearing demand deposits	18,786	16,346
Term deposits	5,416	5,587
Other wholesale deposits	94	119
	26,282	23,901
Accrued interest payable	125	172
	26,407	24,073

Included within term deposits is £3m (2014: £Nil) relating to the Group's associated entity (notes 11 and 21).

27. Provisions

	2015 £m	2014 £m
Payment Protection Insurance redress provision		
Opening balance	515	152
Charge to the income statement (note 7)	390	420
Provision utilised	(131)	(57)
Closing balance	774	515
Customer redress and other provisions		
Opening balance	413	118
Charge to the income statement [(1)] (note 7)	76	376
Provision utilised	(275)	(81)
Closing balance	214	413
Restructuring provision [(2)]		
Opening balance	24	45
Charge to the income statement (note 7)	17	-
Provision utilised	(23)	(21)
Closing balance	18	24
Total provisions	1,006	952

(1) In the year ended 30 September 2014, the income statement effect of the interest rate hedging products provisioning was £Nil as it was offset by a receivable from NAB. The charge of £75m taken in the year ended 30 September 2015 has not been offset.

(2) Restructuring provision includes surplus lease space provision.

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reasonably estimated. The most significant of the provisions held at 30 September 2015 are in relation to conduct risk related liabilities.

The Group has provided its best estimate of conduct risk related liabilities at 30 September 2015 which have arisen as a result of its historical products and past sales practices.

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

Payment Protection Insurance ("PPI") redress

The Group has reassessed the level of provision that is considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and has concluded that additional provisions of £390m (2014: £420m) should be recognised for the year ended 30 September 2015. This incorporates provision for a proactive customer contact and redress programme following a past business review. It also reflects increased costs of administering the remediation programme and higher than expected customer initiated complaint volumes.

The total provision raised to date in respect of PPI is £1,196m (2014: £806m); with £774m of this remaining as at 30 September 2015 (2014: £515m), comprised of £301m for customer initiated complaints and proactive customer contact; £270m for the remediation of complaints closed prior to August 2014; and £203m for costs of administering the redress programme.

27. Provisions (continued)

Payment Protection Insurance ("PPI") redress (continued)

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. To 30 September 2015, the Group has received 226,000 complaints and expects, an estimated further 175,000 claims including 114,000 proactive customer mailings. On 14 April 2015, the FCA issued Clydesdale Bank PLC with a fine of £21m for failings in its PPI complaint handling processes between May 2011 and July 2013. The PPI redress provisions above relate solely to customer redress and processing costs. The fine is included in other operating expenses (note 7).

The Group implemented a comprehensive new PPI complaint handling process from August 2014 which involved making a number of significant changes to the PPI operations, which have resulted in an increase in operational and administrative costs, in addition to committing to undertake a full review of PPI complaints that were closed prior to August 2014 (approximately 180,000). The Group plans to reopen these complaints and review the original decision reached in light of the new PPI complaint handling processes currently in operation. The provision at 30 September 2015 includes a redress provision of £270m for this review.

In addition to the above activity, the Group has also undertaken a past business review ("PBR") of certain PPI sales to determine if there was actual or potential customer detriment in the sales process leading to a risk of mis-sale and the potential for proactive redress. The Group has concluded that the provision increase should incorporate the estimated cost of contacting and redressing, where appropriate, customers who have faced actual detriment or may have experienced potential detriment but who have not actually raised a claim. Proactive customer mailings have not commenced and so key inputs to the calculation such as the level of customer response to mailings are not known but have been based on relevant historical experience and related industry data.

The increase in provisions takes into account all of the above factors as well as a higher than previously expected level of new customer initiated complaints with the overall provision based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including: (i) the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; (iv) any additional amounts that may need to be paid in respect to previously handled claims; (v) the response rates to the proactive customer contact; and (vi) the costs of administering the remediation programme.

As such, the factors discussed above meant there is a risk that existing provisions for PPI customer redress may not cover all potential costs. In light of this, the eventual costs of PPI redress and complaint handling may therefore differ materially from that estimated and further provision could be required. Accordingly, the final amount required to settle the Group's potential PPI liabilities remains uncertain.

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

Assumptions	Change in assumption	Sensitivity [1]
Number of expected future customer initiated complaints	+/-10%	£9m
Uphold rates:		
Future complaints	+/-1%	£4m
Pre August 2014 complaints review	+/-1%	£8m
Customer contact response rate		
Pre August 2014 complaints review	-1%	£(3)m
PBR response rate	+/-1%	£5m
Average redress costs [2]	+/-1%	£8m

[1] There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged. The sensitivities disclosed do not incorporate the impact, if any, on the administrative cost element of the provision.

[2] Sensitivity to a change in average redress across customer initiated complaints, pre August 2014 complaints review and PBR customer populations.

Payment Protection Insurance ("PPI") redress (continued)

The number of complaints received is monitored against past experience and future expectations and the Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop. This includes the FCA announcement on 2 October 2015 to consult on proposals to introduce a time limit for complaints and the impact of complaints arising from the "Plevin" judgement. Further commentary on the contingent nature of the PPI provision can be found in note 33.

Customer redress and other provisions

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

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

The Group also undertook a secondary review of all past FRTBL complaints not in scope of the formal review. Where the secondary complaint assessment identified a different outcome, the customer has been contacted and, if appropriate, redress offered. The Group is also dealing with a number of new complaints from customers in relation to FRTBLs. Any new complaints from January 2014 have been assessed on a consistent basis.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for all of these matters and concluded that a further provision of £75m (2014: £364m) is appropriate with the charge included within the Group's operating and administrative expenses for the year (note 7). This brings the total provisions raised in respect of IRHPs to £506m (2014: £431m); with £192m of this remaining as at 30 September 2015 (2014: £362m).

The ultimate cost to the Group of the IRHP provision is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs for IRHP. These factors could result in the total cost of the review and redress exercise and associated costs varying materially from the Group's estimate. The final amount required to settle the Group's potential IRHP liabilities in this matter is therefore uncertain and further provision could be required.

In previous years, the income statement effect of the IRHP provision has been £Nil due to the recognition of an offsetting receivable from NAB. As noted above, a £75m charge to the income statement has been raised this year with NAB contributing additional capital to offset the cost of this matter and PPI as part of the conduct mitigation package it publicly announced on 7 May 2015.

Other provisions include provisions in respect of legal proceedings, a number of individually less significant conduct related matters, and claims arising in the ordinary course of the Group's business. The charge in respect of these other provisions in the year to 30 September 2015 is £1m (2014: conduct £13m, other £(1)m).

Restructuring provision

Restructuring within the Group is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. In the year to 30 September 2015 the total provision decreased by £6m to £18m with a charge to the income statement (net of any write backs) of £17m (2014: £Nil) (note 7).

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

28. Bonds and notes

	2015 £m	2014 £m
Residential mortgage backed securities	3,017	2,421
Covered bonds	697	1,097
	3,714	3,518
Fair value hedge adjustments	38	(85)
Total securitised notes and covered bonds (note 17)	3,752	3,433
Accrued interest payable	14	20
	3,766	3,453

On 11 December 2014, €550m and £275m of residential mortgage backed securities were issued through Lanark 2014-2. On 6 August 2015, £300m and €280m of residential mortgage backed securities were issued through Lanark 2015-1. In May 2015, the Lanark 2012-1 EUR issuance of €615m was redeemed. In June 2015, the £400m floating rate covered bond (2012-1) was redeemed. Both redemptions were in line with the scheduled programme terms.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC to parties outside of the NAB Group as at 30 September 2015 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Maturity/call date
Class A residential mortgage backed securities				
27 July 2012	USD	343	3M USD LIBOR + 1.40%	22 February 2016
27 July 2012	GBP	522	3M GBP LIBOR + 1.63%	22 November 2017
13 July 2013	USD	166	3M USD LIBOR + 0.50%	22 August 2016
13 July 2013	GBP	296	3M GBP LIBOR + 0.45%	22 August 2016
19 March 2014	EUR	206	3M EURIBOR + 0.40%	22 August 2017
19 March 2014	GBP	335	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	EUR	384	3M EURIBOR + 0.40%	22 August 2018
11 December 2014	GBP	274	3M GBP LIBOR + 0.60%	22 February 2020
6 August 2015	GBP	299	3M GBP LIBOR + 0.50%	22 August 2018
6 August 2015	EUR	206	3M EURIBOR + 0.45%	21 May 2021
		3,031		
Covered bonds				
31 May 2012	GBP	721	4.63%	8 June 2026
		3,752		

29. Retirement benefit obligations

The Group operates both defined benefit and defined contribution arrangements. The Group is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ("the Scheme"). The Scheme was established under trust on 30 September 2009 as the result of the merger of the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund. The assets of the Scheme are held in a trustee administered fund, the trustee is responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

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

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.3m (2014: £0.3m) and would have no material impact upon service costs and interest costs.

29. Retirement benefit obligations (continued)

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

	2015 £m	2014 £m
Active members defined benefit obligation	(891)	(775)
Deferred members defined benefit obligation	(1,299)	(1,160)
Pensioner and dependent members defined benefit obligation	(1,323)	(1,285)
Total defined benefit obligation	(3,513)	(3,220)
Fair value of scheme assets	3,565	3,269
Net defined benefit pension asset	52	49
Post-retirement medical benefits obligations	(4)	(4)
Retirement benefits obligation	(4)	(4)

IAS19 allows the recognition of an asset, which reflects the Group's ability to recover a surplus either through reduced contributions in the future or through refunds from the Scheme following the settlement of plan assets once all members have left the Scheme.

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

The Group implemented additional reforms to the Scheme which were effective from April 2012. These included changing the inflation index used to determine benefit increases from the Retail Price Index ("RPI") to the Consumer Price Index ("CPI") for future accruals and introducing member based contributions into the Scheme, increasing annually over a three year period. As an alternative to contributions, employees have the option of reducing their future annual rate of accrual from 1/60th of salary to 1/80th.

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

Reconciliation of the net defined benefit pension asset/(liability)	2015 £m	2014 £m
Opening net defined benefit pension scheme asset/(liability)	49	(197)
Service cost	(11)	(23)
Interest on net defined benefit asset/(liability)	3	(3)
Remeasurement effects recognised in SOCI	(36)	24
Employer contributions	51	252
Administrative expenses	(4)	(4)
Closing fair value of net defined benefit pension scheme asset	52	49

Reconciliation of the defined benefit pension scheme assets	2015 £m	2014 £m
Opening fair value of defined benefit pension scheme assets	3,269	2,718
Interest income on scheme assets at discount rate	133	129
Return on scheme assets greater than discount rate	206	254
Employer contributions (note 11)	51	252
Benefits paid	(84)	(77)
Transfer payments	(6)	(3)
Administrative costs paid	(4)	(4)
Closing fair value of defined benefit pension scheme assets	3,565	3,269

29. Retirement benefit obligations (continued)

Reconciliation of the defined benefit pension scheme obligations	2015 £m	2014 £m
Opening defined benefit pension scheme obligations	(3,220)	(2,915)
Current service cost	(27)	(21)
Past service credit/(cost)	16	(2)
Interest expense on the defined benefit obligation	(130)	(132)
Actuarial gain- experience adjustments	40	31
Actuarial (loss) – demographic assumptions	-	(23)
Actuarial (loss) – financial assumptions	(282)	(238)
Benefits paid from scheme assets	84	77
Transfer payments	6	3
Closing defined benefit pension scheme obligations	(3,513)	(3,220)

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

	2015 £m	2014 £m
Quoted		
Equities	862	853
Government bonds	1,611	1,346
Global sovereign bonds	49	102
Corporate bonds	767	699
Other [(1)]	45	70
Cash	32	27
Secure income alternatives	67	62
Unquoted		
Property	132	110
Fair value of defined benefit pension scheme assets	3,565	3,269

(1) Includes amounts held in an Emerging Market Currency fund.

The Scheme is not invested in any of the Group's own financial instruments. The property value above includes £16m (2014: 16m) in respect of the Group's offices at Merrion Way, Leeds.

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

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

Amounts recognised in the income statement	2015 £m	2014 £m
Current service cost	27	21
Past service (credit)/cost	(16)	2
Net interest on net defined benefit liability/asset	(3)	3
Defined benefit expense for the year	8	26
Administration costs incurred	4	4
Cost recognised in the income statement	12	30

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

29. Retirement benefit obligations (continued)

In the current and prior year past service cost of £2m (2014: £2m) relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements and in both years these were fully offset in the income statement by a corresponding release from the restructure provision.

Amounts recognised in the statement of comprehensive income	2015 £m	2014 £m
Opening cumulative actuarial losses	(634)	(658)
Actuarial gain due to liability experience adjustments	40	31
Actuarial loss due to liability assumption changes	(282)	(261)
Return on scheme assets greater than discount rate	206	254
Cumulative actuarial losses recognised in the statement of comprehensive income	(670)	(634)

Actuarial assumptions	2015 % p.a.	2014 % p.a.
Financial assumptions		
Discount rate	3.80	4.10
Inflation ("RPI")	3.25	3.15
Inflation ("CPI")	2.25	2.15
Career average revalued earnings ("CARE") revaluations:		
Pre 31 March 2012 benefits (RPI)	3.25	3.15
Post 31 March 2012 benefits (CPI capped at 5% per annum)	2.25	2.15
Pension increases (capped at 2.5% per annum)	2.10	2.10
Pension increases (capped at 5% per annum)	3.15	3.00
Rate of increase for pensions in deferment	2.25	2.15

Demographic assumptions

Post retirement mortality:	2015 years	2014 years
Current pensioners at 60 – male	27.6	27.5
Current pensioners at 60 – female	29.5	29.4
Future pensioners at 60 – male	29.1	29.0
Future pensioners at 60 – female	31.0	30.9

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

Assumption change	Impact on defined benefit obligation £m	Impact on pension cost £m
Discount rate		
+0.25%	(178)	(8)
-0.25%	192	10
Inflation		
+0.25%	162	8
-0.25%	(152)	(6)
Life expectancy		
+1 year	113	6
-1 year	(113)	(4)

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

The discounted mean term of the defined benefit obligation at 30 September 2015 is 22 years. The expected contributions for the year ended 30 September 2016 are £32m and expected benefit payments for the year ended 30 September 2016 are £90m.

30. Other liabilities

	2015 £m	2014 £m
Accruals and deferred income	136	78
Notes in circulation	1,791	1,831
Other	146	186
	2,073	2,095

31. Called up share capital

Allotted, called up and fully paid	2015 Number of shares	2014 Number of shares	2015 £m	2014 £m
Ordinary shares of £0.10 each (previously £1 each)				
Opening ordinary share capital	1,882,012,500	1,582,012,500	1,882	1,582
Issued during the year	350,000,012	300,000,000	350	300
Nominal share value reduction	-	-	(2,009)	-
Closing ordinary share capital	2,232,012,512	1,882,012,500	223	1,882
Preference shares of £1 each				
Opening preference share capital	-	100,000,000	-	100
Repurchased during the year	-	(100,000,000)	-	(100)
Closing preference share capital	-	-	-	-
Closing called up and fully paid share capital	2,232,012,512	1,882,012,500	223	1,882

On 29 December 2014, 350,000,000 ordinary shares of £1 were issued. All ordinary shares issued in the year were at par and fully paid up.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Company. All shares in issue at 30 September 2015 rank equally with regard to the Company's residual assets.

On 28 May 2015, the Board approved the reduction of the nominal value of each ordinary share to £0.10 by cancelling and extinguishing £0.90 of liability on each issued ordinary share in the capital of the Company. The existing share capital was reduced from £2,232,012,500 divided into 2,232,012,500 ordinary shares of £1 each to £223,201,250 divided into 2,232,012,500 ordinary shares of £0.10 each. The nominal share value reduction has been transferred to retained earnings.

On 19 June 2015, one ordinary share was issued for a nominal value of £0.10 and a premium of £49,999,999.90.

On 8 July 2015 one non-voting income share of £1 (2014: £1) was subdivided into 10 non-voting income shares of £0.10 and were subsequently converted into ordinary shares.

On 24 September 2015, one ordinary share was issued for a nominal value of £0.10 and a premium of £619,999,999.90.

In accordance with the Articles of Association ("Articles") of the Company, with the non-objection of the PRA, the Company obtained the consent of National Australia Bank Limited, London Branch ("the Holder") to redeem 100,000,000 non-cumulative preference shares of £1 issued on 17 December 2008. The preference shares were repurchased on 20 December 2013.

The preference shares repurchased were classified as equity instruments. The preference shares entitled the Holder to a discretionary fixed non-cumulative dividend of 12% per annum payable every six months on the capital paid up.

32. Total equity

	2015 £m	2014 £m
Share capital (note 31)	223	1,882
Share premium account	670	-
	893	1,882
Other equity instruments	450	300
Capital redemption reserve	-	100
Share option reserve	3	2
Asset revaluation reserve	2	2
Available for sale reserve	12	8
Cash flow hedge reserve	(13)	(16)
Total other reserves	4	96
Retained earnings	2,096	260
Total equity	3,443	2,538

Share premium account

On 19 June 2015, 1 ordinary share was issued by the Company to National Equities Limited for a nominal value of £0.10 and a premium of £49,999,999.90. On 24 September 2015, one ordinary share was issued by the Company to National Equities Limited for a nominal value of £0.10 and a premium of £619,999,999.90.

Other equity instruments

Other equity instruments represent Additional Tier 1 ("AT1") notes. On 20 December 2013, Perpetual Capital Notes (6m LIBOR + 763bps) were issued with a principal amount of £300m to the Company's ultimate parent. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV. A further £150m Perpetual Capital Notes (6m LIBOR + 690bps) were issued to NAB on 29 December 2014. AT1 distributions of £18m were paid in June 2015.

Capital redemption reserve

The capital redemption reserve was cancelled in the year end and transferred to retained earnings.

Share option reserve

The Group's share option reserve represents the outstanding fair value amount in respect of share based payment expense recharged by its ultimate parent that has been charged through the income statement and adjusted for deferred tax.

Asset revaluation reserve

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

Available for sale reserve

The available for sale reserve records the gains and losses arising from changes in the fair value of available for sale financial assets.

Cash flow hedge reserve

The cash flow hedge reserve records fair value revaluations of derivatives designated as cash flow hedging instruments to the extent that they are effective.

As at 30 September 2015 the cash flow hedge reserve comprises the crystallised net fair value losses arising from de-designated cash flow hedges (£2m) and net deferred losses on derivatives in ongoing cash flow hedges (£15m). The balance on the cash flow hedge reserve is net of tax. £17m (2014: £48m) was recycled into the income statement in relation to de-designated hedges in the year. £1m (2014: £2m) was transferred to the income statement due to ineffectiveness arising from cash flow hedges.

Non-controlling interests

No distributions were paid to the non-controlling interests of Rmond LP in the current year (2014: £8m). Before intercompany eliminations Rmond LP recorded revenue, profit and total comprehensive income for the year of £Nil (2014: £5m); net cash flows for the year of £Nil (2014: £Nil); total assets at 30 September 2015 of £Nil (2014: £Nil); and Members' interests at 30 September 2015 of £Nil (2014: £Nil). Rmond LP was dissolved on 20 December 2013.

33. Contingent liabilities and commitments

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

Contingent liabilities (note 39)	2015 £m	2014 £m
Guarantees and assets pledged as collateral security:		
At call	-	-
Due in less than 3 months	25	32
Due between 3 months and 1 year	13	25
Due between 1 year and 3 years	9	9
Due between 3 years and 5 years	2	3
Due after 5 years	52	61
No specified maturity	8	6
	109	136
Other credit commitments (note 39)		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	7,801	8,422

Capital commitments

The Group had future capital expenditure which had been contracted for but not provided for in the financial statements at 30 September 2015 of £1.9m (2014: £3.6m).

Operating lease commitments

Leases as lessor	2015 £m	2014 £m
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	2	2
Between 1 year and 5 years	6	6
Over 5 years	2	2
	10	10
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	31	30
Between 1 year and 5 years	95	94
Over 5 years	122	121
	248	245

33. Contingent liabilities and commitments (continued)

Other contingent liabilities

Financial Services Compensation Scheme ("FSCS")

The FSCS provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, claims were triggered against the FSCS, initially to pay interest on borrowings which the FSCS has raised from the UK Government to support the protected deposits. During 2015, the FSCS levy was also invoiced to institutions for the third of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings, which remains after the three annual levies have been paid, is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2016 and an accrual of £9m (2014: £7m) is held for the Group's calculated liability to that date. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 27 to the annual report and consolidated financial statements reflecting the Group's current position in relation to redress provisions for PPI and IRHPs.

As at 30 September 2015, a provision of £774m is held with respect to complaints and redress issues arising out of historic sales of PPI. This provision is based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement. There remain risks and uncertainties in relation to these assumptions and consequently in relation to ultimate costs of redress and related costs, including: (i) the number of PPI claims (including the extent to which this is influenced by the activity of claims management companies); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; (iv) the impact of the Supreme Court decision in Plevin v Paragon Personal Finance Ltd ("Plevin") referenced below (including the impact of any new FCA rules or guidance issued further to that decision); (v) any additional amounts that may need to be paid in respect of previously handled claims; (vi) the costs of administering the remediation programme; and (vii) the response rates to proactive customer contact. The requirement for further proactive customer contact has been determined by the Group undertaking a past business review and is included in the charge of £390m which also incorporates changes in complaint levels, changes in the cost of redress and uphold rates, and increased costs of administering the programme. Further detail is provided in note 27.

The November 2014 Supreme Court case of Plevin held that, judged on its own facts, non-disclosure of the amount of commission payable in that case in connection with the sale of single premium PPI to a customer created an unfair relationship under s140A of the Consumer Credit Act 1974.

On 2 October 2015, the FCA announced its intention to issue a consultation, before the end of the calendar year, in relation to the introduction of a deadline by which consumers would need to make their PPI complaints and also in relation to how firms should handle PPI complaints fairly in the light of the Plevin case. The principal elements of the consultations include a deadline for PPI complaints falling two years from the date the proposed rule comes into force (not anticipated to be before spring 2016) and a proposal that a failure to disclose a commission of 50% or more gave rise to an unfair relationship under s.140A in respect of sums payable under the underlying credit agreement on sales on or after 6 April 2008. The proposed PPI complaint deadline would also apply to the handling of these complaints. Noting that the consultation documents have not been published and that the final rules and guidance may therefore change from that proposed, it is too early to estimate the impact of these matters which may impact the level of walk in complaints the Group experiences as well as the activity of claims management companies amongst other factors. Accordingly, no adjustment to the PPI provision has been recorded in relation to these matters.

Therefore the final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

33. Contingent liabilities and commitments (continued)

The Group's provision for IRHPs at 30 September 2015 is £192m. In common with PPI, the IRHP provision and ultimate final amount required to settle the Group's potential IRHP liability is uncertain and is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. These factors could result in the total cost of the review and redress exercise and associated costs varying materially from the Group's estimate. The final amount required to settle the Group's potential IRHP liability in this matter is therefore uncertain and further provision could be required.

As part of the demerger and IPO announced on 7 May 2015, NAB confirmed its intention to provide support to the Group against potential losses related to legacy conduct costs, including those relating to PPI and IRHPs. Further detail can be found in note 43.

In addition to PPI and IRHPs, UK retail banks have been recently experiencing an increase in the number of complaints in relation to sale of packaged bank accounts. Whilst the activity in this area is not material at present, the Group continues to monitor complaint volumes (initiated from both customer and claims management companies) and the final customer outcomes of these complaints and will review its position going forward as matters develop.

Legal claims

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

34. Notes to the statements of cash flows

	2015 £m	2014 £m
Adjustments included in the loss before tax		
Interest receivable	(1,110)	(1,135)
Interest payable	323	363
Depreciation and amortisation (note 7)	83	78
Net gain on capital and debt restructure (note 6)	(61)	-
Loss/(profit) on sale of tangible fixed assets [(1)]	1	(7)
Transfer from cash flow hedge reserve	(1)	(2)
Derivative financial instruments fair value movements	(2)	(9)
Impairment losses on credit exposures (note 16)	78	74
Impairment losses on software (note 7)	10	23
	(679)	(615)
Changes in operating assets		
Net (increase)/decrease in:		
Balances with supervisory central banks	(2)	1
Due from other banks	(113)	171
Derivative financial instruments	1	(26)
Financial assets at fair value through profit or loss	478	585
Loans and advances to customers	(1,663)	(2,001)
Due from customers on acceptances	1	(1)
Defined benefit pension assets	(39)	-
Other assets	(157)	94
	(1,494)	(1,177)
Changes in operating liabilities		
Net increase/(decrease) in:		
Due to other banks	(567)	395
Derivative financial instruments	(39)	(135)
Financial liabilities at fair value through profit or loss	(23)	(31)
Due to customers	2,380	(245)
Liabilities on acceptances	(1)	1
Provisions	54	637
Defined benefit pension obligations	-	(223)
Other liabilities	179	163
	1,983	562

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

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	2015 £m	2014 £m
Cash and balances with central banks (note 10)	6,387	5,944
Other assets	86	143
Due to other banks	(72)	(26)
Due to related entities	(33)	(108)
Other liabilities	(31)	(58)
	6,337	5,895

35. Employees

The average number of full time equivalent employees of the Group during the year was made up as follows:

	2015 Number	2014 Number
Managers	2,449	2,344
Clerical staff	4,367	4,355
	6,816	6,699

All staff are contracted employees of the Group and its subsidiary undertakings. Comparative figures have been updated to remove NAB UK employees included in the prior year. The average figures above do not include contractors. Comparative disclosures have been amended to conform with the current year's presentation.

36. Equity based compensation

Share incentive plans, share offers, performance options and performance rights are used to provide short-term and long-term incentives to employees. These incentives are an integral part of the Group's remuneration strategy in rewarding employees' current and future contribution to the Group's performance. All UK awards are made in accordance with the principles set out within the PRA's Remuneration Code.

The plans described below involve the provision of shares, performance options and performance rights to employees, senior management and Directors of the Group.

Short term incentive ("STI")

The STI plan has an element of deferral to provide an appropriate level of reward aligned with sound risk management principles. STI deferral encourages longer-term sustainable decision making and assurance of individual and business performance. Deferral applies to all levels of performance across the organisation. Deferral is in the form of NAB shares, rights or cash. The deferred amount is subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet compliance requirements. A reduction or forfeiture of deferred amounts can also be determined by the Principal Board, at its absolute discretion. Such a determination may be made in relation to the NAB Group, a business unit, executive committee, role or individual.

Recognition and retention shares

These shares enable retention and recognition awards to be provided in the form of shares, rather than in cash. Such awards are made on a very limited basis with NAB Group Principal Board Remuneration Committee approval, to individuals in significant key roles where retention is critical over a medium-term timeframe (two to three years). Awards under the programme may also be provided to individuals accepting significant project leadership or additional responsibilities for a limited period of time with no related increase in their fixed remuneration. The provision of shares under this plan is desired over the use of cash payments, as it provides a stronger retention and shareholder value link to the reward. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, or retirement or failure to meet compliance requirements. The minimum restriction period is until the final key date or milestone has been achieved.

Commencement shares

These shares enable 'buyout' of evidenced equity from previous employment for significant new hires. Shares are provided under this programme or commencement performance options and performance rights if more appropriate. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet compliance requirements.

UK Share Incentive Plan

The UK Share Incentive Plan is an approved HM Revenue and Customs share plan. Employees are entitled to purchase up to £1,800 worth of NAB shares each year through the Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on the market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,000 of free shares may be awarded by the employer to employees per annum.

36. Equity based compensation (continued)

General employee shares

NAB free shares are not expected be granted to employees of the Group for the year ended 30 September 2015. Alternative awards in relation to the year are being finalised as part of the planned demerger and IPO.

NAB long term incentives ("NAB LTI")

NAB LTI taking the form of shares, performance options or performance rights, help to drive management decisions focused on the long-term prosperity of the NAB Group through the use of challenging performance hurdles. The Executive NAB LTI program is awarded to senior executives across the Group. A NAB LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. Performance hurdles (both internal and external) are measured at the end of a four to five year restriction period and during the restriction period an executive's performance rights or performance options will lapse (or their shares will be forfeited) for cessation of employment (if the Board so determines) or, if compliance requirements or performance hurdles are not met.

For historical awards a variety of performance measures are used for different grants of long-term incentives including Total Shareholder Return ("TSR") compared against peer companies, and regional or NAB Group ROE and cash earnings. The measures used depend on the level and impact of the participant's role, the business or region in which they work and the relevant program.

Vesting of an NAB LTI award generally occurs to the extent that the relevant performance hurdle is satisfied (as determined by the NAB Board Remuneration Committee). The performance options and performance rights generally have an expiry date between three and six years from the effective date, if they remain unexercised.

Each performance option or performance right is exchanged for one fully paid ordinary share in NAB Limited upon exercise, subject to standard adjustments for capital actions. The exercise price for performance options is generally the market price for NAB Limited's fully paid ordinary shares as at the date the performance option was granted or such other relevant date determined by the NAB Board Remuneration Committee. No exercise price is payable by the holder on exercise of performance rights.

NAB LTI awards are not expected be granted to Directors of the Group for the year ended 30 September 2015. Alternative long-term incentive awards in relation to the year are being finalised as part of the planned demerger and IPO.

The movement in performance options and performance rights granted and exercised during the year was as follows:

Performance options	2015		2014	
	Number	Weighted average exercise price A$	Number	Weighted average exercise price A$
Outstanding at 1 October	-	-	85,715	19.89
Granted during the year	-	-	-	-
Forfeited and lapsed during the year	-	-	(4,947)	19.89
Exercised during the year	-	-	(80,768)	19.89
Expired during the year	-	-	-	-
Outstanding at 30 September	-	-	-	-
Exercisable at 30 September	-		-	

There were no share options carried over from 2014 and no share options granted during 2015.

36. Equity based compensation (continued)

Performance rights	2015 Number	2014 Number
Outstanding at 1 October	259,093	186,119
Granted during the year	136,812	197,835
Forfeited and lapsed during the year	(103,965)	(124,861)
Exercised during the year	(10,874)	-
Outstanding at 30 September	281,066	259,093
Exercisable at 30 September	18,480	-

Unvested performance rights of 103,965 (2014: 124,861) were forfeited.

The number of performance rights exercised during the year was 10,874 (2014: Nil). For performance rights outstanding at 30 September 2015, the weighted average remaining contractual life is 3.38 years (2014: 4.04 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

No performance options were granted during the year ended 30 September 2015 (2014: Nil). 136,812 performance rights were granted during the year ended 30 September 2015 (2014: 197,835). Included within personnel expenses (note 7) is a fair value of goods or services to the value of £1.2m, which was measured indirectly by reference to the fair value of the performance rights granted during the year (2014: £2.1m).

37. Directors' emoluments

2015 £'000	Salary and fees [1]	Benefits and allowances [2]	Short term incentives [3]	Commencement awards [4]	Variable pay	Emoluments
Executive Directors						
David Duffy [5]	318	78	450	500	950	1,346
Ian Smith [6]	253	53	253	-	253	559
Debbie Crosbie	367	119	450	-	450	936
Richard Sawers [9]	-	-	-	-	-	-
David Thorburn [10]	460	952	-	-	-	1,412
John Hooper [11]	248	609	-	-	-	857
Total Executive	1,646	1,811	1,153	500	1,653	5,110
Non-executive Directors						
David Allvey	92	-	-	-	-	92
David Browne	80	-	-	-	-	80
Adrian Grace [7]	47	-	-	-	-	47
Richard Gregory OBE	140	-	-	-	-	140
Jim Pettigrew	300	-	-	-	-	300
Barbara Ridpath	70	-	-	-	-	70
Dr Teresa Robson-Capps [8]	67	-	-	-	-	67
Alex Shapland	70	-	-	-	-	70
Total Non-executive	866	-	-	-	-	866
Total Directors	2,512	1,811	1,153	500	1,653	5,976

2014 £'000	Salary and fees [1]	Benefits and allowances [2]	Short term incentives [3]	Commencement awards [4]	Variable pay	Emoluments
Executive Directors						
Debbie Crosbie	127	28	61	-	61	216
John Hooper	400	63	200	-	200	663
David Thorburn	450	99	180	-	180	729
Total Executive	977	190	441	-	441	1,608
Non-executive Directors						
David Allvey	82	-	-	-	-	82
David Browne	80	-	-	-	-	80
Richard Gregory OBE	140	-	-	-	-	140
Barbara Ridpath	70	-	-	-	-	70
Jim Pettigrew	119	-	-	-	-	119
Alexander Shapland	70	-	-	-	-	70
Total Non-executive	561	-	-	-	-	561
Total Directors	1,538	190	441	-	441	2,169

Performance related pay - long term incentive schemes

NAB LTI awards are not expected be granted to Directors of the Group for the year ended 30 September 2015. Alternative long term incentive awards in relation to the year are being finalised as part of the planned demerger and IPO.

Accordingly, in addition to the amounts shown in the above table, £120,000 has been recognised in the income statement for the year ended 30 September 2015 in respect of estimated Directors' long term incentive award costs, including £75,000 in relation to the highest paid Director. Note that the total amount of the award, if granted, will be recognised over the vesting period of the award (typically three years). As a result, this estimate is not directly comparable with the total award values detailed below in respect of the year ended 30 September 2014 which represents the total value of the awards granted. Further details will be disclosed as part of the planned demerger and IPO transaction.

In relation to the year ended 30 September 2014 Directors were granted awards under the NAB LTI [12] with a value of £263,000, including £225,000 in relation to the highest paid Director.

37. Directors' emoluments (continued)

Social security costs

In addition to the amounts shown in the above table, Social security costs were payable in respect of emoluments for Directors amounting to £617,000 (2014: £305,000) and in respect of emoluments for the highest paid Director of £185,000 (2014: £130,118).

Notes

(1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors.

(2) Benefits and allowances include cash payments in lieu of pension contributions, other taxable allowances, benefits and compensation for loss of office. Retirement benefits accrued to two Directors (2014: two) under a defined benefit pension plan. Pension contributions amounting to £33,666 (2014: £50,013) were paid during the year. The highest paid Director is not a member of the defined benefit or defined contribution pension plans.

(3) The short-term incentive figures include a cash element to be paid in the forthcoming year and the deferred amount represents rights and shares deferred for six months to two years. The highest paid Director received £450,000 performance related pay in respect of 2015.

(4) The commencement figure of £500,000 awarded to David Duffy was in NAB shares which will vest over a 3 year period.

(5) David Duffy was appointed as an Executive Director on 5 June 2015 and accordingly the figures in the table above represent his emoluments from this date.

(6) Ian Smith was appointed as an Executive Director on 11 March 2015 and accordingly the figures in the table above represent his emoluments from this date and not from the date of his appointment as Chief Financial Officer.

(7) Adrian Grace was appointed as a Non-executive Director on 23 December 2014 and accordingly the figures in the table above represent his emoluments from this date.

(8) Dr Teresa Robson-Capps was appointed as a Non-executive Director on 8 October 2014 and accordingly the figures in the table above represent her emoluments from this date.

(9) Richard Sawers is remunerated as an employee of NAB and did not receive incremental remuneration in respect of his duties as a Director of the Company. The Directors believe it would be appropriate to apportion A$930,000 (2014: A$618,000) of his remuneration as being in respect of his duties to the Company.

(10) David Thorburn left the organisation on 28 February 2015 and accordingly the figures in the table above represent his emoluments to this date. No performance related pay is payable. Note that for the purpose of identifying the highest paid Director, compensation for loss of office and pension contributions are excluded.

(11) John Hooper left the organisation on 31 October 2014 and accordingly the figures in the table above represent his emoluments to this date. No performance related pay is payable.

(12) Long term incentive awards include deferred cash, deferred performance rights and deferred shares.

37. Directors' emoluments (continued)

The tables below show, for the highest paid Director in the given year, the number of shares in respect of share options, performance rights, short term incentive, long term incentive and other employee share plans (including free shares, commencement shares, recognition shares).

2015 Number	Share options	Performance rights	Short term incentive shares	Long term incentive shares	Commencement shares	Other employee share plans
Outstanding at 1 October	-	-	-	-	-	-
Granted during the year	-	-	-	-	31,357	-
Exercised/disposed during the year	-	-	-	-	-	-
Expired during the year	-	-	-	-	-	-
Forfeited during the year	-	-	-	-	-	-
Restrictions ceased	-	-	-	-	-	-
Outstanding at 30 September	-	-	-	-	31,357	-

2014 Number	Share options	Performance rights	Short term incentive shares	Long term incentive shares	Commencement shares	Other employee share plans
Outstanding at 1 October	-	47,894	-	9,205	-	76
Granted during the year	-	51,322	1,657	-	-	26
Exercised/disposed during the year	-	-	(1,657)	(3,953)	-	-
Expired during the year	-	-	-	-	-	-
Forfeited during the year	-	(36,016)	-	(5,252)	-	-
Restrictions ceased	-	-	-	-	-	-
Outstanding at 30 September	-	63,200	-	-	-	102

38. Fair value of financial instruments

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

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

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

- Level 1 fair value measurements - quoted prices (unadjusted) in active markets for an identical financial asset or liability.
- Level 2 fair value measurements - inputs other than quoted prices within Level 1 that are observable for the financial asset or liability, either directly (as prices) or indirectly (derived from prices).
- Level 3 fair value measurements - inputs for the financial asset or liability that are not based on observable market data (unobservable inputs).

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values are based on relevant information available at the reporting date and involve judgement. The methodologies and assumptions used in the fair value estimates are described in the footnotes to the tables.

There are various limitations inherent in this fair value disclosure particularly where prices may not represent the underlying value due to dislocation in the market. Not all of the Group's financial instruments can be exchanged in an active trading market. The Group obtains the fair values for investment securities from quoted market prices where available. Where securities are unlisted and quoted market prices are not available, the Group obtains the fair value by means of discounted cash flows and other valuation techniques that are commonly used by market participants. These techniques address factors such as interest rates, credit risk and liquidity. The difference between carrying value and fair value is relevant in a trading environment, but is not relevant to assets held to maturity and loans and advances.

	30 September 2015					30 September 2014				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets										
Loans and advances to customers	27,482	27,537	-	1,111	26,426	25,901	25,734	-	1,293	24,441
Financial liabilities										
Due to customers	26,407	26,423	-	26,423	-	24,073	24,083	-	24,083	-
Due to related entities	998	1,017	-	1,017	-	2,677	2,633	-	2,633	-
Bonds and notes	3,766	3,869	-	3,869	-	3,453	3,534	-	3,534	-

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

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

(a) *Cash and balances with central banks, Due from and to other banks, Due from customers on acceptances, Liabilities on acceptances, Other assets and Other liabilities* – carrying values approximate fair value as they are short term in nature and or receivable or payable on demand.

(b) *Amounts due from related entities* – amounts due from related entities are repayable on demand or within twelve months. As a result, the carrying value approximates the fair value.

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

(d) *Due to customers* – the fair value of deposits is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(e) *Amounts due to related entities* – the fair value of subordinated loans; and notes issued to related entities is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity. All other amounts due to related entities are repayable under varying maturities but are materially repriced every 3-6 months relative to market rates.

(f) *Bonds and notes* – the fair value is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(b) Fair value of financial instruments recognised on the balance sheet at fair value

The following tables provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, using the fair value hierarchy described in note 38(a) above.

	Fair value measurement as at 30 September 2015				Fair value measurement as at 30 September 2014			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	285	-	285	-	220	-	220
Available for sale – investments – listed	1,447	-	-	1,447	1,161	-	-	1,161
Available for sale – investments – unlisted	-	-	8	8	-	-	7	7
Available for sale – other	-	-	7	7	-	-	-	-
Other financial assets at fair value	-	-	1,097	1,097	-	-	1,583	1,583
Total financial assets measured at fair value	1,447	285	1,112	2,844	1,161	220	1,590	2,971
Financial liabilities								
Derivative financial liabilities	-	534	-	534	-	548	-	548
Other financial liabilities at fair value	-	-	67	67	-	-	91	91
Total financial liabilities measured at fair value	-	534	67	601	-	548	91	639

(b) Fair value of financial instruments recognised on the balance sheet at fair value (continued)

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

(a) *Derivative financial assets and liabilities* – the fair value of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from quoted closing market prices as at the balance sheet date, discounted cash flow models or option pricing models as appropriate.

(b) *Available for sale – investments* - the fair values of listed investments are based on quoted closing market prices. For unlisted equity investments the Group's share of the net asset value of the undertaking is considered the best representation of the fair value of the investment.

(c) *Available for sale – other* – the fair value of deferred consideration is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

(d) *Other financial assets and liabilities at fair value* – fair values are derived from data or valuation techniques based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument.

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

Assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3):

Level 3 movements analysis:	2015		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	1,583	(91)
Total gains/(losses)			
In profit or loss[1]	-	2	2
Purchases	8	-	-
Settlements	-	(488)	22
Balance at the end of the year	15	1,097	(67)

Level 3 movements analysis:	2014		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	2,171	(123)
Total gains/(losses)			
In profit or loss [1]	-	(56)	4
Settlements	-	(532)	28
Balance at the end of the year	7	1,583	(91)

[1] Net gains or losses were recorded in other operating income, interest income or interest expense and impairment losses as appropriate.

There were no transfers out of Level 3 in the year ended 30 September 2015 (2014: £Nil).

Settlements for the year ended 30 September 2015 include a realised loss of £33m (2014: loss of £12m) relating to financial assets that are measured at fair value. Such fair value gains or losses are included in non-interest income (note 6).

38. Fair value of financial instruments (continued)

Quantitative information about significant unobservable inputs in Level 3 valuations

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2015.

	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Financial assets					
Available for sale – investments - unlisted	8	Underlying/net asset value	Price	Nil	Market value on disposal
Available for sale – other	7	Discounted cash-flow	Customer attrition rate	10%	30%
Other financial assets at fair value	1,097	Discounted cash-flow	Portfolio lifetime probability of default	4.4%	11.3%

The unlisted available for sale investments primarily relates to the Group's holding of shares in Vocalink Limited, an unquoted company registered in England and Wales which operates the BACS and direct debits schemes in the UK as well as connecting ATMs using the LINK network. This represents the Group's percentage holding in this entity. The valuation is based on the net asset value in the most recent set of publically available financial statements for the Company and represents the fair value of the investment.

The available for sale - other financial asset represents deferred consideration receivable following the purchase of CYB Intermediaries Holdings Limited from the ultimate parent on 30 September 2015 and consists of the rights to future commissions. The valuation is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

The Group has £67m (2014: £91m) of financial liabilities at fair value classed as Level 3 which represent a portfolio of term deposits that are directly linked to the customer loans, which are also held at fair value and classed as Level 3. Their relationship to the fair value assets is such that should the liability be settled, the amount payable would be net of the fair value asset.

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

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

The most significant exposure to Level 3 fair value measurements is in respect of the Group's fair value loan portfolio.

The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £8m and vice versa. The most significant input impacting the carrying value of the available for sale – other asset is the Funds Under Management Attrition rate. If this rate was 30% the carrying value would reduce by £3m, if it was 10% the carrying value would increase by £2m. The Group currently assumes a 15% attrition rate.

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

39. Financial risk management

Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates for various periods, and seeks to earn interest margins by investing these funds in assets. The Group seeks to improve these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

Fair value hedges

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

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate and foreign currency risk arising from variable interest rate assets and liabilities using cross currency and interest rate swaps. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives entered into is also disclosed in note 14.

Credit risk

Credit risk is inherent within any transaction that creates an actual or potential obligation for a borrower to pay the Group.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral, corporate, and personal guarantees where appropriate.

Derivatives

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

Master netting agreements and collateral arrangements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if a counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis. Derivative financial instrument contracts are typically subject to International Swaps and Derivatives Association ("ISDA") master netting agreements, as well as Credit Support Annexes ("CSA"), where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house.

Credit risk (continued)

Credit-related commitments

Credit-related commitments are facilities where the Group is under a legal obligation to extend credit unless some event occurs, which gives the Group the right, in terms of the commitment letter of offer or other documentation, to withdraw or suspend the facilities. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry similar credit risk to loans.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss of an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. In the event of a deterioration of a customer's circumstances lending can often be withdrawn. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Forbearance

Identification and classification

Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group.

A concession refers to either of the following actions:

- a modification of the previous terms and conditions of a debt; and/or
- a total or partial refinancing of a contract.

Typically, concessions will include the granting of more favourable terms and conditions than those provided either at drawdown of the facility or which would not ordinarily be available to others with a similar risk profile. Loans that have been renegotiated and/or restructured for solely commercial reasons where there is no financial difficulty are not treated as forborne.

The Group continues to develop its forbearance policies and practices. During the year the policy guidance for non-retail forbearance has been revised such that financial or non-financial covenant breaches (whether waived or rights reserved) and financial covenant resets, are now considered to require an assessment for forbearance concessions where customers are experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. Comparative non-retail forbearance disclosures presented for 30 September 2014 have been restated.

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

Depending on circumstances and when operated within robust parameters and controls, the Group believes forbearance can help support the customer in the short to medium-term.

A range of parameters are considered when the Group looks to identify those customers to whom forbearance would be applicable and these parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions. The Group continues to make every effort to follow its principles of treating customers fairly and aligns its forbearance practices to those principles.

Credit risk (continued)

Forbearance (continued)

Identification and classification (continued)

The Group operates a range of forbearance measures depending on the type of customer and exercises forbearance in two distinct areas: retail and non-retail.

Exit from forbearance

Exposures classified as forborne and performing at the date forbearance measures are granted, continue to be reported as subject to forbearance for a minimum period of two years from that date (the 'probation period').

In addition, each of the following requirements need to be met at the end of the two year probation period referred to above for the exposure to exit from being classified as forborne:

- none of the exposures to the customer are more than 30 days past due at the end of the probation period; and
- regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period. This assessment is based on the forbearance terms for repayment.

When the conditions are not met at the end of the probation period, the exposure shall continue to be identified as a performing forborne exposure until all of the conditions are met.

Exposures classified as forborne and which are non-performing when, or after, customers were granted forbearance cannot exit non-performing status for a minimum of twelve months from the date forbearance was granted, and cannot exit forbearance status for a further two years from the date of returning to performing status (three years in total).

Retail forbearance

Forbearance may be extended to retail customers (primarily on residential mortgages) when they have been identified as experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. The Group makes every effort to work with customers in times of financial difficulty in order to find a solution that brings customer facilities back into a sustainable position which, for residential mortgages, also means keeping customers in their homes.

Forbearance is exercised on retail customers in a number of different ways and is specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action. The Group has implemented appropriate policies and procedures to ensure consistent application of forbearance. The operation, maintenance and governance surrounding these policies are regularly reviewed to confirm they remain relevant, appropriate and, most importantly, of value to our retail customers who have been identified as requiring forbearance.

At an operational level, the majority of forbearance measures are granted by Mortgage Collections who seek to negotiate positive outcomes for customers who have fallen into arrears. Forbearance is also exercised from within a dedicated Financial Management and Customer Solutions Team ("FMCST"), part of whose remit is to assist retail customers in financial difficulty to manage their finances more effectively on a case by case basis. The support provided by FMCST is tailored specifically for individual customers and includes an income and expenditure assessment along with other relevant financial management support.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

The Group classifies the forbearance measures offered to retail customers into the following categories:

- *Formal arrangements:* A permanent change which could include capitalisation of arrears, or arrangement with the customer to repay arrears over a shorter period than capitalisation would involve.
- *Temporary arrangements:* Short term measures that allow a period of relief for customers in financial difficulty, these can include short-term payment holidays.
- *Interest only conversion:* A permanent or temporary conversion to interest only repayments, allowing the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term.
- *Term extension:* A permanent change to the loan term allowing the customer to make lower repayments whilst still repaying the outstanding balance in full, over a longer period.
- *Other:* A segment of forbearance exposures specifically dealt with through FMCST, which includes product switches.
- *Legal:* Court mandated forbearance exposures.

Where the Group has made a demand for repayment, the customers facilities have been withdrawn or where a debt repayment process has been initiated, the exposure is classified as forborne if the debt is subject to any of the forbearance concessions above.

Retail forbearance - mortgage lending

The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. The Group reports retail forbearance at the exposure level. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

As at 30 September 2015 [(1)]

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount	% of total portfolio	Impairment allowance	Coverage
		£m		£m	%
Formal arrangements	2,115	179	0.87	4.0	2.22
Temporary arrangements	985	99	0.48	1.5	1.57
Interest only conversion	88	12	0.06	-	0.15
Term extension	131	11	0.06	0.1	0.84
Other	11	1	0.01	-	0.39
Legal	216	23	0.11	1.5	6.56
	3,546	325	1.59	7.1	2.19

(1) All forbearance reporting is at the balance sheet date.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

As at 30 September 2014

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount	% of total portfolio	Impairment allowance	Coverage
		£m		£m	%
Formal arrangements	2,282	189	1.03	3.7	1.97
Temporary arrangements	581	49	0.27	1.1	2.24
Interest only conversion	40	7	0.04	-	0.02
Term extension	72	6	0.03	-	0.03
Other	6	1	-	-	0.61
Legal	221	25	0.14	2.0	7.90
	3,202	277	1.51	6.8	2.46

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to pro-actively track and facilitate pre-maturity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2015, the Group had 116 (2014: 162) customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £12m (2014: £20m).

A further forbearance reserve of £4m (2014: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £11.1m (2014: £10.8m) :and to increase overall coverage to 3.42% (2014: 3.90%).

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2015 there were 87 repossessions of which 17 were voluntary (2014: 155 including 53 voluntary).

Retail forbearance – consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including money transmission accounts, unsecured loans and credit cards. Forbearance strategies implemented on consumer credit are of low financial significance in the context of the Group's overall lending operations. The Group reports consumer credit forbearance at the exposure level.

The Group has assessed the total loan balances subject to forbearance on other types of consumer credit to be £18m at 30 September 2015 (2014: £22m), representing 1.62% of the total portfolio (2014: 1.87%). Impairment provisions on forborne balances totalled £5.5m at 30 September 2015 (2014: £6.0m), providing overall coverage of 29.90% (2014: 27.03%).

Non-retail forbearance

Forbearance may be extended to non-retail customers for reasons relating to the actual, or apparent, financial stress of the customer or when they have been identified as experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. Authority to grant forbearance measures for non-retail customers is held by the Group's Strategic Business Services unit and is exercised, where appropriate, on the basis of detailed consideration of a customer's financial position and prospects.

Credit risk (continued)

Forbearance (continued)

Non-Retail forbearance (continued)

The Group reports non-retail forbearance at a customer level, with customers that have forbearance granted on one or more facilities recorded as a single customer, but at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Where a customer is part of a larger group, forbearance is exercised and reported across the Group at the individual entity level. Forbearance is considered to exist where one or more of the following occurs, on a non-commercial basis, for reasons relating to the actual or apparent stress of a customer:

- *Term extension* - Extending the loan facility payment term or the term of an overdraft which is not fluctuating (e.g. where a term loan has matured and the balance passed to an overdraft which is then extended on a non-commercial basis, then forbearance is considered to exist).
- *Deferral of contracted capital repayments* – Includes capital repayment holiday, conversion to interest only for an extended period, or rescheduling, but still repaying within the remaining contracted term.
- *Reduction in the contracted interest rate* – Includes a reduction in the level of accrued interest or amendment to original fee structure.
- *Alternative forms of payment* - Including debt for equity, asset transfer and repayment made by taking possession of collateral;
- *Debt forgiveness* – Total or partial debt forgiveness by write-off of the debt.
- *Refinancing* - A complete or partial repayment of a loan with a new contract granted on or up to 3 months after the day when the original contract expires. In the case of partial repayment both the original and new loans shall be classified as forborne.
- *Covenant breach/waiver/reset* – Financial or non-financial covenant breach (whether waived or rights reserved) and financial covenant resets.

Where the Group has made a demand for repayment, where the customer's facilities have been withdrawn or where a debt repayment process has been initiated this will be classified as forbearance if the debt is subject to any of the forbearance concessions above.

Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forborne.

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

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

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance (continued)

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

As at 30 September 2015 [(1)]	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount	% of total portfolio	Impairment allowance	Coverage
		£m		£m	%
Term extension	491	429	6.00	42.9	10.02
Deferral of contracted capital repayments	166	152	2.12	18.6	12.23
Reduction in contracted interest rate	17	29	0.40	6.8	23.64
Alternative forms of payment	3	16	0.22	4.5	28.76
Debt forgiveness	24	55	0.78	14.2	25.61
Refinancing	33	61	0.86	4.7	7.56
Covenant breach/reset/waiver	62	166	2.32	6.0	3.64
	796	908	12.70	97.7	10.77

[(1)] All forbearance reporting is at the balance sheet date.

As at 30 September 2014	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount	% of total portfolio	Impairment allowance	Coverage
		£m		£m	%
Term extension	573	466	5.76	51.5	11.03
Deferral of contracted capital repayments	192	264	3.26	39.1	14.83
Reduction in contracted interest rate	23	17	0.20	3.4	20.34
Alternative forms of payment	11	27	0.33	12.7	47.07
Debt forgiveness	43	82	1.02	19.5	23.64
Refinancing	49	48	0.60	2.3	4.81
Covenant breach/reset/waiver	75	297	3.67	7.6	2.55
	966	1,201	14.84	136.1	11.32

Included in other financial assets at fair value is a portfolio of loans which are included in the above table. The value of fair value loans subject to forbearance at 30 September 2015 is £162m (2014: £133m), representing 2.27% of the total non-retail portfolio (2014: 1.65%). Impairment allowances on these amounts totalled £14m (2014: £29m), a coverage of 8.68% (2014: 21.69%).

Comparative disclosures have been amended to conform with the current year's presentation.

39. Financial risk management (continued)

Credit risk (continued)

Maximum exposure to credit risk

The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

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

	2015 £m	2014 £m
Cash and balances with central banks (note 10)	6,431	5,986
Due from related entities (note 11)	786	1,487
Due from other banks	128	13
Financial assets available for sale (note 12)	1,462	1,168
Other financial assets at fair value (note 13)	1,097	1,583
Derivative financial assets (note 14)	285	220
Loans and advances to customers (note 15)	27,482	25,901
Due from customers on acceptances	4	5
	37,675	36,363
Contingent liabilities (note 33)	109	136
Other credit commitments (note 33)	7,801	8,422
Maximum credit risk exposure	45,585	44,921

Offsetting of financial assets and liabilities

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

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

The offsetting and collateral arrangements and other credit risk mitigation strategies are further explained within this note.

2015	Amounts subject to enforceable netting arrangements					
		Related amounts not offset				
	Gross and net amount reported on balance sheet £m	Financial instruments (1) (2) (3) £m	Cash collateral (2) (3) £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m	Total recognised on balance sheet £m
Assets						
Derivative financial instruments (4)	149	(149)	-	-	136	285
Liabilities						
Derivative financial instruments (4)	492	(149)	(246)	97	42	534

39. Financial risk management (continued)

Credit risk (continued)

Offsetting of financial assets and liabilities (continued)

2014

	Amounts subject to enforceable netting arrangements					
		Related amounts not offset				
	Gross and net amount reported on balance sheet £m	Financial instruments (1) (2) (3) £m	Cash collateral (2) (3) £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m	Total recognised on balance sheet £m
Assets						
Derivative financial instruments (4)	88	(88)	-	-	132	220
Liabilities						
Derivative financial instruments (4)	522	(88)	(317)	117	26	548
Securities sold under repurchase agreements (5)	644	(644)	-	-	-	644
Total liabilities	1,166	(732)	(317)	117	26	1,192

(1) Financial instruments include recognised financial instruments on the balance sheet.
(2) Amounts relate to master netting and collateral agreements which have been determined to be legally enforceable but do not meet all criteria required for net presentation within the consolidated balance sheet.
(3) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over-collateralisation.
(4) Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.
(5) Securities sold under repurchase agreements are reported on the Group's balance sheet within due to other banks.

Derivative assets and liabilities

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

Repurchase agreements

Repurchase agreements will typically be subject to Global Master Repurchase Agreements ("GMRAs") or similar agreements whereby all outstanding transactions with the same counterparty can be offset and closed out upon a default or insolvency event (i.e. close out netting).

Where the Group has a right of offset on default or insolvency only, the related financial instruments comprise of highly liquid securities pledged, which can be realised in the event of a default or insolvency by the counterparty.

Credit quality of financial assets

An assessment of the credit quality of loans and advances to customers can be found in note 15 with an assessment of the credit quality of investments contained in note 12.

39. Financial risk management (continued)

Credit risk (continued)

Collateral held as security and other credit enhancements

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

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

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

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to business rules and confidence levels. The loan to value ratio of the Group mortgage portfolio is disclosed in note 15.

Commercial property

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

Non-property related collateral

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

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

The following table shows the total non-property collateral held by sector at 30 September 2015 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high quality) and netting. The exposure amount shown below is the total gross exposure (before any Credit Risk Mitigation and Credit Conversion Factors have been applied where applicable) for arrangements which have some form of associated collateral held against it and is not the total exposure for each asset class, as disclosed in the Strategic Report.

39. Financial risk management (continued)

Credit risk (continued)

Collateral held as security and other credit enhancements (continued)

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

2014	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	49	-	-	49	51
Corporates	91	68	66	225	265
Financial institutions	910		-	910	966
Past due items	1	-	1	2	13
Public sector entities	-	-	-	-	-
Regional Government or local authorities	-	-	138	138	144
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	35	-	34	69	165
Secured by mortgages on residential property	6	-	7	13	33
	1,092	68	246	1,406	1,637

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

Risk concentration

Concentration of risk is managed by client/counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to limit exposure to a single entity/counterparty.

Eurozone risk

The Group and Company have no material operations outside the UK and have no direct sovereign exposure to any Eurozone countries (2014: Nil). The Group has an exposure to the European Investment Bank of £100m at 30 September 2015 (2014: £100m).

39. Financial risk management (continued)

Credit risk (continued)

Industry concentration of assets

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

Gross loans and advances to customers including loans designated at fair value through profit or loss	2015 £m	2014 £m
Government and public authorities	27	55
Agriculture, forestry, fishing and mining	1,515	1,677
Financial, investment and insurance	659	421
Property – construction	260	394
Manufacturing	576	733
Instalment loans to individuals and other personal lending (including credit cards)	1,477	1,712
Property – mortgage	20,504	18,444
Asset and lease financing	426	417
Other commercial and industrial	3,340	3,851
	28,784	27,704

Contingent liabilities and credit related commitments (note 33)	2015 £m	2014 £m
Government and public authorities	-	8
Agriculture, forestry, fishing and mining	985	1,022
Financial, investment and insurance	405	43
Property – construction	44	75
Manufacturing	146	188
Instalment loans to individuals and other personal lending (including credit cards)	3,410	3,742
Property – mortgage	1,814	2,107
Other commercial and industrial	1,106	1,373
	7,910	8,558

Financial assets available for sale	2015 £m	2014 £m
Government and public authorities	1,447	1,161
Financial, investment and insurance	15	7
	1,462	1,168

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimis risk position in accordance with the Bank's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

Interest rate risk in the banking book ("IRRBB").

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

39. Financial risk management (continued)

Market risk (continued)

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

- historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- VaR and EaR are measured on a statistical basis: 99% confidence level; three month holding period;
- economic capital is allocated for IRRBB based on a higher confidence interval and a longer holding period;
- EaR utilises a twelve month forecast period;
- eight years of business day historical data;
- VaR methodology is based on proportional rather than absolute changes in historical interest rates;
- investment term for capital is modelled with an established benchmark term of between one and five years; and
- investment term for core “non-interest” bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between one and five years.

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of the UK Asset & Liability Committee.

Interest rate risk	Value at risk		Earnings at risk	
	2015 £m	2014 £m	2015 £m	2014 £m
As at 30 September	27	36	9	2
Average value during the year	25	37	5	3
Minimum value during the year	19	32	2	2
Maximum value during the year	29	48	9	8

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

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

Prepayment risk

Customers may prepay certain loans and advances ahead of the contractual repayment schedule. This form of optionality gives rise to prepayment risk for the Group whereby the expected timing of cash flows from loan repayments differs from the actual experience. The impact on the Group would differ according to changes in the level of interest rates.

The Group assesses the risks arising from prepayment behaviour in order to show the potential impact on future cash flows. The impact is also managed through terms and conditions within loans and advances.

Maturity analysis of assets and liabilities

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

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

2015	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,978	-	-	-	-	1,453	6,431
Due from related entities	772	-	-	-	14	-	786
Due from other banks	36	92	-	-	-	-	128
Financial assets available for sale	-	-	100	782	565	15	1,462
Other financial assets at fair value	1	11	78	731	276	-	1,097
Derivative financial instruments	3	27	48	70	137	-	285
Loans and advances to customers	2,221	203	701	3,844	20,137	376	27,482
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	86	58	47	-	-	839	1,030
Total assets	8,097	395	974	5,427	21,129	2,683	38,705
Liabilities							
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	1	1	65	-	-	67
Derivative financial instruments	3	28	41	248	214	-	534
Due to customers	20,370	1,505	2,045	2,487	-	-	26,407
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	135	8	-	380	475	-	998
Bonds and notes	-	14	852	1,973	927	-	3,766
All other liabilities	1,825	114	114	-	-	1,040	3,093
Total liabilities	22,333	2,064	3,056	5,153	1,616	1,040	35,262
Off balance sheet items							
Contingent liabilities	-	25	13	11	52	8	109
Other credit commitments	7,801	-	-	-	-	-	7,801
Total off balance sheet items	7,801	25	13	11	52	8	7,910

Market risk (continued)

Maturity analysis of assets and liabilities (continued)

2014	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,670	-	-	-	-	1,316	5,986
Due from related entities	1,487	-	-	-	-	-	1,487
Due from other banks	13	-	-	-	-	-	13
Financial assets available for sale	-	2	1	101	1,058	6	1,168
Other financial assets at fair value	3	33	105	589	853	-	1,583
Derivative financial instruments	2	29	59	47	83	-	220
Loans and advances to customers	2,519	293	769	4,063	17,893	364	25,901
Due from customers on acceptances	-	5	-	-	-	-	5
All other assets	143	71	45	-	-	770	1,029
Total assets	8,837	433	979	4,800	19,887	2,456	37,392
Liabilities							
Due to other banks	-	664	250	-	-	-	914
Other financial liabilities at fair value	-	2	6	65	18	-	91
Derivative financial instruments	2	36	60	170	280	-	548
Due to customers	17,872	2,039	2,464	1,698	-	-	24,073
Liabilities on acceptances	-	5	-	-	-	-	5
Due to related entities	359	8	346	838	1,126	-	2,677
Bonds and notes	-	20	730	2,039	664	-	3,453
All other liabilities	1,938	107	65	-	-	983	3,093
Total liabilities	20,171	2,881	3,921	4,810	2,088	983	34,854
Off balance sheet items							
Contingent liabilities	-	32	25	12	61	6	136
Other credit commitments	8,422	-	-	-	-	-	8,422
Total off balance sheet items	8,422	32	25	12	61	6	8,558

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

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

2014	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	665	250	-	-	-	915
Other financial liabilities at fair value	-	3	9	79	20	-	111
Trading derivative financial instruments	2	36	24	74	275	-	411
Due to customers	17,873	2,050	2,487	1,721	-	-	24,131
Liabilities on acceptances	-	5	-	-	-	-	5
Bonds and notes	-	40	782	2,214	880	-	3,916
All other financial liabilities	1,504	-	-	-	-	-	1,504
Hedging derivative liabilities							
Contractual amounts payable	-	85	481	840	34	-	1,440
Contractual amounts receivable	-	(55)	(429)	(705)	-	-	(1,189)
Total liabilities	19,379	2,829	3,604	4,223	1,209	-	31,244

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

40. Management of risk

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy, as well as that of its ultimate parent entity NAB. The key components of the Group's risk management strategy are detailed below:

Risk control and management

Risk culture

Establishing and maintaining an appropriate risk framework within the Group is a key objective. Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships, to which end they seek to establish effective risk governance, a sound risk appetite framework, clearly defined enterprise behaviour and compensation practices that promote appropriate risk taking behaviour.

Initiatives that support the appropriate risk culture include: the performance management framework, which incorporates an assessment of factors including risk management, behaviour and a transparent compliance gateway rating; training; and escalation procedures (both through the management hierarchy and anonymously through the Group's whistle-blower facility) allowing staff to raise concerns; messaging from the Chief Executive Officer and members of the CYB Leadership Team of the Group, which has been delegated authority by the Board.

The Board and senior management are responsible for providing a clear view of risk culture through their actions and words, and proactively address any identified areas of weakness or concern. They must ensure:

- all employees understand and adhere to the core components of the Risk Management Framework; and
- failures in risk culture, either internal or external, are reviewed at all levels of the organisation and are seen as an opportunity to strengthen our risk culture and make it more robust.

Underpinning the risk management operating model, and at the heart of the Group's risk culture, is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model (which articulates specific accountabilities for core elements of risk management across the Group) and a formal delegation framework through which staff are able to make risk based decisions.

Strategic planning and risk appetite

'Risk Appetite' is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives. The Board formally approve the Group's Risk Appetite Statement ("RAS"), in line with the strategic planning process.

Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the RAS process. More broadly, the RAS articulates and helps communicate risk appetite incorporating the broad direction of risk taking activity; physical capital available; limits on capital use; and quantitative and qualitative measures put in place to restrict or moderate risk taking activities. An understanding of risk appetite, and its overarching tone, provides direction to the level of risk the Group is prepared to take which is ultimately reflected in changes to the Group's risk profile. As such it operates as a defence against excessive risk taking beyond the Board approved appetite thresholds and supports the delivery of the Group's strategic initiatives.

To further embed risk appetite top down through the organisation, individual Business Units have supporting Risk Setting Statements ("RSS"). RSSs are defined as supplementary measures which are Business Unit specific and are intrinsically linked to RAS settings, support the Group's strategy and drive management decisions.

Monthly reporting to the Asset & Liability Committee, Risk Committee and Board includes details of performance against relevant RAS and RSS settings (breaches and trends).

Risk control and management (continued)

Risk Management Framework

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the businesses' front-line teams to be effective. This overriding principle embodies the following concepts:

- commercial decisions should be made on the basis of proactive consideration of risk and the impact on customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components; and
- employees are responsible for risk management in their day-to-day activities.

Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. Within this context, the Group manages risk within a "three lines of defence" framework. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are responsible for ensuring that the risk and control environment is actively and appropriately managed through the provision of risk insight, appetite and oversight. The third line of defence is the internal audit team, which provides independent assurance and reporting on the effectiveness of the risk management and internal control environment.

Risk Governance

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

The NAB Group Risk and Reward Management Committee, chaired by the NAB Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance on the performance of the overall Risk Management Framework. This Committee is supported by four sub-committees - the NAB Group Credit and Market Risk Committee, the NAB Group Asset and Liability Committee, the NAB Group Regulatory Compliance & Operational Risk Committee and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated by the Boards' Risk and Audit Committees, the Boards approve the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Group's Corporate Governance statement on the Group's website (www.cbonline.co.uk) for further information on Board committees. The table below details the Group's Governance and Management Assurance Committees and their risk focus.

40. Management of risk (continued)

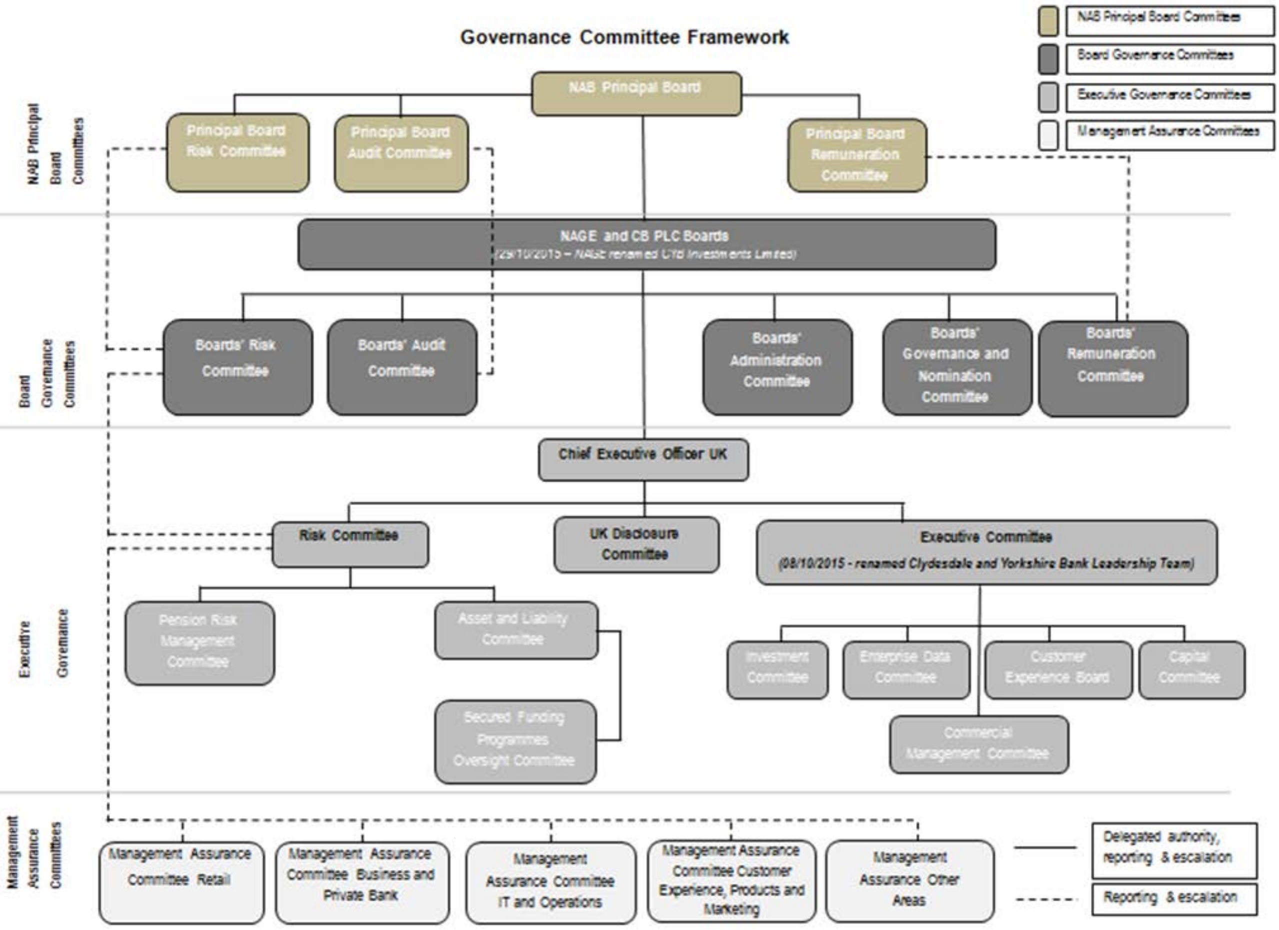
The following Governance Committees have been established under the authority of the Chief Executive Officer UK (CEO)	
Committees	Risk Focus
Risk Committee	The Management Risk Committee supports the CEO in respect of his risk and control accountabilities and serves to provide leadership focus on key risk issues including: • Devising the Risk Appetite Statement for approval by the Boards; • Overseeing and challenging the enterprise wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools; • Monitoring the status of regulatory relationships, the reputation of the Group in relation to its regulators and the changing state of the regulatory landscape including the impacts for and readiness of the Group; • Monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and • Reviewing and endorsing risk policies, frameworks and tools for use across the Group.
UK Disclosure Committee	The UK Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations of the exchange(s) on which it has securities listed.
Clydesdale and Yorkshire Bank Leadership Team	The Clydesdale and Yorkshire Bank Leadership Team supports the CEO to lead the Group to be a strong, customer focused bank for its communities by focusing on four business priorities; customers, risks and controls, sustainable returns and people.
The Risk Committee is supported by the following Committees:	
Pension Risk Management Committee	The Pension Risk Management Committee is responsible for overseeing pension risk management and strategy. This Committee also oversees and governs interaction with UK pension scheme trustees.
Asset & Liability Committee	The Asset and Liability Committee is responsible for monitoring the performance of the Group against the Boards' approved capital and funding plans. The Committee focuses on the Group's non-traded market risks including capital, funding, liquidity, interest rate risk and pension risk to ensure that the Group's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives.
Secured Funding Programmes	The Secured Funding Programmes Oversight Committee is responsible for supporting the Asset and Liability Committee in relation to its risk monitoring and oversight responsibilities of all secured funding programmes and supporting the CEO in relation to the compliance of the Regulated Covered Bond ("RCB") Programme with FCA regulations and the RCB Sourcebook.
The Clydesdale and Yorkshire Bank Leadership Team is supported by the following Committees:	
Enterprise Data Committee	The Enterprise Data Committee is responsible for providing direction and oversight of information and data practices, including oversight of management's resolution of data issues.
Commercial Management Committee	The Commercial Management Committee supports the Executive Committee with management of pricing decisions, sales performance, mortgage and term deposit product balance sheet maturities, review of customer funding plan and visibility of external environment.
Capital Committee	The Capital Committee is responsible for ensuring effective governance of UK capital usage and performance. This includes monitoring key capital and related performance metrics; development of infrastructure to deliver key capital measures out to business functions; and optimising capital efficiencies.
Customer Experience Board	The Customer Experience Board is responsible for championing the end to end customer experience. This included 'Treating Customers Fairly' principles, management actions for insight, culture, capability and complaints policy management and reporting.
Investment Committee	The Investment Committee is responsible for prioritising, approving and reviewing execution of the approved Group strategy via an investment portfolio of projects that align to strategic outcomes, fair customer outcomes, balanced risk outcomes and provide sustainable and appropriate returns.

40. Management of risk (continued)

First line responsibility for risk management resides with the business unit director supported by the Management Assurance Committees which provide reports to the Risk Committee based on the Board's risk profile

Management Assurance Committee (Retail; Business and Private Bank; IT & Operations; Customer Proposition; Other Areas)	Each major first line business unit has established a Management Assurance Committee, which supports the business unit director to lead the business unit in respect of risk matters and provides advice, guidance, challenge and recommendations. This includes recommending risk setting statements to the Risk Committee; monitoring performance against risk settings and tolerances; reviewing the strength of the control environment and risk capability; and monitoring the effectiveness of risk culture and on-going compliance with regulatory requirements.

The Group's risk management structure as at 30 September 2015 is diagrammatically represented below:



The UK Risk Management team independently monitors and systematically assesses the risk profile within the Group against established risk appetite parameters. They also assist the front line business units in the design and implementation of appropriate risk management policies and strategies and work with the business units to promote awareness of the need to manage risk.

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

Stress testing within the Group has been developed to inform future business and risk planning initiatives, strategic risk management (including risk appetite setting) and capital management. Specifically, stress testing is used or considered in informing the following management decisions:

Risk appetite and strategic business planning - As part of an annual assessment of future opportunities for, and threats to, the Group, stress testing outputs are used to inform the strategic planning process and to develop risk appetite settings.

Capital planning ("ICAAP") - Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP process.

Liquidity management ("ILAA") - Scenarios provide insight into potential vulnerabilities in the Group's funding strategies. Regular stress tests are undertaken to understand and monitor exposure to liquidity risk with their regularity being aligned to the nature of, and exposure to, the risk type.

Recovery plan ("RP") – the RP (including the Contingency Funding Plan) helps inform both stress testing and reverse stress testing scenario development. Reverse stress testing explores circumstances, or a set of circumstances, that render the Group's business model unviable, moving the Group into a resolution by the authorities. As a result, these stresses are recognised as a required risk management tool in the form of an early warning indicator of potential stress events.

Strategic risk management - stress testing informs the nature and level of risk carried by the Group arising from opportunistic assessments such as investments, divestments and acquisitions through emerging material risks posed by trends in, or changes to, the business environment.

Stress Testing Oversight and Governance

The CYB Leadership Team are responsible for ensuring that the outcome of the capital stress testing is subject to robust challenge and endorsement prior to Board approval.

Asset and Liability Committee ("ALCO") - The ALCO reviews the scenarios, assumptions and results of liquidity stress testing. The results of liquidity stress scenarios are reported to the ALCO monthly. These scenarios are the liquidity stress scenarios approved by the Board as part of the individual liquidity adequacy assessment.

Clydesdale and Yorkshire Bank Leadership Team - The CYB Leadership Team are engaged in stress testing to provide review, discussion and debate into the scenario selection process, based on their experience and knowledge as heads of each business unit. The CYB Leadership Team also consider and assess results in the context of future strategic decision-making, contingency planning, capital and business planning.

Board of Directors – The Board engages at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to scenario selection and development. In addition, the Board considers how the results are integrated into the future strategic decision-making, contingency planning, capital and business planning and risk appetite.

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality.

40. Management of risk (continued)

Credit risk (continued)

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

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Group Credit and Market Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the NAB Group Chief Credit Officer (and associated teams) provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management within the UK, with appropriate oversight through the UK Executive Governance Committees.

The Group's credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

Single large exposure policies are in place within the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems or from external events. This includes legal risks as well as operational risk components associated with other risks categories (e.g. credit, traded market, non-traded market).

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events. These risk categories are defined as follows:

- Customer, products and sales practices ("conduct risk") – the treatment of customers and the management of customers impacts on all the Group's core activities. This is a principal focus of the Board, senior management and the regulators and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, that customer expectations are met and complaints are dealt with effectively and fairly. Consideration of customer outcomes is embedded within the Group's operating processes and metrics are regularly monitored to ensure outcomes are appropriate.
- Regulatory environment and market practices – the Group is required to comply with a large volume of laws and regulations and the regulatory environment has also been subject to substantial change in recent years. This is likely to continue and represents an on-going focus of the Group's management in ensuring the Group continues to operate within prudential parameters and that the conduct of the Group's activities meets the expectations of the Group's customers, shareholders and regulators. The Group operates a zero tolerance for regulatory breaches and organises its activities to ensure controls over regulatory risk are maintained in addition to maintaining a strong, open and trusted relationship with its regulators.
- Monitoring, reporting and oversight – effective controls over business operations are essential for the protection of the Group's customers and shareholders and is a key responsibility of all employees and managers. The Group continues to reinforce frameworks, standards and oversight arrangements to enhance the quality of risk management in the organisation. Each business unit maintains a risk profile with embedded controls and actions to manage inherent risks.
- Payments and process management – the Group processes a large volume of transactions for customers every day and manages the risks in this and other operations to ensure these activities are conducted safely and efficiently. However, in all operational activity there is a potential risk of established procedures not being followed, a failure to detect errors or that inadequate controls are in place.
- External fraud and criminal activities – the Group takes seriously its responsibilities to protect customers against financial crime. This includes preventing fraud activities in all channels through which customers transact; the prevention of money laundering; and compliance with legal sanctions requirements. Fraud management is an ongoing challenge for the financial services industry and presents a constant risk to the Group as criminal activities evolve on a national and global basis. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.

Operational risk (continued)

- Internal fraud and criminal activities – the Group recognises the risk of internal fraud associated with internal acts intended to defraud, misappropriate funds, information and physical assets, and circumvent policy. The Group has zero tolerance for internal fraud and has a strong control framework in place to mitigate this risk.
- Workplace practices and environment – providing a safe environment for customers and colleagues is important for the success of the business and the Group seeks to ensure adequate safeguards are in place and are operating effectively. This includes ensuring there is adequate capacity of resource, with clearly defined objectives and an effective and efficient management structure in place. The Group also recognises the importance of ensuring colleagues have access to industry bench marked training and education material to ensure resources have the required skills and competencies.
- Systems and infrastructure – There is a risk of service interruption due to failure of the Group's systems leading to a period of service disruption. The Group has a strong framework of controls over the continuity of service provision for all critical processes including recovery procedures in the event of unplanned service interruption. A specific example of a Systems and infrastructure risk that is recognised across the industry is Cyber Attack. Dealing with cyber-attacks is an ongoing challenge for the financial services industry and presents a constant risk to the Group as the motivations constantly change, the techniques become more sophisticated and the resources used in the attacks become more readily available as a commodity service. The Group has implemented industry standard tools and internal controls to help prevent external intrusions of the Group's systems and loss of sensitive information; these controls ensure compliance with regulation. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Third party providers - Failure to manage third party providers effectively may also impact on the level of service available to customers. The Group's controls to mitigate this risk include regular oversight of third party processes and assurance testing of the effectiveness of relationship management.

Responsibility for the management of operational risk rests with the business managers with oversight from the risk management function with additional guidance and functional oversight provided by Policy Owners and technical specialists e.g. Information Security, Supplier Management. Independent assurance activities are undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. It is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes and includes:

- an established governance structure that is used to ensure consistent application, control and reporting of the Operational Risk Management process. This element also includes the establishment and communication of the Group's operational risk appetite; and
- a structured process to facilitate the identification, quantification and management of risks underpinned by clear policies and guidelines. Material risks are reported monthly to the Management Assurance Committees and the UK Risk Committee, and to each Boards' Risk Committee to provide visibility and understanding of the Group's overall risk profile.

Balance sheet risks

Balance sheet risks include liquidity and funding risk, structural interest rate risk, foreign exchange risk and risks associated with the Group's defined benefit pension scheme. The primary objective for the management and oversight of balance sheet risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

Policies relating to balance sheet risks are approved by the Board of the NAB Group. The consistent application of NAB Group polices across the Group is the responsibility of the Group's Board with the support of executive management governance committees. In relation to balance sheet risks, the primary management committee is UK ALCO.

Risk appetite and limits are approved for balance sheet risks by the Group's Board, with authority delegated to UK ALCO for their subsequent implementation and monitoring.

UK ALCO meets monthly and reports to the UK Risk Committee. The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from UK Risk.

40. Management of risk (continued)

Balance sheet risks (continued)

Liquidity and funding risk

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

Liquidity within the Group is managed in accordance with the ILAA that is approved by the Board. The ILAA documents the manner in which the Group meets its Overall Liquidity Adequacy Rule which covers all regulatory and internal liquidity requirements. In addition the Group has a Liquidity Policy that details, amongst other items, the control standards and risk measurement requirements for liquidity and authorities and responsibilities. Oversight of liquidity risk is undertaken by UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group is also monitored by NAB Group ALCO. To meet the requirements of local regulatory authorities the liquidity of the Group is managed on a daily basis as a stand-alone undertaking using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. UK ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances.

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

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

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

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

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

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and NAB Group ALCO.

There are three major contributors to interest rate risk:

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

40. Management of risk (continued)

Balance sheet risks (continued)

Structural interest rate risk (continued)

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk management across the Group is directed by UK ALCO with delegation for day-to-day management to the Group's Treasury division. The UK Risk Committee, through UK ALCO oversight, monitors risk to ensure it remains within approved policy, limits and Board requirements.

Basis risk is managed through a combination of wholesale market products, pricing strategies and product innovation.

A key feature of the risk management and oversight framework is the use of VaR as a measure of interest rate risk, along with EaR to measure the impact on future earnings. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group's Balance Sheet & Liquidity Risk Oversight team that is independent of the Treasury division.

Foreign exchange risk

Exposures arise if future cash flows can only be converted to GBP at a rate different to that prevailing at the time of the original transaction. The Group's policy is to fully hedge these exposures at the time of commitment for all exposures that are considered to be of a marketable size.

The transactional currency exposures principally arise from dealings with customers and from wholesale funding transactions and the Group maintains a matched position through transactions with a range of counterparties including the NAB Group in order to comply with the Group's Trading Policy Statement.

Pension risk

Pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. The operation of a pension scheme gives rise to a number of risks, e.g. movements in equity valuations, changes in bond yields and life expectancy of scheme members. The Scheme is managed by independent Trustees. However, the impact of the Scheme on the Group is subject to management by the Group and corresponding risk oversight. The Group's Pension Risk Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support its business strategy against losses, inherent risks and stress events. In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks. The Group is committed to maintaining a strong capital base.

The Group is currently governed by NAB Group's Capital Management Policy. The objectives of the policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators' requirements and managing the ratings agencies assessment of the Group.

The UK Capital Plan is approved by the UK Boards on an annual basis. UK ALCO monitors the capital plan and forecast positions on a monthly basis. This ensures that in the event that further capital is deemed necessary to meet regulatory requirements or support future strategy, the issue is proactively escalated to senior management and the UK Boards to determine the most appropriate strategy for the Group to achieve the desired capital outcome.

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, which implemented CRD IV legislation with effect from 1 January 2014.

41. Capital management overview (continued)

CRD IV also provides for new regulatory capital buffers including a Capital Conservation Buffer ("CCB") and Counter-Cyclical Buffer ("CCyB") to replace the existing Capital Planning Buffer ("CPB"). The CCB will, when fully adopted in 2019, equate to 2.5% of RWAs, whilst the level of the CCyB is dependent upon the authorities' view of credit conditions in the economy. With effect from May 2014, the Financial Policy Committee ("FPC") at the Bank of England assumed formal responsibility for setting the CCyB each quarter. At its September 2015 meeting, the FPC maintained the CCyB rate for UK exposures at 0%. Further detail on the Group's regulatory capital is included on pages 17 to 20 of the Strategic Report.

The PRA announced further changes to their approach to assessing Pillar 2A capital requirements in July 2015 (PRA Policy Statement PS17/15) and the Basel Committee on Banking Supervision is currently consulting on potential changes to the standardised approach for credit risk (issued in December 2014). The Group is currently assessing the potential impacts of these proposals.

The Financial Services (Banking Reform) Act 2013 received Royal Assent in December 2013. The Act seeks to protect deposit holders and ensure the PRA can hold banks to account. The reforms may affect the structure of banks and the amount of capital held. The key aspect of the Act is to establish the concept of ring fenced bodies ("RFB"). A RFB is defined by reference to its core retail deposits which fall within the ring fence and which cannot be allowed to leak outside the ring fence. One of the thresholds for inclusion as a RFB is minimum core customer deposits of £25bn. The PRA has since released a consultation paper (The Implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities). The Group continues to closely monitor progress in this area.

42. Pillar 3 disclosures

Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation ("CRR"). The first consolidated disclosures of the Group, for financial year 2015, can be found at www.cbonline.co.uk.

Since the introduction of Pillar 3 requirements in 2008 under Basel II the Group has previously met the disclosure requirements on a NAB Ltd consolidated level. This was on the basis that equivalent disclosures are made by a parent undertaking which met CRR Article 13(3) and previously PRA (formally the FSA) requirements.

The Group continues to be included in the consolidated NAB Pillar 3 2015 report in addition to publishing its own Pillar 3 disclosures. The NAB 2015 Pillar 3 can be found at http://www.nab.com.au/about-us/shareholder-centre/regulatory-disclosures.

43. Events after the balance sheet date

Conduct indemnity

On 28 October 2015, NAB confirmed its intention to divest the Group to CYBG PLC ("CYBG") through a demerger and subsequently list CYBG by IPO in February 2016. CYBG will be the newly created holding company for the Group. The proposed demerger is subject to a range of matters including various court and regulatory approvals and NAB shareholder approval.

In order to achieve the proposed CYBG demerger and IPO the PRA requires capital support for CYBG of £1.7bn in relation to potential future legacy conduct costs. The provisions of £465m recognised in the year ended September 2015 will form part of the £1.7bn support package.

Company name change

On 29 October 2015 the Company name was changed from National Australia Group Europe Limited to CYB Investments Limited.

CYB Investments Limited

Independent auditor's report to the members of CYB Investments Limited on the Company's financial statements

We have audited the financial statements of CYB Investments Limited for the year ended 30 September 2015 which comprise the Company Statement of Comprehensive Income, the Company Balance Sheet, the Company Statement of Changes in Equity, the Company Statement of Cash Flows and the related notes 44 to 50. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 29, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Company's affairs as at 30 September 2015 and of its loss for the year then ended;
- the Company's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditor's report to the members of CYB Investments Limited on the Company's financial statements (continued)

Matters on which we are required to report by exception

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

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

We have reported separately on the Group financial statements of CYB Investments Limited for the year ended 30 September 2015.

Ernst & Young LLP

Andrew Gilder (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
13 November 2015

CYB Investments Limited

Company balance sheet
as at 30 September 2015

	Note	2015 £m	2014 £m
Assets			
Cash and balances with central banks		-	15
Due from related entities	45	82	776
Current tax assets		4	-
Investments in controlled entities and associates	46	3,071	2,577
Total assets		3,157	3,368
Liabilities			
Current tax liabilities		-	1
Due to related entities	45	101	1,082
Total liabilities		101	1,083
Equity			
Share capital	47	223	1,882
Other equity instruments	48	450	300
Share premium	48	670	-
Other reserves	48	-	100
Retained earnings	48	1,713	3
Total equity		3,056	2,285
Total liabilities and equity		3,157	3,368

The notes on pages 136 to 141 form an integral part of these financial statements.

Company statement of changes in equity for the year ended 30 September 2015

	Note	Share capital £m	Share premium account £m	Capital redemption reserve £m	Other equity instruments £m	Retained earnings £m	Total parent entity interest £m
As at 1 October 2013		1,682	-	-	-	489	2,171
Loss for the year		-	-	-	-	(386)	(386)
Other comprehensive income, net of tax		-	-	-	-	-	-
Total comprehensive losses for the year		-	-	-	-	(386)	(386)
Capital note issued		-	-	-	300	-	300
Shares repurchased		(100)	-	-	-	-	(100)
Shares issued – ordinary		300	-	-	-	-	300
Transfer to capital redemption reserve		-	-	100	-	(100)	-
As at 30 September 2014	47, 48	1,882	-	100	300	3	2,285
Loss for the year		-	-	-	-	(381)	(381)
Other comprehensive losses, net of tax		-	-	-	-	-	-
Total comprehensive losses for the year		-	-	-	-	(381)	(381)
AT1 distributions paid	9	-	-	-	-	(18)	(18)
Capital note issued		-	-	-	150	-	150
Shares issued – ordinary		350	670	-	-	-	1,020
Nominal share value reduction		(2,009)	-	-	-	2,009	-
Transfer from capital redemption reserve		-	-	(100)	-	100	-
As at 30 September 2015	47, 48	223	670	-	450	1,713	3,056

The notes on pages 136 to 141, and cross referenced above, form an integral part of these financial statements.

CYB Investments Limited

Company statement of cash flows
for the year ended 30 September 2015

	Note	2015 £m	2014 £m
Operating activities			
Loss on ordinary activities before tax		(385)	(390)
Adjustments for:			
Non-cash or non-operating items included in loss before tax	49	385	368
Tax (paid)/received - group relief		(1)	11
Net cash provided by/(used in) operating activities		(1)	(11)
Cash flows from investing activities			
Dividends received		13	14
Investment in controlled entities		(1,220)	(300)
Net cash used in investing activities		(1,207)	(286)
Cash flows from financing activities			
Interest received		7	10
Interest paid		(7)	(16)
Proceeds from ordinary shares issued		1,020	300
Redemption of preference shares		-	(100)
Proceeds from other capital issued		150	300
Return of capital from controlled entities		310	-
Redemption of subordinated debt		(605)	-
Redemption of subordinated loans		485	-
Net decrease/(increase) in amounts due from related entities		199	(6)
Net decrease in amounts due to related entities		(314)	(181)
AT1 distributions		(18)	-
Net cash provided by financing activities		1,227	307
Net increase in cash and cash equivalents		19	10
Cash and cash equivalents at the beginning of the year		15	5
Cash and cash equivalents at the end of the year		34	15

The notes on pages 136 to 141 form an integral part of these financial statements.

44. Company basis of preparation

The Company is incorporated in the UK and registered in England and Wales.

The Company financial statements of CYB Investments Limited, the Parent Company (the Company), which should be read in conjunction with the Group Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. No individual profit and loss account is presented for the Company, as permitted by Section 408 of the Companies Act 2006.

Basis of measurement

The financial information has been prepared under the historical cost convention.

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The accounting policies of the Company are the same as those of the Group which are set out in note 2 of the consolidated financial statements except that the Company has no policy in respect of consolidation. These accounting policies have been applied consistently to all periods presented in these financial statements.

45. Company related party transactions

During the year there have been transactions between the Company, its ultimate parent, controlled entities of the ultimate parent, controlled entities of the Company, and other related parties.

The Company receives a range of services from the parent and related parties, including loans and deposits, forward exchange and interest rate cover and various technical and administrative services.

Amounts due from related entities	2015 £m	2014 £m
Loans		
Controlled entities of the Company	82	247
Subordinated loans		
Controlled entities of the Company	-	526
Other receivables		
Controlled entities of the Company	-	3
Total amounts due from related entities	82	776

Included within the amounts due from related parties is £34m (2014: £Nil) of cash and cash equivalents (note 49).

45. Company related party transactions (continued)

Amounts due to related entities	2015 £m	2014 £m
Deposits		
Controlled entities of the ultimate parent	101	100
Controlled entities of the Company	-	313
	101	413
Subordinated liabilities		
Ultimate parent	-	322
Immediate parent	-	344
	-	666
Other payables		
Controlled entities of the ultimate parent	-	3
Total amounts due to related entities	101	1,082

46. Company investments in controlled entities and associates

	2015 £m	2014 £m
At 30 September	3,071	2,577

As a part of a Group rationalisation programme, a number of the Company's subsidiaries were placed into voluntary liquidation with capital returned to the parent.

On 30 September 2015 the Company sold its investment in CYB Services Limited to its subsidiary undertaking, Clydesdale Bank PLC for its book value of £2.

The Company subscribed to £50m ordinary shares issued by Clydesdale Bank PLC on 19 June 2015, and further subscribed to £620m ordinary shares on 24 September 2015 and £100m ordinary shares on 30 September 2015. On 29 December 2014, the Company also subscribed to Perpetual Capital Notes which were issued by Clydesdale Bank PLC with a principal amount of £350m and subscribed to a further £100m on 30 September 2015. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV.

On 25 March 2015, 337,500,000 B shares of £1 were issued by Clydesdale Bank PLC on the capitalisation of its merger reserve. All B shares issued were at par and fully paid up and issued for £Nil consideration. On 28 May 2015, the 337,500,000 shares were cancelled for £Nil consideration.

There were capital reductions of £300m in National Americas Holdings Limited and £10m in National Australia Group Europe Investments Limited in advance of these entities being placed into voluntary liquidation.

Impairment review for subsidiary undertakings

As highlighted in note 3 to the consolidated financial statements, an impairment test on the carrying value of the Company's investment in Clydesdale Bank PLC has been undertaken during the year, resulting in an impairment charge of £416m as at 30 September 2015 (2014: charge of £377m). For the purposes of the impairment test, Clydesdale Bank PLC is regarded as the cash generating unit with the value in use calculation compared to the current carrying value of the investment in Clydesdale Bank PLC in the Company balance sheet.

The key assumptions involved in these calculations are set out below.

46. Company investment in controlled entities and associates (continued)

Key assumptions used in impairment testing

The recoverable amount of the cash generating unit has been derived from a value in use calculation using discounted cash flow techniques and a forecasted performance approved by the Board. Cash flows beyond the forecasted period have been extrapolated using similar forecasted assumptions as in the forecast period. The following rates are used by the Company:

	2015 %	2014 %
Post tax discount rate	10.0	9.9
Projected terminal growth rate	3.9	3.9

The calculation of the value in use is based on a Board approved five year forecast projection and is then extrapolated forward with a terminal growth rate applied. The five year forecast projections encompass a range of economic indications such as GDP growth, unemployment statistics as well as a range of other business assumptions specific to Clydesdale Bank PLC such as asset volumes, product volumes and margins which are commercially sensitive. The Board is satisfied that the assumptions used both within and beyond the forecasted period are appropriate and reasonable at the balance sheet date.

Discount rate

The discount rate applied reflects the current market assessment of the risk specific to Clydesdale Bank PLC. The discount rate was calculated by reference to a series of internal indicators combined with certain identifiable and available sector specific information. The impairment model used is based on post-tax cash flows and utilises a post-tax discount rate. A comparable pre-tax discount rate for the year would be 12% (2014: 12%).

Projected terminal growth rate

The projected terminal growth rate is based on management's expectation of the long term average growth prospects for UK GDP after taking into account the broader historic UK economic outlook and trends.

Sensitivity to changes in assumptions

Changes in the post-tax discount rate or projected terminal growth rate will impact the Company's assessment of the value in use of Clydesdale Bank PLC. If adjusted independently of all other variables, a 10 basis point increase in the post-tax discount rate would result in an additional impairment charge of £58m (2014: £34m) and a 10 basis point decrease in the projected terminal growth rate would result in an additional impairment charge of £34m (2014: £55m).

46. Company investments in controlled entities and associates (continued)

The table below represents the subsidiaries of the Group and Company as at 30 September 2015:

Wholly owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation
Clydesdale Bank PLC	Banking	Ordinary	100%	Scotland
Yorkshire Bank PLC	Dormant	Ordinary	100%	England
CYB Services Limited (formerly known as National Australia Group Europe Services Limited)	IT and Group services	Ordinary	100%	Scotland
Wave (No.4) Limited	In liquidation	Ordinary	100%	Scotland
National Australia Bank Pension Trustee (UK) Limited	Pension trustee	Ordinary	100%	Scotland
CYB SSP Trustee Limited (formerly known as National Australia Group SSP Trustee Limited)	Pension trustee	Ordinary	100%	England
Wave (No.3) Limited	In liquidation	Ordinary	100%	England
CYB Intermediaries Holdings Limited (formerly known as National Wealth Management Europe Holdings Limited)	Insurance intermediary	Ordinary	100%	England
CYB Intermediaries Limited (formerly known as National Australia Insurance Services Limited)	Insurance intermediary	Ordinary	100%	England
YCBPS Property Nominee Company Limited	Property management	Ordinary	100%	England
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland
St Vincent (Equities) Limited	Investment company	Ordinary	100%	England
Shadwell Holdings (UK) Limited	Investment company	Ordinary	100%	England
Craig Yr Haul Management Company Limited	Property management	Ordinary	100%	England
CB Nominees Limited	Dormant	Ordinary	100%	Scotland
11 Tudor Hill Residential Management Company Limited	Dormant	Ordinary	100%	England
Fairway Views (Compton Avenue) Management Company Limited	Dormant	Ordinary	100%	England
Linton Springs Residential Management Company Limited	Dormant	Ordinary	100%	England
St Johns Place Residential Management Company Limited	Dormant	Ordinary	100%	England
Yorkshire and Clydesdale Bank Foundation	Charitable foundation	Ordinary	100%	England
Gracechurch Commercial Investments Limited	In liquidation	Ordinary	50%	England
Plaza Ventures Limited	Property management	Ordinary	100%	Scotland
Yorkshire and Clydesdale Bank Pension Trustee Limited	Pension trustee	Ordinary	100%	Scotland

In addition to the above, the Company also has an interest in a number of securitisation vehicles. Full details of these can be found in note 21 to the consolidated financial statements.

All subsidiaries have a 30 September year end with the exception of Craig Yr Haul Management Company Limited which is 31 January.

47. Company called up share capital

Information on share capital is provided in note 31 to the Group's consolidated financial statements.

48. Company total equity

	2015 £m	2014 £m
Share capital (note 31)	223	1,882
Share premium account	670	-
	893	1,882
Other equity instruments	450	300
Capital redemption reserve	-	100
Retained earnings	1,713	3
Total equity	3,056	2,285

Other equity instruments

Other equity instruments represent Additional Tier 1 ("AT1") notes. On 20 December 2013, Perpetual Capital Notes were issued with a principal amount of £300m to the Company's ultimate parent. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV. A further £150m of Perpetual Capital Notes (6m LIBOR + 690bps) were issued to NAB on 29 December 2014. AT1 distributions of £18m were paid in June 2015 as disclosed in note 9 of the Group's consolidated financial statements.

Capital redemption reserve

On 24 March 2015, the full balance of the capital redemption reserve was cancelled and transferred to retained earnings.

49. Company notes to the statements of cash flows

	2015 £m	2014 £m
Adjustments included in the loss before tax		
Interest receivable	(4)	(11)
Interest payable	6	16
Dividends receivable from subsidiaries	(13)	(14)
Net gain on capital restructure	(20)	-
Adjustment to carrying value of investments	416	377
	385	368

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	2015 £m	2014 £m
Cash and balances with central banks	-	15
Due from related parties (note 45)	34	-
	34	15

50. Company fair value of financial instruments

Fair value of financial instruments carried at amortised cost

The tables below show a comparison of the carrying amounts of financial assets and liabilities measured at amortised cost as reported on the balance sheet and their fair values where these are not approximately equal.

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

- Level 1 fair value measurements - quoted prices (unadjusted) in active markets for identical financial assets or liabilities.
- Level 2 fair value measurements - inputs other than quoted prices within Level 1 that are observable for the financial asset or liability, either directly (as prices) or indirectly (derived from prices).
- Level 3 fair value measurements - inputs for the financial asset or liability that are not based on observable market data (unobservable inputs).

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values are based on relevant information available at the reporting date and involve judgement. The methodologies and assumptions used in the fair value estimates are described in the footnotes to the tables.

There are various limitations inherent in this fair value disclosure particularly where prices may not represent the underlying value due to dislocation in the market. Not all of the Company's financial instruments can be exchanged in an active trading market.

Company	30 September 2015					30 September 2014				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial liabilities										
Due to related entities	101	101	-	101	-	1,082	1,002	-	1,002	-

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

Amounts due from related entities – amounts due from related entities are repayable on demand or within twelve months. As a result, the carrying value approximates the fair value.

Amounts due to related entities – the fair value of subordinated loans due to; and notes issued to related entities is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity. All other amounts due to related entities are repayable under varying maturities but are materially repriced every 3-6 months relative to market rates, as a result, the carrying value approximates the fair value.

Enhanced disclosure task force recommendations

The Group continues to review how it responds to the Enhanced Disclosure Task Force ("EDTF") recommendations that were published in October 2012 and agrees with and supports the primary objectives of the EDTF in improving risk disclosures and providing a greater level of transparency and comparability between banks.

The Group is committed to ensuring compliance with the EDTF's objectives and recommendations and takes a measured and proportionate approach in doing so.

The EDTF's recommendations (categorised into their respective areas) and the Group's responses to these are provided in the following table:

EDTF recommendations	Description	Location within the Group's annual report & consolidated financial statements
1 to 4	General recommendations	• Strategic Report (highlights/business model challenges and top and emerging risks) • Note 39 • Note 40 • Note 41 • Glossary
5 to 8	Risk governance and risk management strategies/business model	• Strategic Report (business model challenges and top and emerging risks) • Note 40
9 to 17	Capital adequacy and risk-weighted assets	• Strategic Report (capital position) • Note 41 • Note 42 Disclosures in this area are consistent with the standardised approach
18 to 21	Liquidity and funding	• Strategic Report (funding and liquidity) • Note 39 • Note 40
22 to 25	Market risk	• Note 39 • Note 40 The Group does not operate a trading portfolio and there is no appetite for traded market risk other than the de minimus positions that arise from the timing of hedging transactions
26 to 30	Credit risk	• Note 14 • Note 15 • Note 16 • Note 39
31 to 32	Other risks	• Strategic Report (business model challenges and top and emerging risks) • Note 27 Other than the above, the Group has not identified other risk types that are deemed material for disclosure purposes

Further relevant disclosures can also be found in the Group's Pillar 3 disclosures which can be downloaded from https://secure.cbonline.co.uk/debtinvestors/clydesdale-bank-update/.

Glossary

Term	Definition
Additional Tier 1 securities	Securities that are considered additional tier 1 (“AT1”) capital in the context of CRD IV.
APRA	Australian Prudential Regulatory Authority.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Bank Levy	This is applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the “International Convergence of Capital Measurement and Capital Standards”.
Basel III	In December 2010, the Basel Committee issued final rules “Basel III: A global regulatory framework for more resilient banks and banking systems” and “Basel III: International framework for liquidity risk measurement, standards and monitoring”. Together these documents present the Basel Committee’s reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements are being phased in starting 1 January 2014 with full implementation by 1 January 2019.
Business lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.
Collateral	The assets of a borrower that are used as security against a loan facility.
Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Commercial paper	An unsecured promissory note issued to finance short term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.
Company	CYB Investments Limited (formerly known as National Australia Group Europe Limited).
Conduct risk	The risk that the Group’s behaviours (culture, governance, systems and controls) have led to inappropriate customer outcomes.
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
Common Equity Tier 1 capital (“CET1”)	The highest quality form of regulatory capital that comprises total shareholders’ equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.

Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
CRD IV	The European Union's ("EU") proposal to implement Basel III, the international agreement on bank capital standards agreed at G20 level. It replaces the EU's earlier capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. The CRD IV package raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision.
CRE	Commercial real estate.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty. Also known as a credit valuation adjustment ("CVA").
Customer deposits	Interest bearing, non-interest bearing and term deposits (including retail and corporate deposits).
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Defined Liquidity Group	The defined liquidity group includes all material operating entities within the Group, excluding consolidated securitisation entities. It reflects the regulatory view with respect to oversight of the Group's liquidity position and resources.
Delinquency	See "Arrears".
Derivative	A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
Earnings at risk ("EaR")	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Effective interest rate method ("EIR")	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (Level 2 and Level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
FCA	Financial Conduct Authority.

Forbearance	The term generally applied to the facilities provided to assist borrowers, both retail and non-retail, who are experiencing, or are about to experience, a period of financial stress. Forbearance can take a variety of forms such as negotiating an arrangement or short term promise to pay, transfer to interest only terms, or term extensions. The granting of a forbearance measure to a borrower is as a consequence of concerns about the borrower's ability to meet their contractual payments when due and specifically relates to such instances where the changes to the existing arrangement have been made on terms that the Group would not ordinarily consider to be on a commercial basis.
Forborne performing loans	Loans to which forbearance measures have been granted and which are less than or up to ninety days past due and do not otherwise meet the criteria of forborne non-performing loans.
Forborne non-performing loans	Forborne non-performing loans to which forbearance measures have been granted and which are more than ninety days past-due, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.
FSCS	Financial Services Compensation Scheme. The FSCS is the UK's compensation fund of last resort for customers of authorised financial services firms. The Group may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	CYB Investments Limited (formerly known as National Australia Group Europe Limited) and its controlled entities.
Hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value of hedging instruments not being fully offset by changes in fair value of hedged items.
Housing lending	Mortgages secured by residential properties as collateral.
IFRS	International Financial Reporting Standards as issued by the International Accounting Standards Board.
Impaired loans	Retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
Impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This may be assessed at either the individual level or collectively.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
Interest rate risk	The risk to the Group's financial performance and position caused by changes in interest rates.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.

Investment grade	This is the highest possible range of credit ratings, from "AAA" to "BBB", as measured by external credit rating agencies.
IRHP	References to "IRHP" incorporate: (i) standalone hedging products identified in the Financial Services Authority ("FSA") 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan ("TBL") products; and (iii) the Group's secondary review of all fixed-rate tailored business loans ("FRTBLs") complaints which were not in scope for the FSA notice.
IRRBB	Interest rate risk in the banking book.
Key management personnel	Directors of the Group, members of the UK leadership team and PRA approved persons with a controlled function 1 – 28 (as defined in SUP 10B.4.3 within the PRA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10B/4) and FCA approved persons with an FCA controlled function 1 – 29 (as defined in SUP 10A.4.4 within the FCA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10A/4#DES95).
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio	This is a regulatory standard ratio proposed by the Basel III reforms and is the Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee has proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.
LIBOR	London Interbank Offered Rate.
Liquidity coverage ratio ("LCR")	The stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loan to value ("LTV")	A mathematical calculation that expresses the amount of a loan as a percentage of the value of security. A high LTV indicates that there is less of a cushion to protect the lender against asset price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of CYB Investments Limited (formerly known as National Australia Group Europe Limited).

Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net interest margin	Net interest income as a percentage of average interest earning assets.
Net profit/(loss) attributable to owners of the Group	Represents the Group's statutory profit/(loss) after tax and reflects the amount of net profit that is attributable to owners.
Net promoter score	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Group, and a consumer.
Net stable funding ratio ("NSFR")	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage.
Non-impaired assets 90+ days past due	Consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Past due loans and advances	Loans and advances on which repayments are overdue.
Pension risk	The risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations.
PPI	Payment Protection Insurance.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.
PRA	Prudential Regulation Authority.
Probability of default ("PD")	The probability that an obligor will default (usually within a one-year time horizon).
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by APRA for the consolidated NAB Group and by local regulators (in the UK the PRA) for individual Group companies.
Residential mortgage-backed securities ("RMBSs")	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: • the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non-market extension of principal repayment period); • the Group has previously made a specific provision for the customer/obligor and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. See also forbearance.

Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as personal loans, residential mortgages, overdrafts and credit card balances.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed.
Risk-weighted assets ("RWAs")	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Return on assets ("ROA")	Net profit/(loss) attributable to equity holders of the parent as a percentage of total assets.
Sale and repurchase agreement ("repo")	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counter-party (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically AAA rated securities secured by the underlying financial asset.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Structured entities ("SE")	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. May also be referred to as an SPV.
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ("ECAI") ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.
Tier 2 capital	A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV.
Tier 1 ratio	Tier 1 capital as a percentage of risk-weighted assets.

Tier 2 ratio	Tier 2 capital as a percentage of risk-weighted assets.
Value at risk ("VaR")	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements.

CYB Investments Limited
Other information

Website	www.cbonline.co.uk
Media	Press office 0800 066 5998 press.office@nab.co.uk
National Australia Bank	NAB Group results are available from www.nab.com.au

CYB Investments Limited
(formerly known as National Australia Group Europe Limited)

Pillar 3 Disclosures

30 September 2015

CYB Investments Limited

(formerly known as National Australia Group Europe Limited)

Pillar 3 Disclosures

30 September 2015

Contents

1. Overview

1.1 Background

This document presents the first consolidated Pillar 3 disclosures of CYB Investments Limited and its controlled entities ("the Group") as at 30 September 2015.

The Group's ultimate parent company, National Australia Bank Limited ("NAB"), announced its intention on 7 May 2015 to pursue a demerger and initial public offering ("IPO") of the Group from NAB. As part of preparation for the transaction, the Company changed its name from National Australia Group Europe Limited to CYB Investments Limited on 29 October 2015.

The disclosures have been prepared in accordance with the Capital Requirements Regulation ("CRR") and Capital Requirements Directive (together referred to as CRD IV). CRD IV is designed to implement the Basel III reforms of the Basel Committee on Banking Supervision ("BCBS") and came into force within the European Union ("EU") on 1 January 2014.

Pillar 3 disclosure requirements apply to banks and building societies and aim to promote market discipline through the disclosure of key information about risk exposures and risk management processes.

Since the introduction of Pillar 3 requirements in 2008 under Basel II, the Group has met the disclosure requirements through inclusion within the NAB consolidated Pillar 3 disclosures. This was on the basis that equivalent disclosures were made by a parent undertaking which met CRR Article 13 (3) 'Application of disclosure requirements on a consolidated basis' and previous Prudential Regulation Authority ("PRA") (formerly the Financial Services Authority ("FSA") requirements.

For 2015 the Group, in addition to publishing its own Pillar 3 disclosures, continues to be included in the consolidated NAB Pillar 3 report. The Group Pillar 3 disclosures are published on the Group's website (*https://secure.cbonline.co.uk/debtinvestors/clydesdale-bank-update/*). The NAB 2015 Pillar 3 report can be found at http://www.nab.com.au/about-us/shareholder-centre/regulatory-disclosures.

1.2 Basis of preparation and frequency of disclosures

This document sets out the 2015 Pillar 3 disclosures for the Group, comprising CYB Investments Limited ("the Company") and its controlled entities, including Clydesdale Bank PLC ("the Bank") in accordance with the rules laid out in the CRR (Part 8). The disclosures may differ from similar information in the annual report & consolidated financial statements for the year ended 30 September 2015, which are prepared in accordance with International Financial Reporting Standards. The information in these disclosures is prepared in accordance with regulatory requirements and may therefore not be directly comparable with that information.

The Group uses the Standardised Approach for credit risk, operational risk, market risk and credit valuation adjustment. This approach uses standard risk weighting percentages prescribed within the CRR and PRA implementing rules. The disclosures in this document are based on these approaches.

Throughout the document, unless otherwise specified, credit risk exposures are defined as the aggregate of drawn (on balance sheet) balances, undrawn (off balance sheet) commitments and contingent liabilities prior to the application of credit risk mitigation and prior to the application of credit conversion factors.

Unless otherwise stated, all figures are as at 30 September 2015, the Group's financial year end, with comparative figures for 30 September 2014 where relevant. These disclosures will be published annually, and concurrently with the annual report & consolidated financial statements in accordance with regulatory guidelines. The Group will publish specific information more frequently where it is required under the European Banking Authority ("EBA") guidelines.

1.3 Scope of disclosures

The Pillar 3 disclosures in this document relate to the Group, with the exception of Appendix 1 which contains the disclosures required for the Bank (PRA firm reference number 121873), the Group's principal subsidiary.

There is a requirement to calculate and maintain regulatory capital ratios on both a Group basis and on an Individual Consolidated (or Solo) basis for the Bank. There are no differences between the bases of consolidation of the Group for accounting and prudential purposes. All of the Group's subsidiary undertakings are included in the data provided in the Pillar 3 disclosures. Full details of the Group's subsidiaries are provided in note 46 of the annual report & consolidated financial statements for the year ended 30 September 2015 (https://secure.cbonline.co.uk/debtinvestors/clydesdale-bank-update/).

The subsidiaries included on the Individual Consolidation basis are:

- Yorkshire Bank Home Loans Limited;
- Clydesdale Bank Asset Finance Limited;
- CGF No. 9 Limited; and
- Clydesdale Bank Nominees Limited.

The Group's capital resources are presented in section 3 of this document and the Bank's Individual Consolidated capital resources are presented in Appendix 1 to this document.

The differences between the Group and the Bank are primarily due to:

- intangible assets held by entities that sit outside of the scope of the Bank's Individual Consolidation that are included in the Group consolidation;
- reserves held by entities that sit outside of the scope of the Bank's Individual Consolidation that are included in the Group consolidation;
- amounts included in the Bank's results in relation to transactions with the Group's securitisation vehicles which are eliminated on consolidation;
- the regulatory requirements governing the recognition of qualifying tier 2 capital instruments at the Group level, where issued by the Bank to entities outside the consolidated group; and
- a small impact from the risk weighted assets of these entities.

As a result of these differences, the Group's capital requirements at 30 September 2015 exceeded the Bank's Individual Consolidated capital requirements.

The following companies are securitisation vehicles established in connection with the Group's securitisation programme. Although the share capital of these securitisation vehicles is not owned by the Group, these vehicles are included in the consolidated financial statements as they are controlled by the Group:

- Lanark Holdings Limited;
- Lanark Trustees Limited;
- Lanark Funding Limited;
- Lanark Master Issuer PLC;
- Lanark Options Limited;
- Lannraig Holdings Limited;
- Lannraig Funding Limited;
- Lannraig Master Issuer PLC; and
- Lannraig Trustees Limited.

There are no current or foreseen material practical or legal impediments to the transfer of capital resources or the repayment of liabilities between consolidated entities within the Group, with the exception of assets and liabilities of the Group's securitisation vehicles which are not immediately available to other members of the Group.

1.4 Review and Challenge

These disclosures have been subject to internal verification and are reviewed by the Group's Board Audit Committee on behalf of the Board. The disclosures have not been, and are not required to be, subject to independent external audit and do not constitute any part of the Group's annual report & consolidated financial statements.

1.5 Summary of key capital ratios

Capital ratios are a measurement of a company's financial strength and reflect the level of protection it holds against any unexpected losses.

The key capital ratios under CRD IV for the Group are presented below. Prior year comparatives are also presented on a CRD IV basis.

Table 1: Key ratios

	2015	2014
Common Equity Tier 1 ("CET1") ratio	13.2%	9.4%
Tier 1 capital ratio	15.7%	11.0%
Total capital ratio	18.9%	17.7%
Leverage Ratio	7.1%	5.2%
	£m	£m
Risk Weighted Assets (£m)	18,227	18,645
Total Assets (£m)	38,705	37,392

Further details on the Group's capital ratios, risk weighted assets and leverage ratio are presented in section 3 of this document. Required disclosures for the Bank are presented in Appendix 1.

1.5.1 Key matters arising during the year

The following significant events, which had an impact on the Group's capital and risk management, took place during the year ended 30 September 2015:

Announcement of intention to demerge the Group from NAB
NAB announced its intention to pursue a public market option of a demerger of approximately 75% of CYB Investments Limited and its subsidiaries to NAB shareholders and a sale of the balance by way of IPO (approximately 25%) to institutional investors. A detailed timetable was announced on 28 October 2015.

Issue of additional capital
The Group's Common Equity Tier 1 ("CET 1") ratio increased from 9.4% in September 2014 to 13.2% in September 2015. In December 2014, a capital restructure was completed to strengthen the Group's capital base and ensure that the PRA's prudential capital requirements continue to be met. As part of this restructure, the Group repaid £650m of Tier 2 capital in the form of subordinated loan debt and issued £350m of ordinary shares and £150m of CRD IV compliant Additional Tier 1 ("AT1") perpetual capital notes to NAB Group. Between June and September 2015, the Group issued 2 ordinary shares at their nominal value of £0.10 per share and a premium of £670m as part of the preparation for the demerger and IPO. These actions led to a strengthening of the CET1 ratio. Further capital benefits from balance sheet optimisation resulted in a reduction in credit risk-weighted assets. These actions were partially offset by the impact of conduct charges incurred in the year.

2. Risk Management

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group’s strategy. The Group identifies and manages risk as part of a risk management framework, which is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, monitor, report and control or mitigate all internal and external sources of material risk (the "risk management framework"). The Group's risk management framework is intended to help to:

- identify, analyse and understand each of the material risks at all levels of the Group;
- ensure that appropriate strategies, policies, effective controls and other mitigants are in place and operate effectively;
- provide reliable and meaningful risk information (i.e. reporting) to decision-makers;
- ensure that there is adequate oversight of the risk profile and risk management framework; and
- facilitate a proactive risk culture.

2.1 Risk control and management

2.1.1 Risk management framework

The Group manages risk with a "three lines of defence" framework. The three lines of defence are the business units themselves, the risk function, and the internal audit team. The Group's approach to risk management is based on an overriding principle that a risk management capability must be embedded within business units to be effective. This overriding principle embodies the following concepts:

- commercial decisions should be made on the basis of proactive consideration of risk and the impact on customers;
- business managers should use the risk management framework, which assists in the balancing of risks and rewards;
- employees are responsible for risk management in their day-to-day activities; and
- risk appetite is clearly defined and communicated to support decision making.

Chart 1: Risk management framework

Within this context, control is exercised through a clearly defined delegation of authority, with communication and escalation channels throughout the organisation.

The first line of defence comprises the business units managing the risks associated with their activities. Each business line is responsible for:

- establishing risk settings, including establishing their risk framework and determining the risk parameters, triggers and thresholds based on understanding of the business objectives and the risk profile, and establishing a risk appetite to direct the future environment;
- identifying, measuring, assessing and controlling risks through the day-to-day activities of the business;
- managing risks within the frameworks set by the second line of defence; and
- establishing and maintaining a suite of procedures that guide the operations of the business in accordance with the risk framework and Board-approved risk appetite.

The second line of defence encompasses dedicated risk functions who are responsible for ensuring that the risk and control environment is actively and appropriately managed through the provision of risk insight, appetite and oversight. The second line of defence:

- designs and overseas the risk management framework;
- challenges, validates and endorses the risk settings;
- develops and maintains policies, tools and processes for risk management;
- oversees, monitors and challenges the first line of defence on risk-related activities;
- defines minimum standards and oversees related consequence management undertaken by the first line of defence; and
- provides insight into the appropriateness of the portfolio of risks.

The third line of defence is the internal audit team, which provides independent assurance and reporting on the effectiveness of the risk management framework and internal control environment. The third line of defence is responsible for:

- preparing and updating the scope of the annual Internal Audit Plan presented to the Board Audit Committee ("BAC"), with regular quarterly updates provided;
- preparing periodic Internal Audit reports on the effectiveness of the risk management and internal control environment including annual internal attestations of compliance with regulatory requirements (where necessary), and other relevant matters;
- reporting to the BAC on the adequacy and effectiveness of the Group's risk management framework; and
- meeting privately, on at least an annual basis, with the BAC without management present.

2.1.2 Risk culture

Establishing and maintaining an appropriate risk culture within the Group is a key objective. Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management framework; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and fulfils customer needs. Important aspects of that culture are the establishment of effective risk governance, a sound risk appetite framework, clearly defined enterprise behaviour and compensation practices that promote appropriate risk taking behaviour and provide fair treatment for Customers.

Initiatives that support an appropriate risk culture include: the performance management framework, which incorporates an assessment of factors including risk management, behaviour and a transparent compliance gateway rating; training; and escalation procedures (both through the management hierarchy and anonymously through the Group's whistle-blower facility) allowing staff to raise concerns; messaging from the Chief Executive Officer ("CEO") and members of the Clydesdale and Yorkshire Bank Leadership Team ("Leadership Team"), which has been delegated authority by the CEO.

Another key supporting element of risk culture is the Group's Conduct Framework that includes a product governance model, a fairness model underpinned by fairness standards, conduct education and awareness for staff and the provision of relevant management information to executive level and Board.

The Board and senior management are responsible for providing a clear view of risk culture through their actions and words, and proactively address any identified areas of weakness or concern. They must ensure:

- all employees understand and adhere to the core components of the risk management framework; and
- failures in risk culture, either internal or external, are reviewed at all levels of the organisation and are seen as an opportunity to strengthen our risk culture and make it more robust.

Underpinning the risk management framework, and at the heart of the Group's risk culture, is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model (which articulates specific accountabilities for core elements of risk management) and a formal delegation framework through which staff are able to make risk-based decisions.

2.1.3 Strategic planning and risk appetite

'Risk Appetite' is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives. The Board formally approve the Group's Risk Appetite Statement ("RAS"), as part of the strategic planning process.

Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the RAS process. More broadly, the RAS articulates and helps communicate risk appetite, incorporating the broad direction of risk taking activity; physical capital available; limits on capital use; and quantitative and qualitative measures put in place to restrict or moderate risk taking activities. An understanding of risk appetite, and its overarching tone, provides direction to the level of risk the Group is prepared to take which is ultimately reflected in changes to the Group's risk profile. As such it operates as a defence against excessive risk taking beyond the Board approved appetite thresholds and supports the delivery of the Group's strategic initiatives.

To further embed Risk Appetite 'top down' through the organisation, individual business units have supporting Risk Setting Statements ("RSS") and Key Risk Indicators. RSSs are supplementary measures which are Business Unit specific and are linked to RAS settings, support the Group's strategy and drive management decisions.

Monthly reporting to Asset & Liability Committee ("ALCO"), Risk Committee, and the Board includes details of performance against relevant RAS and RSS settings (breaches and trends).

Key capital ratios are summarised within section 1.5.

2.2 Principal Risks

The Group identifies the following material risk categories as those to which it has the most significant actual or potential exposure: credit risk, operational risk, conduct risk, regulatory risk, compliance risk, balance sheet and liquidity risk, market risk, defined benefit pension risk and strategic risk.

2.2.1 Credit risk

Definition
Credit risk is the potential that a customer or counterparty will fail to meet its obligations to the Group in accordance with agreed terms and arises from both the Group's lending activities and treasury operations, including hedging activities.

Principal risks
Credit risk manifests itself in the financial instruments/products that the Group offers, and those in which the Group invests (including, among others, loans, guarantees, letters of credit, acceptances, inter-bank transactions, foreign exchange transactions, swaps and bonds). Credit risk can be found both on and off-balance sheet, with the majority being on-balance sheet exposure.

Credit risk arises in relation to the processes by which the Group assesses the credit quality of customers, which requires subjective judgments, including forecasts of how changing macro-economic factors may affect customers' ability to repay loans. The overall credit profile of the Group's borrowers may be adversely affected by a range of factors, including increased unemployment, lowered asset values (particularly in the property market), lowered consumer spending, increased customer indebtedness, increased insolvency levels, reduced business profits, increased interest rates and/or higher default rates.

2.2.2 Operational risk

Definition
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Principal risks
Operational risks arise from the day-to-day operational activities of the Group, which may result in direct or indirect losses and could adversely impact the Group's financial performance and position. These losses may result from both internal and external events, and are categorised using risk categories aligned to Basel II. The Basel II categories facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events. These risk categories include:

Operational Risk Category	Definition
Customer, products and sales practices	The risks associated with the fair treatment of customers and the potential customer impact on all of the Group's core activities. (See below at 2.2.3).
Regulatory environment and market practices	The risks associated with ensuring the Group complies with a large volume of laws and regulations, including managing Regulatory change.
Monitoring, reporting and oversight	The risks associated with failing to deliver effective oversight and governance.
Payments and process management	The risks associated with the management of large volumes of transactions, including ensuring core processing activities are conducted safely and efficiently.
External fraud and criminal activities	The risks associated with the protection of customers from financial crime, including fraud activities; the prevention of money laundering; and compliance with legal sanctions requirements.
Internal fraud and criminal activities	The risks associated with internal fraud, including misappropriation of funds, information and physical assets, and circumvention of policy requirements.
Workplace practices and environment	The risks associated with failing to provide a safe environment for customers and colleagues, including ensuring there is adequate capacity of resource, with clearly defined objectives and an effective and efficient management structure in place.
Systems and infrastructure	The risks associated with failing to maintain the Group's systems and infrastructure, including as a result of a potential cyber-attack.
Third party providers	The risks associated with failing to manage third party providers effectively, which may also impact on the level of service available to customers.

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

Conduct risk

Definition
This is the risk that the Group's operating model, culture or actions result in unfair outcomes for customers.

Principal risks
Conduct risk is managed on a day-to-day basis and is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, customer expectations are met and complaints are dealt with effectively and fairly.

The Group is exposed to many forms of conduct risk, which may arise in a number of ways. In particular:

- The Group's current or past business may be determined by its regulators, including the Financial Conduct Authority ("FCA"), the PRA, the Payment Systems Regulator, HM Treasury, the Financial Ombudsman Service ("FOS"), the Competition & Markets Authority or the courts, as not being conducted in accordance with applicable local or, potentially, overseas laws or regulations, or, in the case of the FOS, with what is fair and reasonable in the Ombudsman's opinion. If the Group fails to comply with any relevant regulations, there is a risk of an adverse impact on its business and reputation due to sanctions, fines or other actions imposed by the regulatory authorities. In particular, regulatory and/or other developments in respect of Payment Protection Insurance ("PPI") and interest rate hedging products have had, and are likely to continue to have, a material impact on the Group's business;
- The Group may be subject to further allegations of mis-selling of financial products, including as a result of having sales practices and/or reward structures in place that are determined to have been inappropriate, which may result in disciplinary action (including significant fines) or requirements to amend sales processes, withdraw products or provide restitution to affected customers, any or all of which could result in significant costs, which may require provisions to be recorded in the Group's financial statements and could adversely impact future revenues from affected products; and
- The Group may be liable for damages to third parties harmed by the manner in which the Group has conducted one or more aspects of its business.

As part of the planned demerger, it is proposed that NAB and the Group will enter into the conduct indemnity deed under which NAB will agree, subject to certain limitations, to provide the Group with an indemnity in respect of certain historic conduct liabilities up to the capped indemnity amount. Further detail on the conduct indemnity deed and capped indemnity amount is available in the Report of the Directors within the annual report & consolidated financial statements for the year ended 30 September 2015.

2.2.3 Regulatory risk

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

Principal risks
The Group is exposed to various forms of regulatory risk in its operations, including:

- that certain aspects of its business may be determined by the relevant legal or regulatory authorities or the courts not to have been conducted in compliance with applicable law or regulation or the terms of relevant licences, permissions or supervisory requirements;
- risks relating to conduct related liabilities, including the possibility of mis-selling financial products or mishandling complaints related to the sale of such products by or attributed to the Group's employees,

resulting in disciplinary action or requirements to amend sales processes, withdraw products or provide restitution to affected customers;

- the possibility that products are improperly designed and/or do not operate as expected or designed not in compliance with applicable law, regulation or supervisory requirements leading to their withdrawal and resulting in disciplinary action or requirements to provide restitution to affected customers and a need to re-design such products;
- the high level of scrutiny of the treatment of customers by financial institutions from regulatory bodies, the press and politicians;
- liability for damages to third parties harmed by the conduct of its business;
- the risk of regulatory proceedings and private litigation, arising out of regulatory investigations, enforcement actions or otherwise; and
- non-compliance with regulatory and statutory reporting requirements.

2.2.4 Compliance risk

Definition

Compliance risk is the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives, as well as internal policies, standards, procedures and frameworks. Compliance risk incorporates financial crime risk, which includes risks relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes.

Principal risks

Compliance risk is inherent in doing business in the financial industry, and may arise from:

- failure to design and implement and comply with operational arrangements, systems and controls that achieve legal and regulatory compliance;
- failure to design and operate and follow systems and controls to maintain compliance with prudential requirements;
- financial markets activity that is inappropriate and/or does not comply with regulatory requirements; and
- failure to establish and maintain effective systems and controls to prevent the risk that the Group might be used to further financial crime, including money laundering, counter-terrorism financing, sanctions, and bribery and corruption.

2.2.5 Balance sheet and liquidity risk

Definition

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

Principal risks

The Group faces balance sheet and liquidity risk in its ability to meet intra-day collateral requirements in relation to clearing and settlement obligations, its ability to meet its refinancing requirements for a predefined period (including the potential impact of undrawn commitments) and the liquidity risk profile of its balance sheet to accommodate the Group's strategic plan and associated risk appetite. The Group faces the risk that its funding needs may increase and that its funding structure may not continue to be efficient, giving rise, in both cases, to a requirement to raise other forms of funding (e.g. wholesale).

2.2.6 Market risk

Definition

Market risk is the risk associated with adverse changes in the fair value of positions held by the Group as a result of movement in market factors such as interest rates, foreign exchange rates, volatility and credit spreads.

Structural interest rate risk

Definition

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

Principal risks
In the Group's activities, the main market risk arises from interest rate levels and the related volatility and basis risk. There are three major contributors to interest rate risk:

- the investment of non-interest-bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities ("mismatch risk"); and
- the inability of the pricing 'basis' for asset and liability products to be replicated in the financial markets ("basis risk").

In the retail banking business, interest rate risk arises from the different re-pricing characteristics of assets and liabilities. Interest rates affect the cost and availability of the Group's sources of funding, product margins and, in turn, net interest margin and revenue. Interest rates also affect net interest income, impairment levels and customer affordability. The interest rate levels of interest rate swaps also affect the returns achieved on certain investments.

Foreign exchange risk
Definition
Foreign exchange risk exposures arise as a result of future cash flows being converted to pounds sterling ("GBP") at a rate different to that prevailing at the time of the original transaction.

Principal risks
The Group's primary foreign exchange exposure arises from the Group's business conducted outside of the UK and its transactions with customers, banks and other counterparties in different currencies, most frequently the Euro and the US dollar, and its business may be affected by a change in currency exchange rates or change in the reserve status of these currencies.

The Group prepares and presents its financial statements in GBP, and therefore any fluctuations in GBP as compared to other currencies, in particular the Euro and US dollar, might affect the carrying value of non-GBP denominated assets and liabilities and the reported profit (or loss) incurred on non-GBP denominated transactions.

2.2.7 Defined benefit pension risk

Definition
Defined benefit pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations.

Principal risks
The Group has funding obligations for its defined benefit occupational pension schemes. Defined benefit pension risk arises from the risk that the returns from the schemes' assets, together with ongoing employer and member contributions, will be insufficient to cover the projected obligations of the scheme over time. The return on assets varies with movements in equity prices, interest rates, property prices and the value of other assets. The projection of the schemes' obligations includes estimates of mortality, inflation and future salary rises, and discount factors; the actual outturn of which may differ from the estimates. The schemes are also exposed to possible changes in pension legislation.

2.2.8 Strategic risk

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

Principal risks
Strategic risk can arise if the Group designs and/or implements an inappropriate strategic plan, designs an appropriate plan but fails to implement it and/or implements the strategic plan as intended however external circumstances change (e.g. CMA review on competition, regulatory impositions, competitor actions) and anticipated growth outcomes are not achieved.

The risk of the Group failing to execute its strategy and generating an unsustainable business model is contemplated as part of the Board's Risk Profile. The Group understands that this could be due to the Group's inability to respond to cultural, structural and regulatory changes that need to be made; failure to establish and execute a compelling digital strategy and platform and/or increase organisational capability (through investment); an inappropriate governance framework or it not operating as designed; inadequate product, portfolio or pricing decisions; and/or being an inefficient, high cost, uninspiring and/or uncompetitive provider of product and service.

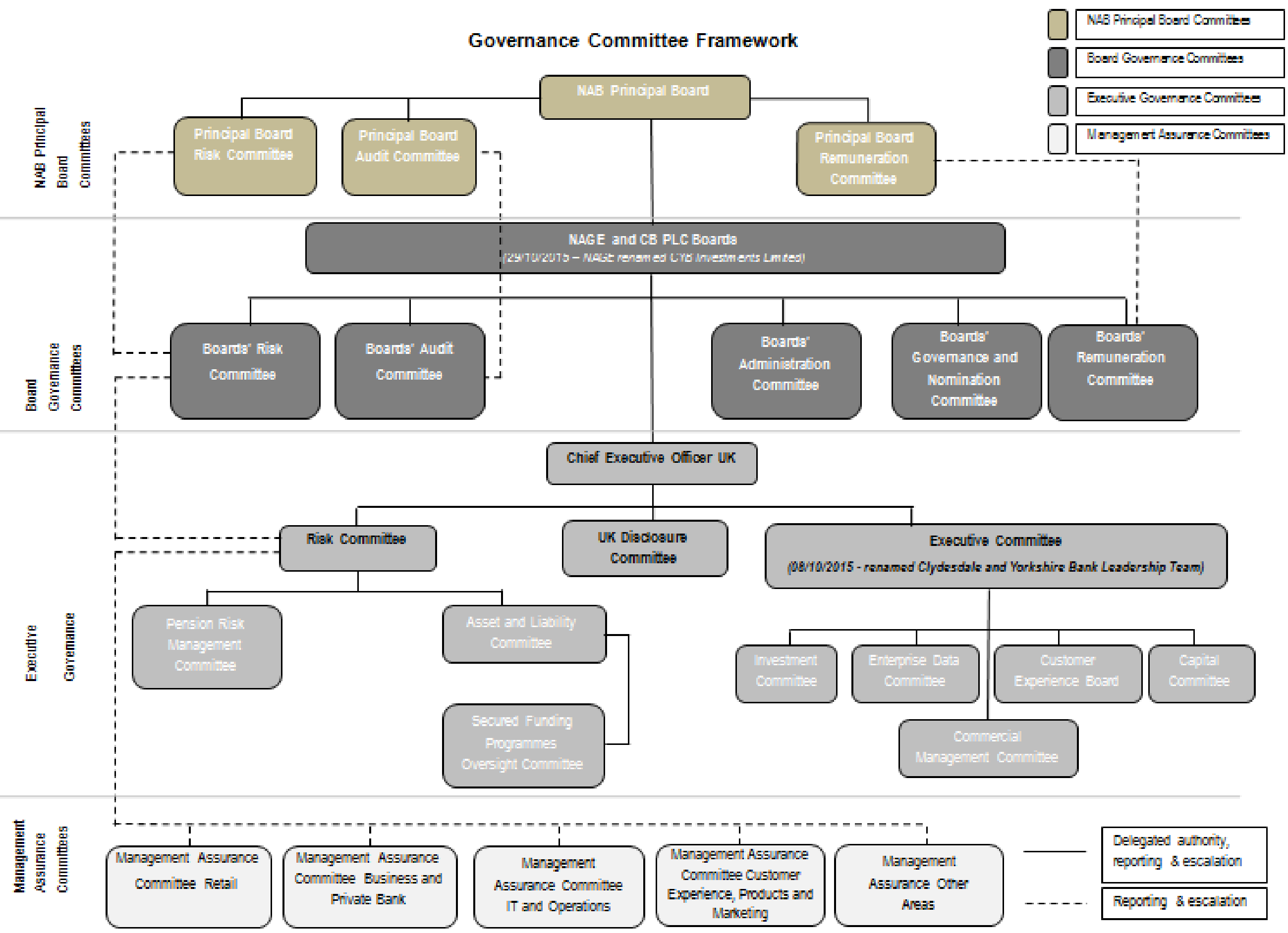
2.3 Risk Governance

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

The oversight of the risk governance structure is facilitated by the Board which approves the Board's Risk Committee's overall governance, risk and control frameworks and risk appetite. This risk and control framework was comprehensively reviewed following the FSA's (now the FCA's) skilled persons review in 2012-2013 and is continually reviewed for new risks and developments.

Additional oversight of risk appetite is provided by the Board's Risk Committee. The table below details the Group's board and management risk reporting structure for the year and as at 30 September 2015.

Chart 2: Governance Committee Framework



2.4 The Board and Governance

The number of directorships held by Executive and Non-Executive Directors who served on the Board of the Company during the year are shown below[1]. In line with the relevant rules[2], directorships in organisations which don't pursue predominantly commercial objectives have been excluded. In addition, where a Director has a number of directorships within one group these are counted as a single directorship.

Table 2: Directorships Held

Name	Directorships Held
James Pettigrew[3]	5
David Duffy	1
Debbie Crosbie	2
Ian Smith	2
Richard Gregory	2
David Allvey	3
Adrian Grace	2
David Browne	2
Barbara Ridpath	1
Teresa Robson-Capps	3
Alex Shapland	3
Richard Sawers	4

Board Diversity

In the normal course the Board's Governance & Nomination Committee leads the process for the appointment of Directors and makes appointment recommendations to the Board based on merit, against objective criteria (set out in a role profile agreed by the Committee) and with due regard to the benefits of diversity on the Board.

Once the selection process is completed, the Governance & Nomination Committee meets to agree to recommend the appointment of the prospective Director to the Board. The Board resolves to approve the appointment in accordance with the company's articles.

The Group plays an important role in the lives of many different people from diverse backgrounds. Customers are from all walks of life and the Group strives to give them high quality customer service every day, from a workforce that represents the communities in which we live and work. Recognising 'diversity of thought' and valuing differences amongst the Group's employees is a key way to achieve this. The Group is therefore committed to sustaining an inclusive culture that allows every employee to reach their full potential at the various stages of their lives and careers. This commitment to attract, develop and retain talented people from all life stages and from diverse backgrounds (including gender diversity) also applies to the Board.

The Board currently includes three female members, 23% of its total composition.

Board Committees

Board oversight of risk management and financial control is facilitated by the Board Risk and Audit Committees. The Board approves the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Group's Corporate Governance statement on the Group's website (*www.cbonline.co.uk*) for further information on Board committees.

The Board Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures of the Group and future risk strategy, reviewing and approving various formal reporting requirements, promoting a risk awareness culture within the Group and ensuring that the Group's strategy,

1 On 22 October 2015 David Bennett was appointed to the Board.
2 PRA Rulebook 'General Organisational Requirements' 5.5 (having regard to General Organisational Requirements 5.6) and Senior Management Arrangements, Systems and Controls (SYSC) 4.3A.6R (having regard to SYSC 4.3A.7R.).
3 During the year the Prudential Regulation Authority and the Financial Conduct Authority jointly approved a modification of General Organisation Requirements 5.5 and SYSC 4.3A.6R in relation to Mr Pettigrew's directorship portfolio, effective until 1 July 2016. The modification is published on the Financial Services Register.

principles, policies and resources are aligned to its risk appetite, as well as to regulatory and industry best practices. The Board Risk Committee's reporting obligations are set out in the Board Risk Committee Charter and include the requirement for the Committee, through the Committee Chairman or his nominee, to report to the Board, at the earliest possible Board meeting after each Committee meeting, any matters that should be brought to the attention of the Board including:

- any recommendations requiring Board approval and/or action such as the RAS, the Board's Risk Profile or risk-related limits and policies; and
- any other issues on which the Board has requested the Committee's opinion or the Committee believes should be brought to the attention of the Board, including any recommendations requiring approval or action.

During FY2015 the Board Risk Committee met eight times in the period which includes five business as usual meetings of the committee, two joint meetings with the BAC and one joint meeting with the NAB Principal Board Risk Committee.

The BAC assists the Board in discharging its responsibilities with regard to financial reporting, external and internal audits and controls, including reviewing the Group's annual report & consolidated financial statements, reviewing and monitoring the extent of the non-audit work undertaken by external auditors, advising on the appointment of external auditors and reviewing the effectiveness of the Group's internal audit activities, internal controls and risk management systems. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual report & consolidated financial statements and the half-yearly reports remains with the Board.

A Board level Remuneration Committee was set up in 2015, which assists the Board in determining its responsibilities in relation to remuneration, including making recommendations to the Board on the application of Group policy for executive remuneration, determining the individual remuneration and benefits package of each of the executive directors, including pension rights and any compensation payments and determining the remuneration arrangements of senior management below Board level.

Risk Disclosure Statement
As at 30 September 2015, the Board is satisfied that the risk management arrangements for providing assurance and risk management systems in place are adequate and appropriate for the Group's risk profile and strategy.

Governance Committees
On the 8 October 2015 the CEO announced that the 'Executive Committee' would be renamed 'Clydesdale and Yorkshire Bank Leadership Team', the wider committee structure is also subject to review and change, the outcomes of which, will be reported in future periods.

The table below details the Group's Management Governance and Management Assurance Committees and their risk focus during the year to 30 September 2015. The following Executive Governance Committees have been established under the authority of the CEO.

Table 3: Governance Committees

Committees	Risk Focus
Risk Committee	The Risk Committee supports the CEO in respect of his risk and control accountabilities and serves to provide leadership focus on key risk issues including: • Devising the RAS for approval by the Boards; • Overseeing and challenging the enterprise wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools; • Monitoring the status of regulatory relationships, the reputation of the Group in relation to its regulators and the changing state of the regulatory landscape including the impacts for and readiness of the Group; • Monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and • Reviewing and endorsing risk policies, frameworks and tools for use across the Group.
Disclosure Committee	The Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations of the Exchange(s) on which it has securities listed.
Executive Committee (renamed Clydesdale and Yorkshire Bank Leadership Team)	Supports the CEO to lead the Group to be a strong, customer-centric Group for our communities by focussing on four business priorities: customer, risk and control, sustainable returns and people.

The Risk Committee is supported by:

Pension Risk Management Committee	The Pension Risk Management Committee is responsible for overseeing pension risk management and strategy. This committee also oversees and governs interaction with UK pension scheme trustees.
Asset and Liability Committee	Responsible for monitoring the performance of the Bank against the Boards' approved Capital and Funding Plans. The committee focuses on the Bank's non-traded market risks including capital, funding, liquidity, interest rate risk and pension risk to ensure that the Bank's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives.
Secured Funding Programmes Oversight Committee	The Secured Funding Programmes Oversight Committee is responsible for supporting the Asset and Liabilities Committee in relation to its risk monitoring and oversight responsibilities of all secured funding programmes and supporting the CEO in relation to the compliance of the Regulated Covered Bond ("RCB") Programme with RCB regulation and the FCA's RCB Sourcebook.

The Leadership Team is supported by:

Enterprise Data Committee	The Enterprise Data Committee is responsible for providing direction and oversight of information and data practices, including oversight of management's resolution of data issues.
Commercial Management Committee	The Commercial Management Committee supports the Executive Committee with management of pricing decisions, sales performance, mortgage and term deposit product balance sheet maturities, review of customer funding plan and visibility of external environment.

Capital Committee	The Capital Committee is responsible for ensuring effective governance of UK capital usage and performance. This includes monitoring key capital and related performance metrics; development of infrastructure to deliver key capital measures out to business functions; and optimising capital efficiencies.
Customer Experience Board	The Customer Experience Board is responsible for championing the end to end customer experience. This included 'Treating Customers Fairly' principles, management actions for insight, culture, capability and complaints policy management and reporting.
Investment Committee	The Investment Committee is responsible for prioritising, approving and reviewing execution of the approved Group strategy via an investment portfolio of projects that align to strategic outcomes, fair customer outcomes, balanced risk outcomes and provide sustainable and appropriate returns.

First line responsibility for risk management resides with the business unit director, supported by the Management Assurance Committees, which provide reports to the Risk Committee based on the Board's risk profile.

Management Assurance Committees (Retail; Business and Private Bank; IT & Operations; Customer Proposition; and Other Areas)	Each major first line business unit has established a Management Assurance Committee, which supports the business unit director in leading the business unit in respect of risk matters and provides advice, guidance, challenge and recommendations. This includes recommending risk settings statements to the Risk Committee; monitoring performance against risk settings and tolerances; reviewing the strength of the control environment and risk capability; and monitoring the effectiveness of risk culture and ongoing compliance with regulatory requirements.

Changes to the Approved Persons Regime

During 2015 the FCA and PRA published final rules aimed at strengthening accountability and improving professional standards in the UK banking industry. These rules will replace the Approved Persons regime for UK banks and come into force on 7 March 2016 with a staged implementation. The changes will introduce a new Senior Managers Regime for individuals subject to regulatory approval, a Certification Regime for banking firms which will require relevant firms to assess the fitness and propriety of certain employees, and a new set of Conduct Rules. A programme is underway to prepare the Bank for compliance with these rules, with industry good practice being incorporated into the design and implementation.

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

Stress testing within the Group is conducted to inform future business and risk planning initiatives, strategic risk management (including the setting of risk appetite) and capital management.

The Leadership Team members are engaged in stress testing to provide review, discussion and debate into the scenario selection process, based on their experience and knowledge as heads of each business unit. The committee also considers and assesses results in the context of future strategic decision-making, contingency planning and capital and business planning.

ALCO reviews the scenarios, assumptions and results of liquidity stress testing. The results of liquidity stress scenarios are reported to the ALCO monthly. The scenarios are the liquidity stress scenarios approved by the Board as part of the individual liquidity adequacy assessment.

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

Specifically, stress testing is used or considered in informing the following management decisions:

- *Risk appetite and strategic business planning* - As part of an annual assessment of future opportunities for, and threats to, the Group, stress testing outputs are used to inform the strategic planning process and to develop risk posture and risk appetite settings.
- *Capital planning ("ICAAP")* - Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP process.
- *Liquidity management ("ILAAP")* - Scenarios provide insight into potential vulnerabilities in the Group's funding strategies. Regular stress tests are undertaken to understand and monitor exposure to liquidity risk with their regularity being aligned to the nature of, and exposure to, the risk type.
- *Recovery plan ("RP")* - the RP (including the Contingency Funding Plan) helps inform both stress testing and reverse stress testing scenario development. Reverse stress testing explores circumstances, or a set of circumstances, that render the Group's business model unviable, moving the Group into a resolution by the authorities. As a result, these stresses are recognised as a required risk management tool in the form of an early warning indicator of potential stress events.

3. Capital Resources

3.1 Own Funds

The table below shows the composition of the Group's regulatory capital position as at 30 September 2015 on a CRD IV basis. The table includes 2014 comparatives prepared on the same basis. The table follows the disclosure format required by the EBA Implementing Technical Standard on Disclosure for Own Funds, however only items applicable to the Group are shown.

The capital resources of the Bank are presented in Appendix 1 of this document.

Table 4: Capital composition

As at 30 September	2015	2014
Common Equity Tier 1 (CET1) capital: Instruments and reserves	£m	£m
Capital instruments and the related share premium accounts	893	1,882
Retained earnings	2,096	256
Accumulated other comprehensive income (and other reserves)	1	86
Common Equity Tier 1 (CET1) capital before regulatory adjustments	2,990	2,224
Common Equity Tier 1 (CET1) capital: regulatory adjustments		
Additional value adjustments	(5)	(2)
Intangible assets (net of related tax liability)	(265)	(213)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences	(273)	(223)
Defined benefit pension fund assets	(42)	(39)
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(585)	(477)
Common Equity Tier 1 (CET1) capital	2,405	1,747
Additional Tier 1 (AT1) capital: instruments		
Capital instruments and the related share premium accounts	450	300
Additional Tier 1 (AT1) capital	450	300
Tier 1 Capital	2,855	2,047
Tier 2 (T2) capital: Instruments and provisions		
Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	-	575
Qualifying own funds instruments included in consolidated T2 capital issued by subsidiaries and held by third parties	460	550
Of which: instruments issued by subsidiaries subject to phase out	*175*	*250*
Credit risk adjustments	138	135
Tier 2 (T2) capital	598	1,260
Total Capital	3,453	3,307
Total risk weighted assets	18,227	18,645
Capital Ratios		
Common Equity Tier 1	13.2%	9.4%
Tier 1	15.7%	11.0%
Total Capital	18.9%	17.7%

Tier 1 Capital

Tier 1 capital comprises:

- ordinary shares;
- share premium;
- retained earnings;
- accumulated other comprehensive income (and other reserves);
- Additional Tier 1 (AT1) Instruments; and
- adjustments as set out by the regulatory requirements governing capital resources.

Accumulated other comprehensive income (and other reserves) represents adjustments for asset revaluation, cash flow hedge and available for sale reserves. The inclusion of available for sale asset reserves became a requirement under CRR with effect from 1 January 2015.

Additional details of the perpetual capital notes are included in appendix 2 and note 32 to the annual report & consolidated financial statements for the year ended 30 September 2015.

Tier 2 Capital

Tier 2 capital comprises:

- subordinated loan debt;
- general and collective provisions; and
- adjustments as set out by the regulatory requirements governing capital resources.

Subordinated loan debt is unsecured and ranks below the claims of all depositors and other ordinary creditors. Additional details of the subordinated notes are included in Appendix 2 and in note 11 to the annual report & consolidated financial statements for the year ended 30 September 2015.

Under the regulatory rules, the percentage of subordinated loan debt permitted to be included as qualifying regulatory capital is limited to a maximum of 25% of total capital.

3.2 Movements in capital

In December 2014, a capital re-structure was completed to strengthen the Group's capital base and to ensure that the PRA's prudential capital requirements continue to be met. As part of this re-structure, the Group repaid £650 million of Tier 2 capital in the form of subordinated loan debt and issued £350 million of ordinary shares and £150 million of CRD IV compliant AT1 perpetual capital notes to NAB.

Further issuances of ordinary shares were completed in June 2015 (£50 million) and September 2015 (£620 million). £465 million of this additional issuance was used to offset conduct risk provisions during the year for a net neutral impact to the Group's CET1 capital ratio, with the remainder serving to further strengthen the Group's capital base. The nominal value of the Company's ordinary shares was reduced from £1.00 to £0.10, with the total share capital reduction of £2,009 million transferred to retained earnings.

Table 5: Capital flow statement

	2015 £m	2014 £m
CET1 capital		
CET1 capital at 1 October	1,747	1,901
Share capital: ordinary share new issuance	350	300
Share premium	670	-
Share capital: redenomination	(2,009)	-
Retained earnings and other reserves	1,755	(193)
Prudent valuation adjustment	(3)	1
Intangible assets	(52)	2
DTAs relying on future profitability	(50)	(223)
Defined benefit pension fund assets	(3)	(39)
Pension fund deficit adjustment	-	(2)
	2,405	1,747
Tier 1 capital		
Tier 1 capital at 1 October	300	300
Share capital repurchased: perpetual non-cumulative preference shares	-	(100)
Share capital repurchased : Hybrid Tier 1 Capital	-	(200)
Share capital issued: Additional Tier 1 capital perpetual notes	150	300
	450	300
Total Tier 1 capital	2,855	2,047
Tier 2 capital		
Tier 2 capital at 1 October	1,260	1,255
Subordinated debt repurchase	(665)	-
Credit risk adjustments	3	(20)
Asset revaluation reserve	-	(2)
Excess Tier 2 Capital	-	24
Qualifying and material holding Tier 2 deductions	-	3
	598	1,260
Total capital at 30 September	3,453	3,307

A number of deductions are applied in calculating regulatory capital under CRD IV. This includes deductions for: intangible assets, deferred tax assets that rely on future profitability of the bank to be realised, defined benefit pension funds assets, prudent valuation adjustments and certain investments in other financial institutions. The most significant of which are discussed further below:

- The IAS19 valuation of the Defined Benefit Pension Scheme is included in accounting reserves and this means that a deficit is also reflected in regulatory capital. However, if the scheme is in surplus, regulatory rules do not permit this to contribute towards regulatory capital. At 30 September 2015, the IAS19 position was £52 million surplus. The deduction of £42 million represents this surplus less the associated deferred tax liabilities.
- Regulatory adjustments are also required in respect of DTAs that rely on future profitability and intangible assets (computer software and other IT development which has been capitalised). At 30 September 2015, £273 million was deducted from CET1 capital in respect of DTAs and £265 million was deducted in respect of intangible assets.

Table 6 shows the capital position on a transitional CRD IV basis, comparing this against the end-point basis (as if CRD IV was fully in force and no transitional provisions applied). The end point CET1 and Tier 1 ratios remain at 13.2% and 15.7% (30 September 2014: 9.4% and 11%) as transitional provisions apply in full under the PRA rules the Group applies. For Tier 2 the difference is due to capital instrument grandfathering provisions which allow certain subordinated debt instruments to be eligible as capital during a transitional period on a phased basis (ending on 31 December 2021). This applies to £175m of subordinated debt instruments recognised as at 30 September 2015 (30 September 2014: £825m). In addition CRD IV brought in new requirements in relation to recognising qualifying Tier 2 capital instruments issued by a subsidiary to outside the consolidated group. The Bank has issued £300m of

Tier 2 capital to NAB. In applying the calculation under CRR article 87 the £300m cannot be fully recognised. Under CRD IV transitional rules, this is implemented on a phased basis (ending on 31 December 2017).

Table 6 : CRD IV end-point vs transitional comparison

As at 30 September	Current Rules 2015	Current Rules 2014	Full Impact 2015	Full Impact 2014
	£m	£m	£m	£m
Common Equity Tier 1 (CET1) capital: Instruments and reserves				
Capital instruments and the related share premium accounts	893	1,882	893	1,882
Retained earnings	2,096	256	2,096	256
Accumulated other comprehensive income (and other reserves)	1	86	1	86
Common Equity Tier 1 (CET1) capital before regulatory adjustments	2,990	2,224	2,990	2,224
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments	(5)	(2)	(5)	(2)
Intangible assets (net of related tax liability)	(265)	(213)	(265)	(213)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences	(273)	(223)	(273)	(223)
Defined benefit pension fund assets	(42)	(39)	(42)	(39)
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(585)	(477)	(585)	(477)
Common Equity Tier 1 (CET1) capital	2,405	1,747	2,405	1,747
Additional Tier 1 (AT1) capital: instruments				
Capital instruments and the related share premium accounts	450	300	450	300
Additional Tier 1 (AT1) capital	450	300	450	300
Tier 1 Capital	2,855	2,047	2,855	2,047
Tier 2 (T2) capital: Instruments and provisions				
Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	-	575	-	-
Qualifying own funds instruments included in consolidated T2 capital issued by subsidiaries and held by third parties	460	550	263	228
Of which: instruments issued by subsidiaries subject to phase out	*175*	*250*	-	-
Credit risk adjustments	138	135	138	135
Tier 2 (T2) capital	598	1,260	401	363
Total Capital	3,453	3,307	3,256	2,410
Total risk weighted assets	18,227	18,645	18,227	18,645
Capital Ratios				
Common Equity Tier 1	13.2%	9.4%	13.2%	9.4%
Tier 1	15.7%	11.0%	15.7%	11.0%
Total Capital	18.9%	17.7%	17.9%	12.9%

3.3 Reconciliation of Statutory Equity to Regulatory Capital

Table 7: Reconciliation of Statutory Equity to Regulatory Capital

As at 30 September	2015 £m	2014 £m
Statutory Total Equity	3,443	2,538
Less pension regulatory adjustments	(42)	(39)
Less other deductions from capital	(270)	(215)
Less share option reserve	(3)	(2)
Less available for sale reserve	-	(8)
Less deferred tax assets relying on future profitability	(273)	(223)
Less structured entities reserves	-	(4)
Regulatory Tier 1 capital	2,855	2,047

3.4 Leverage Ratio

3.4.1 Management of excessive leverage

The risk of excessive leverage is the risk resulting from the Group's vulnerability to leverage or contingent leverage that may require unintended corrective measures to the business plan, including distressed selling of assets which might result in losses or in valuation adjustments to the remaining assets.

The Leverage Ratio is monitored against a Board set RAS and with the responsibility of managing the ratio falling to ALCO, who monitor it on a monthly basis.

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

- capital: Tier 1 capital defined according to CRD IV on an end point basis (assuming the full impact of CRD IV requirements on Tier 1 capital were in force with no transitional provisions).
- exposures: total on and off balance sheet exposures (subject to credit conversion factors) as defined in the Delegated Act amending CRR article 429 (Calculation of the Leverage Ratio), which includes deductions applied to Tier 1 capital.

Table 8: Leverage Ratio

As at 30 September	2015	2014
	£m	£m
Total Tier 1 capital for the leverage ratio		
Total Common Equity Tier 1 (CET1) capital	2,405	1,747
Additional Tier 1 (AT1) capital	450	300
Total Tier 1	2,855	2,047
Exposures for the leverage ratio		
Total statutory assets per the statement of financial position	38,705	37,392
Off balance sheet items	1,998	2,155
Derivative exposures adjustment	19	160
SFT exposures adjustment	-	58
Other regulatory adjustments	(585)	(477)
Leverage ratio exposure	40,137	39,288
Leverage ratio	7.1%	5.2%

The Group's leverage ratio is 7.1% which exceeds the Basel committees proposed minimum of 3%, applicable from 2018. The Group will continue to monitor closely the leverage ratio against emerging rules and minimum calibration.

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

4. Capital Requirements

4.1 Capital Management

Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support its business strategy against losses, inherent risks and stress events. In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks.

The Group manages capital in accordance with prudential rules set out under CRD IV, and relevant rules issued by the PRA and FCA. The Group is committed to maintaining a strong capital base and has complied with all capital requirements set by the regulators throughout the period.

As part of the Internal Capital Adequacy Assessment Process ("ICAAP") the Board is required to consider the material risks to which the Group is exposed to determine whether additional capital needs to be held in respect of these risks to ensure that the Group is sufficiently well capitalised. The Group's ICAAP supplements the Pillar 1 capital requirements (covering Credit Risk, Operational Risk, Counterparty Credit Risk and Market Risk) and is subject to a robust review, challenge and approval process by the Board before being submitted to the PRA.

The key risks assessed as part of the ICAAP include:

Risks not fully captured under Pillar 1

- credit concentration risk – credit concentration risk is the risk of the Group incurring losses as a result of concentration of exposures to specific geographies, sectors or customers.
- operational risk – the Group calculates Pillar 1 operational risk capital using the Standardised Approach. However, an appropriate Pillar 2 add-on is determined using a more risk sensitive approach supported by modelling.

Risks not captured under Pillar 1

- interest rate risk in the banking book ("IRRBB") – the risk from changes in Market Interest Rates that may adversely affect the Group's financial condition in terms of its earnings or the economic value of the balance sheet.
- Pension Risk – the risk arising from volatility in the Group's Defined Benefit Pension Scheme.

A number of less material risks are considered, with an assessment of any capital that is required. The ICAAP also considers and assesses a wide range of other risks for which it is concluded that no additional capital is required to be held.

Stress Scenarios

As part of the ICAAP, the Group's forecast capital position is subject to stress testing to determine the impact on the Group's position should a severe economic downturn materialise. These stress testing scenarios consider not only changes in the macroeconomic environment but also the key risks to, and vulnerabilities within, the Group's business model. Stress testing scenarios are developed during workshops with representation from various business units including the second and third line. As part of these workshops changes in the macroeconomic and business environment are considered alongside the Group's strategy and business model to develop scenarios which are severe, relevant and plausible.

The outputs of these stress tests are then used by the Board and PRA to determine the Capital Planning Buffer which the Group is required to maintain as mitigation against future stress scenarios.

The Capital Planning Buffer will be replaced by CRD IV buffers (Capital Conservation Buffer, and Systemic Risk Buffers) that transition in from 1 January 2016. Alongside the Countercyclical Buffer (which came in from 1 January 2015 and for UK exposures is currently set at 0%) these will provide the "floor" for Pillar 2B requirements, however the PRA will also make its own assessment and if this is higher than the combined CRD IV buffers then a PRA Buffer will apply. The PRA Buffer will be set using supervisory judgment informed by stress scenarios and other factors including leverage and systemic importance. The Bank of England ("BoE") has published its approach to stress testing for the next three years until 2018, outlining an explicitly countercyclical approach and introducing a biennial exploratory scenario based on emerging threats to financial stability or individual banks. The framework will continue to cover banks with total retail deposits greater than £50 billion (though the BoE will select the participants in the exploratory scenario based on the scenario itself.) The BoE will publish further information in due course on its approach to stress testing beyond 2018.

4.2 Minimum capital requirement

To determine minimum capital requirements under the CRD IV Framework, the Group applies the Standardised Approach to measure credit risk and the Standardised Approach for operational risk. Under the approach the Group calculates its Pillar 1 capital requirement based on 8% of total risk weighted assets ("RWAs"). The Group's Pillar 1 capital requirements cover credit risk, operational risk, counterparty credit risk and credit valuation adjustment ("CVA").

The table below shows the Group's RWAs and capital requirements under Pillar 1.

Table 9: Pillar 1 Capital Requirements

As at 30 September	2015		2014	
	RWA	Capital	RWA	Capital
Pillar 1 Capital Requirements	£m	£m	£m	£m
Central Governments or Central Banks	-	-	-	-
Regional Government or Local Authority	22	2	22	2
Public Sector Entities	3	-	3	-
Multilateral Development Banks	-	-	-	-
Institutions	222	18	224	18
Corporates	3,264	262	3,692	295
Retail	930	74	994	79
Secured by Mortgages on Immovable Property	10,862	869	10,552	845
Exposures in Default	427	34	611	49
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	-	3	-
Claims in the Form of CIU	3	-	3	-
Equity Exposures	16	1	12	1
Other Items	545	44	647	52
Total Credit Risk	16,294	1,304	16,763	1,341
Credit Counterparty Risk	138	11	181	14
Credit Valuation Adjustment	206	16	137	11
Operational Risk	1,589	127	1,564	125
Market Risk	-	-	-	-
	18,227	1,458	18,645	1,491

The items included in the 'Other' exposure class that attract a capital charge include items in the course of collection, cash in hand, fixed assets and deferred tax assets that rely on future profitability.

5. Credit Risk

5.1 Credit risk overview

Credit risk is the risk that a counterparty or customer will fail to meet its obligations to the Group in accordance with agreed terms. This risk applies to both customer facing segments of the business (Retail and SME Banking) as well as our treasury operations and is continually assessed as the Group's business and key initiatives evolve. Bank lending activities account for most of the Group's credit risk, with a strategic focus on managing the acceptance of a range of potential credit risk exposures.

5.2 Credit risk exposure: analysis by exposure class

As at 30 September 2015, the total credit risk exposures of the Group amounted to £46.2 billion (2014: £45.5 billion). The overall capital requirement for Credit Risk has reduced by 2.8% from £1,341 million in 2014 compared to £1,304 million 2015.

The table below shows movements in credit risk RWAs from 1 October 2014 to 30 September 2015, with movements ascribed to changes in book size and book quality.

Table 10: Credit Risk RWAs

	Credit Risk RWAs £m
RWAs at 1 October 2014	16,763
Book Size growth/ (reduction)	(154)
Book Quality (improvement)/ deterioration	(180)
Methodology and Policy	(130)
Other	(5)
RWAs at 30 September 2015	16,294

Although the total credit risk exposure figure has increased, the portfolio mix has shifted away from higher risk weighted exposures (corporates) to lower risk weighted exposures (retail mortgage) resulting in small RWA movements. This is in line with the continued growth of the Group's residential mortgage portfolio as well as ongoing active management of the customer portfolio. The book size reduction above is driven by a decrease in other assets (non lending assets) with the increase in book quality due in the main to improvements in the underlying economy. Methodology and Policy movement is a result of the ongoing review of data flows and the refinement of our interpretation of the regulatory rules.

Credit risk exposures by exposure class are provided in the table below, together with the associated average credit risk exposure.

Exposure is defined as the maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or if assets and off balance sheet positions (after offsets) have to be realised. The exposure amounts disclosed are pre-application of Credit Risk Mitigation and pre-application of Credit Conversion Factors, unless otherwise stated. This contrasts with the exposures disclosed within the Strategic Report in the annual report & consolidated financial statements for the year ended 30 September 2015, which are disclosed after any relevant Credit Risk Mitigation and Credit Conversion Factors have been applied.

The credit risk exposures at 30 September 2015 and the averages for the year are summarised as follows:

Table 11: Credit Risk Exposures by Exposure Class[4]	2015		2014	
	Credit Risk Exposure	Average Credit Risk Exposure	Credit Risk Exposure	Average Credit Risk Exposure
Exposure Class	£m	£m	£m	£m
Central Governments or Central Banks	6,477	6,645	5,155	5,666
Regional Government or Local Authority	594	582	620	582
Public Sector Entities	16	16	16	8
Multilateral Development Banks	100	88	50	88
Institutions	841	1,136	1,795	1,034
Corporates	5,914	6,136	6,567	6,965
Retail	3,125	3,161	3,299	3,314
Secured by Mortgages on Immovable Property	26,823	26,402	25,437	24,734
Exposures in Default	367	412	511	503
Claims on Institutions and Corporates with a Short-term Credit Assessment	-	5	15	19
Claims in the Form of CIU	4	4	5	5
Equity Exposure	10	9	8	6
Other Items	1,905	2,023	1,989	2,138
Total	46,176	46,619	45,467	45,062

Total exposure value for credit risk as at 30 September 2015 was 1.6% higher compared to 30 September 2014. Key drivers being the growth in retail mortgages and reshaping of the business lending portfolio, focusing principally on small and medium sized businesses ("SME") in core regional markets. The increase in the Central Governments and Central Bank credit risk exposure class between reporting periods is due to the increased amount held in BoE Reserves and UK Government Bonds.

[4] Average Credit Risk Exposure is calculated using the previous four quarters exposure per the EBA's Common Reporting 'Credit Risk Standardised Approach' returns.

5.3 Credit risk exposure: analysis by industry

Table 12: Credit Risk Exposure by Industry

The table below shows credit risk exposure by industry, including SME exposures. The regulatory SME definition is based on customers with an annual turnover not exceeding EUR 50 million. This is consistent with the SME definition in CRR article 501, which states that among the criteria listed in Commission Recommendation 2003/361/EC (concerning the definition of micro, small and medium-sized enterprises) only the annual turnover is to be taken into account.

As at 30 September 2015

Exposure Type	Government and public authorities	Agriculture forestry, fishing and mining	Financial, investment and insurance	Real estate – construction	Manufacturing	Personal Lending	Real estate – mortgage	Asset and lease financing	Other commercial and industrial	Non-customer assets	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Central Governments or Central Banks	1,282	-	5,195	-	-	-	-	-	-	-	6,477
Regional Government or Local Authority	594	-	-	-	-	-	-	-	-	-	594
Public Sector Entities	-	-	-	-	-	-	-	-	16	-	16
Multilateral Development Banks	-	-	100	-	-	-	-	-	-	-	100
Institutions	-	-	841	-	-	-	-	-	-	-	841
Corporates	-	504	225	275	1,055	-	-	232	3,623	-	5,914
Retail	-	-	-	-	-	3,125	-	-	-	-	3,125
Secured by Mortgages on Immovable Property	-	1,652	19	59	280	-	22,212	21	2,580	-	26,823
Exposures in Default	-	29	-	8	7	16	151	-	156	-	367
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	-	-	-	-	-	-	-	-	-	-
Claims in the Form of CIU	-	-	-	-	-	-	-	-	4	-	4
Equity Exposures	-	-	-	-	-	-	-	-	10	-	10
Other Items	106	-	1,519	-	-	-	1	-	75	204	1,905
Total Exposure	1,982	2,185	7,899	342	1,342	3,141	22,364	253	6,464	204	46,176
Of which: SME	-	1,862	77	181	807	-	-	145	3,694	-	6,766

As at 30 September 2014

Exposure Type	Government and public authorities	Agriculture forestry, fishing and mining	Financial, investment and insurance	Real estate – construction	Manufacturing	Personal Lending	Real estate – mortgage	Asset and lease financing	Other commercial and industrial	Non-customer assets	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Central Governments or Central Banks	467	-	4,688	-	-	-	-	-	-	-	5,155
Regional Government or Local Authority	620	-	-	-	-	-	-	-	-	-	620
Public Sector Entities	-	-	-	-	-	-	-	-	16	-	16
Multilateral Development Banks	-	-	50	-	-	-	-	-	-	-	50
Institutions	-	-	1,795	-	-	-	-	-	-	-	1,795
Corporates	-	554	338	270	1,078	-	-	203	4,124	-	6,567
Retail	-	-	-	-	-	3,198	-	-	101	-	3,299
Secured by Mortgages on Immovable Property	-	1,740	31	78	334	-	20,408	21	2,825	-	25,437
Exposures in Default	-	28	3	10	10	23	154	3	280	-	511
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	-	15	-	-	-	-	-	-	-	15
Claims in the Form of CIU	-	-	5	-	-	-	-	-	-	-	5
Equity Exposures	-	2	-	-	-	-	-	-	6	-	8
Other Items	116	-	1,531	-	-	-	1	-	94	247	1,989
Total Exposure	1,203	2,324	8,456	358	1,422	3,221	20,563	227	7,446	247	45,467
Of which: SME	-	2,004	95	191	830	-	-	138	4,245	-	7,503

5.4 Credit risk exposure: analysis by residual maturity

Table 13: Credit Risk Exposure by Residual Maturity

Exposure Type	At 30 September 2015				
	<= 1 year	>1 year, <= 5 years	>5 years	undated	Total
	£m	£m	£m	£m	£m
Central Governments or Central Banks	5,154	-	1,279	44	6,477
Regional Government or Local Authority	582	1	11	-	594
Public Sector Entities	16	-	-	-	16
Multilateral Development Banks	-	100	-	-	100
Institutions	173	1	-	667	841
Corporates	3,299	2,213	309	93	5,914
Retail	2,419	599	107	-	3,125
Secured by Mortgages on Immovable Property	2,657	2,702	21,464	-	26,823
Exposures in Default	109	113	145	-	367
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	-	-	-	-
Claims in the Form of CIU	-	4	-	-	4
Equity Exposures	10	-	-	-	10
Other Items				1,905	1,905
	14,419	5,733	23,315	2,709	46,176

Exposure Type	At 30 September 2014				
	<= 1 year	>1 year, <= 5 years	>5 years	undated	Total
	£m	£m	£m	£m	£m
Central Governments or Central Banks	4,599	50	464	42	5,155
Regional Government or Local Authority	608	1	11	-	620
Public Sector Entities	16	-	-	-	16
Multilateral Development Banks	-	50	-	-	50
Institutions	947	-	-	848	1,795
Corporates	3,640	2,357	415	155	6,567
Retail	2,536	645	118	-	3,299
Secured by Mortgages on Immovable Property	2,836	2,841	19,760	-	25,437
Exposures in Default	193	151	167	-	511
Claims on institutions and corporates with a short-term credit assessment	-	-	-	15	15
Claims in the Form of CIU		5-	-	-	5
Equity Exposures	6	-	-	2	8
Other Items	-	-	-	1,989	1,989
Total	15,381	6,100	20,935	3,051	45,467

The maturity of exposures is shown on a contractual basis rather than the actual redemptions experienced by the Group.

5.5 Credit risk exposure: analysis by geography

Table 14: Credit Risk Exposure by Geography

Exposure Type	At 30 September 2015		
	UK	Other	Total
	£m	£m	£m
Central Governments or Central Banks	6,477	-	6,477
Regional Government or Local Authority	594	-	594
Public Sector Entities	16	-	16
Multilateral Development Banks	-	100	100
Institutions	841	-	841
Corporates	5,913	1	5,914
Retail	3,110	15	3,125
Secured by Mortgages on Immovable Property	26,772	51	26,823
Exposures in Default	366	1	367
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	-	-
Claims in the Form of CIU	4	-	4
Equity Exposures	10	-	10
Other Items	1,905	-	1,905
	46,008	168	46,176

Exposure Type	At 30 September 2014		
	UK	Other	Total
	£m	£m	£m
Central Governments or Central Banks	5,155	-	5,155
Regional Government or Local Authority	620	-	620
Public Sector Entities	16	-	16
Multilateral Development Banks	-	50	50
Institutions	1,795	-	1,795
Corporates	6,567	-	6,567
Retail	3,284	15	3,299
Secured by Mortgages on Immovable Property	25,387	50	25,437
Exposures in Default	510	1	511
Claims on institutions and corporates with a short-term credit assessment	15	-	15
Claims in the Form of CIU	5	-	5
Equity Exposures	8	-	8
Other Items	1,989	-	1,989
Total Exposure	45,351	116	45,467

Credit risk exposures outside of the UK arising on lending are not material and have been classified as 'Other'. The geographical location is based on the physical location of the counterparty with which the Group deals. In some cases this may differ from the location of the counterparty's ultimate parent company.

Exposures arising on supranational bonds issued by multilateral development banks are held as part of the Group's liquidity buffer. In line with guidance issued by the EBA, these have been classified to the geographical area 'Other' irrespective of the location of the issuer.

5.6 Impaired Lending and Provisions

5.6.1 Definition

The following definitions are employed:

- past due but not impaired: loans and advances that are past due but are not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal enforcement, realisation costs etc.) due on the facility. Unsecured retail lending and credit cards are written off when they reach 180 days past due and are not designated as impaired.
- impaired assets: retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
- impairment provisions: a provision held on balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
- a collective impairment provision: an impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
- specific provision: relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.

5.6.2 Managing impaired exposures and impairment provisions

Provisioning policy
The management of impaired assets, the setting of impairment provisions and the write-off of impaired assets are included with the Group's Credit Policy and Procedures, and are reviewed and attested to on an annual basis. The treatment of impaired assets is determined by the Risk function and the calculation of impairment provisions aligns with current accounting policy, as agreed with the Finance function.

Accounting policy
The Group first assesses whether objective evidence of impairment exists individually for loans and advances that are individually significant, and individually or collectively for loans and advances that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment. The amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is included in the income statement.

For the purposes of a collective evaluation of impairment, loans and advances are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated. The Group uses historical loss experience and its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process.

Adequacy reviews
All impaired lending assets are managed by either Strategic Business Services (Non Retail) or the Financial Care Team (Retail) and are reviewed on a continual basis and must be formally reviewed at least quarterly.

All non-impaired lending is subject to a collective assessment for pools of assets with similar credit risk characteristics where no objective evidence of impairment exists. The provisioning policy requires impairment losses to be based on events which have already taken place and prevailing economic conditions.

Reporting
The formal reporting of impaired lending, provisions and associated relevant asset quality metrics and trends are completed on a monthly basis and distributed to the appropriate portfolio managers, Senior Managers, Management Committees, Risk Committee and Board.

The Bank reviews, at least bi-annually, its provision reserves against actual experience to identify whether its policies have resulted in over or under provisioning across the economic cycle. The responsibility for the review rests with the Risk function which reports its findings and recommendations to the Risk Committee, and the Board.

Management of customers experiencing financial difficulties
Information and analysis on the measures adopted by the Group to support customers experiencing financial difficulties are detailed in the notes to the Group's annual report & consolidated financial statements.

5.7 Analysis of past due and impaired loans and advances to customers

As at 30 September 2015, past due but not impaired exposures in respect of loans and advances to customers amounted to £483m (2014: £628m). Impaired exposures in respect of loans and advances to customers amounted to £263m (including £25m of Fair Value loans) (2014: £375m (including £56m of Fair Value loans)).

5.8 Analysis by Industry Sector

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers, by Industry Sector, is provided in the table below:

Table 15: All Past Due and Impaired Loans and Advances to Customers by Industry

As at 30 September	2015 Past due but not impaired £m	2015 Impaired £m	2014 Past due but not impaired £m	2014 Impaired £m
Agriculture, forestry, fishing and mining	63	13	81	10
Asset and lease financing	2	3	3	7
Financial, investment and insurance	2	-	5	3
Government and public authorities	-	-	-	-
Personal Lending	57	-	58	-
Manufacturing	6	4	16	9
Other commercial and industrial	80	175	125	276
Real estate - construction	5	2	6	6
Real estate - mortgage	268	66	335	64
Total	483	263	629	375

5.9 Analysis by Geography

All past due but not impaired loans and advances to customers and impaired loans and advances to customers are categorised as being in the United Kingdom. All closing impairment provisions, the net charge to the income statement, and advances written off in respect of loans and advances to customers are categorised as being in the United Kingdom.

5.10 Analysis of impairment provisions in respect of loans and advances to customers

The movement in impairment provisions, from 1 October 2014 to 30 September 2015, is provided below:

Table 16: The Movement in Impairment Provisions (Includes Fair Value)

	Specific Provisions		Collective Provisions		Total Provisions	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Opening balance	141	157	178	209	319	366
Other adjustments[5]	(3)	(4)	(8)	(5)	(11)	(9)
Advances written off	(113)	(134)	-	-	(113)	(134)
Recoveries of advances written off in previous years	13	16	-	-	13	16
Charge to the income statement	65	106	(5)	(26)	60	80
Closing balance	103	141	165	178	268	319

5.11 Analysis by Industry

The movement in total impairment provisions, from 1 October 2014 to 30 September 2015, by Industry sector is provided below:

Table 17: Analysis of Impairment Provisions by Industry (including Fair Value)

	2015			2014		
As at 30 September	Impairment Provisions	Net Charge	Advances Written Off	Impairment Provisions	Net Charge	Advances Written Off
	£m	£m	£m	£m	£m	£m
Agriculture, forestry, fishing and mining	22	1	-	22	1	(15)
Asset and lease financing	2	-	(1)	2	2	(3)
Financial, investment and insurance	4	3	(2)	3	1	(7)
Government and public authorities	-	-	-	-	-	-
Personal Lending	42	19	(33)	45	16	(41)
Manufacturing	22	8	(3)	16	3	(4)
Other commercial and industrial	150	17	(65)	209	49	(53)
Real estate - construction	4	1	(3)	5	-	(2)
Real estate - mortgage	22	11	(6)	17	8	(9)
Total	268	60	(113)	319	80	(134)

5 Other adjustments relate to transfers to NAB UK Commercial Real Estate, Fair Value Accounting Adjustments and Net Present Value Provision Amortisation

5.12 Use of ECAIs

The Bank makes limited use of credit assessments by external credit assessment institutions ("ECAIs") in assigning risk weights to credit risk exposures under the Standardised Approach. This typically applies in the case of certain Central Government, Central Bank and institution exposures.

Where a credit assessment is used this must be provided by an eligible ECAI from the PRA's approved list. The appropriate risk weight to apply to the credit risk exposure is determined by assigning the exposure to the relevant credit quality step under CRR Chapter 2 (Standardised Credit Risk), based on the PRA's mapping of credit assessments to credit quality steps. A table containing the current mappings is published on the PRA's website. Where appropriate, the Bank makes use of credit assessments provided by Standard & Poor's, Fitch and Moody's.

The table below shows exposure by credit quality step pre- and post-application of credit risk mitigation but before credit conversion factors. For retail exposures secured by mortgages, however, the protection effect of mortgage collateral is intrinsically part of the definition of the original exposure class and is therefore taken into account in the calculation of RWAs.

Table 18: Exposure Values associated with Credit Quality Step

As at 30 September		2015		2014	
Exposure Type	Credit Quality Step (CQS)	Exposure Pre Mitigation £m	Exposure Post Mitigation £m	Exposure Pre Mitigation £m	Exposure Post Mitigation £m
Central Governments or Central Banks	CQS 1	6,477	6,477	5,155	5,106
Regional Government or Local Authority	Unrated	594	480	620	482
Public Sector Entities	Unrated	16	16	16	16
Multilateral Development Banks	CQS 1	100	100	50	50
Institutions	CQS 1	98	98	312	55
	CQS 2	1	1	399	4
	CQS 3	34	34	224	24
	CQS 4	5	5	-	-
	Unrated	703	703	860	860
Corporates	CQS 1	7	7	-	-
	CQS 3	12	12	17	17
	Unrated	5,895	5,774	6,550	6,393
Retail	Unrated	3,125	3,125	3,299	3,299
Secured by Mortgages on Immovable Property	Unrated	26,823	26,778	25,437	25,354
Exposures in Default	Unrated	367	367	511	509
Claims on institutions and corporates with a short-term credit assessment	Unrated	-	-	15	15
Collective investments undertakings (CIU)	Unrated	4	4	5	5
Equity Exposures	Unrated	10	10	8	8
Other Items	Unrated	1,905	1,905	1,989	1,989
Total Exposure		46,176	45,896	45,467	44,186

The large movement in exposure pre-mitigation within institutions is due to the fact there were no repo or reverse-repo style transactions as at 30 September 2015.

5.13 Credit risk mitigation

The Group uses a range of approaches to mitigate credit risk. The Group has a RAS and comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries.

5.13.1 Collateral held as security and other credit enhancements

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

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

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

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Residential mortgages
Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or automated valuation models subject to business rules and confidence levels. The loan to value ratio of our mortgage portfolio is disclosed in note 15 of the Group's annual report & consolidated financial Statements for the year ended 30 September 2015.

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

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

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

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

Table 19: Use of credit risk mitigation techniques

As at 30 September	2015		2014	
	Guarantees	Eligible Collateral	Guarantees	Eligible Collateral
Exposure Type	£m	£m	£m	£m
Central Governments or Central Banks	-	-	-	49
Regional Government or Local Authority	-	-	-	-
Public Sector Entities	-	-	-	-
Multilateral Development Banks	-	-	-	-
Institutions	-	-	-	910
Corporates	53	64	68	91
Retail	-	-	-	-
Secured by Mortgages on Immovable Property	-	6	-	41
Exposures in Default	-	-	-	1
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-
Claims in the Form of CIU	-	-	-	-
Equity Exposures	-	-	-	-
Other Items	-	-	-	-
Total	53	70	68	1,092

The decrease in eligible collateral held is driven by the fact there were no repo or reverse style transactions as at 30 September 2015, reflected within institutions.

5.13.2 Treasury

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

Repurchase agreements
Repurchase agreements will typically be subject to Global Master Repurchase Agreements ("GMRAs") or similar agreements whereby all outstanding transactions with the same counterparty can be offset and closed out upon a default or insolvency event (i.e. close out netting).

Where the Group has a right of offset on default or insolvency only, the related financial instruments comprise of highly liquid securities pledged, which can be realised in the event of a default or insolvency by the counterparty.

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

6. Operational Risk

6.1 Introduction

Operational risks arise from the day-to-day operational activities of the Group, which may result in direct or indirect losses and could adversely impact the Group's financial performance and position. These losses may result from both internal and external events, and risks, including, but not limited to, process error or failure, inadequate process design, poor product development and maintenance, poor change management, ageing infrastructure and systems, system failure, security and physical protection, fraud, deficiencies in employees' skills and performance or human error, operational failures by third party providers (including offshored and outsourced providers), natural disasters, extreme weather events, political, security and social events and failings in the financial services industry or other idiosyncratic components of operational risk that are related to the Group's particular size, nature and complexity.

Operational risk exists across the Group and is present in all business activities (including those that give rise to other risk types, such as credit risk), organisational changes such as project and business initiatives, the systems that support business activities and the way the Group's people perform these activities. Poorly designed, implemented, understood or managed processes, systems, controls and how people interact with these can result in the potential for significant operational risks to arise. These could lead to financial loss and/or negative non-financial impacts that can affect the Group's ability to meet business objectives and targets, core processes, the ability to satisfy compliance obligations and the Group's obligations to depositors, policy holders and/or customers and shareholders.

Operational risk cannot be fully mitigated and requires informed choice i.e. determining the appropriate balance between accepting potential losses (within Board approved appetite) and incurring costs to better manage operational risks and improve operating efficiencies. Responsibility for the management of operational risk rests with the business managers with oversight from the risk management function, with additional guidance and functional oversight provided by policy owners and technical specialists e.g. Information Security, Supplier Management, and independent assurance activities undertaken by Internal Audit.

While the day-to-day management of operational risk is focused on low value, high volume events, the Group, in common with other financial institutions, is also exposed to extreme, but plausible, operational risk events. Such risk events can have extreme impacts on the Group if and when they occur. The Group undertakes scenario analysis to gain insights into the potential impact of this type of operational risk event. The Group maintains a suite of operational risk scenarios covering the Basel II event types relevant to its business. The suite of operational risk scenarios are reviewed on a regular basis by a cross section of business stakeholders and specialist functions, considering the potential worst case impact of an extreme event, including the likelihood of the event occurring, based on the current control environment. External data is also monitored through use of industry standard data consortiums to identify any new or emerging risks, and management actions are tracked through governance committees.

6.2 Measurement

The Group calculates its operational risk capital requirements under the Standardised Approach ("TSA"). The capital requirement is calculated using the historic three year average risk weighted income method where different income streams are allocated a different risk weighting.

6.3 Operational risk RWAs and capital requirement

The capital requirement calculated under TSA at 30 September 2015 was £127 million (2014: £125 million). The capital charge is included in Table 9.

The table below shows movements in RWAs for operational risk from 1 October 2014 to 30 September 2015.

Table 20: Operational risk RWAs

Operational risk RWAs	£m
As at 1 October 2014	1,564
Movement	25
As at 30 September 2015	1,589

The increase in RWAs for operational risk is due to the increase in revenue generated by the Group over the last three years compared to the three years prior to 30 September 2014.

7. Securitisation

7.1 Objectives and roles in relation to securitisation activity

The Group has established two master trust Residential Mortgage Backed Security ("RMBS") securitisation programmes which provide the Group with term funding via public debt capital markets, intra group funding and potential contingent liquidity. The master trust structure facilitates the issuance of multiple series of notes which can have different rated tranches, tenor and repayment features tailored specifically to investor preference. Each series of notes is supported by the same pool of mortgage assets that can be replenished, subject to eligibility criteria, as the trust reduces in size due to prepayments.

The master trust structure comprises of three Special Purpose Vehicles ("SPVs") which legally isolates the underlying mortgage assets beyond the reach of the Group and its creditors in a bankruptcy, winding-up or receivership event. The three SPVs are:

- Trustees – The purpose of which is to acquire mortgage assets and their related security from the Seller (the Bank) from time to time as required and hold such mortgage assets and their related security on trust.
- Funding – The purpose of which is to purchase a beneficiary share in the trust property, using the proceeds of an inter-company loan from the master issuer.
- Master Issuer – The purpose of which is to issue RMBS notes which represent the mortgage backed obligations, and to lend the note proceeds to Funding under the inter-company loan arrangements.

7.2 Roles

The Group's role in the securitisation programmes are sponsor, originator, servicer, cash manager and transaction account provider. The obligations in these roles are outlined in the transaction documents in accordance with market practice and regulatory requirements.

The master trust structures are supported by fully funded reserve accounts that are sized according to rating agency requirements. The reserve accounts are funded from a subordinated loan from Clydesdale Bank PLC. The programmes have to date repaid all outstanding subordinated loans. Clydesdale Bank PLC also provides a start-up loan for each issuance. This loan provides for fees charged in relation to new issuances and is repaid in the form of revenue receipts generated by the asset pool.

The Group is under no obligation to support any losses incurred by the securitisation programmes or noteholders. The principal and interest received from the mortgage assets are used to repay note principal and meet interest payments.

7.3 Associated risks

The Group has not sought to obtain regulatory capital relief from securitisation as significant risk transfer is not achieved. Capital is therefore calculated in accordance with the underlying risk weighting on the balance sheet. The principal risks within the securitised transformation are:

- credit risk: the risk that borrowers fail to meet their obligations as and when they fall due. This risk is assessed by credit rating agencies both at note issuances and on an ongoing basis. All Class A notes have a AAA credit rating from at least two of the main rating agencies (Standard & Poors, Fitch and Moody's). The Group monitors the performance of its mortgage book and the securitisation portfolio by assessing key metrics such as arrears, loan-to-value and geographic distributions.
- prepayment risk: the risk that customers could prepay all or part of their outstanding debt before the maturity of outstanding bonds. This risk is factored into credit rating agencies cash flow and Group models and is mitigated through mortgage substitution or pool replenishment.
- basis risk: there is a fixed-floating interest rate mismatch between the mortgage pool assets and the 3 month Sterling Libor linked intercompany loan. To mitigate this risk, Funding has entered into interest rate swap agreements.

- foreign exchange rate risk: there is a mismatch between the GBP denominated intercompany loan between Funding and Master Issuer, and the amounts payable to non-GBP denominated noteholders. This risk is mitigated by a balance guaranteed cross currency swap. Where there are non-GBP tranches, a cross currency swap has been executed with a counterparty to mitigate foreign exchange currency risk.
- call risk: there is a risk that any series issued notes are not called on their respective call dates.
- liquidity risk: there is a mismatch between the capital and interest payments on the underlying mortgage assets and the capital and interest payments through securitisation structures to investors.

The Group retains credit risks associated with the mortgage assets as these remain on-balance sheet. The risk to the programme is mitigated by the over collateralisation of mortgage assets, seller share and reserve accounts.

7.4 Issuer and retained positions

In August 2007, the Group launched the inaugural issuance from Lanark Master Trust ("Lanark"). The asset pool originally comprised of owner-occupied residential mortgage loans and a small amount of Buy to Let ("BTL") loans. In June 2011, BTL loans were removed from the Lanark mortgage pool and replaced with owner occupied mortgage loans.

To date, there have been seven issuances from Lanark. An external credit rating assessment is provided and monitored by three rating agencies: Moody's, Fitch and Standard and Poor's. All outstanding Class A notes are rated AAA. Credit enhancement for the securitisation structures is provided by subordinated notes representing specific reserves and excess spread. Clydesdale Bank PLC retains the unrated Lanark Class Z variable funding notes ("Z VFN"). The Z VFN operates in the same manner as a Z Note, however there is a flexible feature in that these notes can be partially amortised.

In September 2011, the Group established Lannraig Master Trust ("Lannraig"). The asset pool is exclusively made up of BTL mortgage loans. There have been two issuances since the debut issuance. External credit rating assessments are provided by Moody's and Fitch. The Class A notes are retained by Clydesdale Bank PLC and NAB. Clydesdale Bank PLC retains two unrated Lannraig Class Z notes.

Table 21: Outstanding notes

At 30 September 2015, outstanding notes are:

Issuer	Class A Notes	Class Z Notes	Total retained position
Lanark Master Issuer plc	£3,031m	£380m	£380m
Lannraig Master Issuer plc	£1,228m	£214m	£1,060m

Table 22: On balance sheet securitised exposures

As at 30 September 2015, on balance sheet securitised exposures are:-

Issuer	Mortgage Asset pool	Impaired and 90 days Past Due
Lanark Trustee Ltd	£4,275m	£23m
Lannraig Trustee Ltd	£1,648m	£8m

The SPVs are fully consolidated in the Group's annual report & consolidated financial statements.

The Group does not have any synthetic securitisations outstanding or any re-securitisations.

7.5 Securitisation accounting policies

Clydesdale Bank PLC has sold mortgages to the securitisation vehicles. However, these mortgages continue to be recognised on the Group's balance sheet. The mortgages do not qualify for de-recognition from the balance sheet because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. It is exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration.

8. Asset Encumbrance

8.1 Overview

The term encumbrance is used to denote those assets on a bank's balance sheet which have been pledged as security, collateral or legally 'ring-fenced' in some other way which prevents the firm from being able to transfer, pledge, sell or otherwise use/dispose of these assets.

These disclosures are based on the EBA guidelines on disclosure of encumbered and unencumbered assets, and on the PRA's Supervisory Statement 11/14.

8.2 Debt securities

Sale and Repurchase ("Repo") transactions are used, in the ordinary course of business, to manage short-term cash flow requirements and mismatches. A Repo transaction involves the pledge of marketable securities as security in exchange for receiving a short-term money market deposit. During the period of the Repo, the securities pledged become encumbered. The Group has entered into a number of Repo agreements with both NAB and other market counterparties. These arrangements are covered by GMRAs.

The Bank is a direct participant in a number of payment and clearing systems, all of which require collateral to be posted to support its obligations. Where the collateral requirements are met with marketable securities, the securities pledged become encumbered.

8.3 Loans and advances

The Group's wholesale term funding requirements are currently met via issuance from the SPVs. These structured issuances result in a portion of the Bank's mortgage assets becoming encumbered.

The Group has three Structured Funding Programmes: two securitisation Master Trust structures as outlined in Section 7 and one Regulated Covered Bond programme ("Clydesdale Covered Bonds No. 2 LLP"), also backed by retail mortgages.

Over-collateralisation levels are embedded in each programme to meet the minimum levels as specified by the programme documents and as agreed with the ratings agencies and regulators to mitigate certain legal risks, such as set-off rights.

The SPVs also hold cash balances in segregated Guaranteed Investment Certificate ("GIC") bank accounts. The use of these balances is restricted to the repayment of debt securities issued by the SPVs and other legal obligations associated with these structures. These balances are, therefore, considered by the Group to be encumbered.

Items also included within 'loans and advances' are note cover, the Cash Ratio Deposit ("CRD") with the BoE and cash margin collateral supporting Repo transactions.

Note cover and cash ratio deposit
Under Part 6 of The Banking Act 2009, banks in Scotland and Northern Ireland which issue bank notes are required to hold backing assets for their notes at all times and banks may use a combination of BoE notes, UK coin and funds in an interest-bearing bank account at the BoE. As a result of this permanent requirement for note-issuing banks to provide 100% 'cover' for the value of their bank notes in circulation at all times, note cover requirements are considered to be encumbered assets. If note issuance increases then additional cash/balances are required to be placed with the BoE. However, as this process creates equal and offsetting liabilities for the assets encumbered there is no material risk to depositors or the Group.

CRDs are non-interest bearing deposits lodged with the BoE by eligible institutions (i.e. banks and building societies), who have reported average eligible liabilities of over £600 million over a calculation period. The level of each institution's CRD is currently calculated twice-yearly (currently in May and November) at 0.18% of average eligible liabilities, over the previous six end-calendar months, in excess of £600m. The purpose of the CRD scheme is to support the running costs of the BoE and, due to the permanent nature of the CRD, the requirement is considered to be an encumbered asset.

Cash margin collateral supporting Repo transactions
As noted above, a repo transaction involves the pledge of marketable securities as security in exchange for receiving a short-term money market deposit. During the period of the repo, the market value of the securities pledged fluctuates whilst the value of the underlying cash deposit remains fixed. To account for the fluctuations in the market value of the securities, additional cash ('margin') is passed between the parties. Where the Group has paid out additional cash margin, this is treated as encumbered by the Group.

8.4 Other assets

Other encumbered assets include cash collateral supporting UK payment systems, cash held at the Dutch Central Bank supporting EU payment systems and cash collateral supporting derivative transactions.

The Bank is a direct participant in a number of UK payment and clearing systems, all of which require collateral to be posted to support the bank's obligations. Where the collateral requirements are met with cash, the value of the cash pledged becomes encumbered.

Target2 ("Trans-European Automated Real-time Gross Settlement Express Transfer") is a real time automated payment system for sending and receiving Euro Payments within the EU between Member Banks. The Bank is a direct member of Target2 and the Dutch Central Bank operates the settlement process on behalf of the Bank on a pre-funded basis. This is facilitated via an account held with the Dutch Central Bank which is funded as and when required to meet payments. The balance of this account is, therefore, treated as encumbered by the Group.

The Group has entered into a number of derivative netting agreements with both NAB and other market counterparties. The existence of these netting agreements enables the Group to net all derivative exposures covered by the agreement by substituting the current replacement cost with the net replacement cost (i.e. netting the positive mark-to-market values against the negative mark-to-market values). The net replacement cost position is then fully cash collateralised on a daily basis. Where the Group has paid out cash collateral, this is treated as encumbered. These arrangements are covered by an ISDA agreement.

8.5 Encumbered assets

The amounts disclosed in the Table 23 and Table 24 below are median values for the financial year 2015 calculated using quarterly data.

Table 23 shows the carrying and, where included in the regulatory templates, the fair value of encumbered and unencumbered assets by asset category. Table 24 shows the carrying value of encumbered assets and associated liabilities by sources of encumbrance. The disclosures are in accordance with PRA/EBA regulatory reporting requirements and as such differ from the disclosures contained in the annual report & consolidated financial statements as at 30 September 2015.

Table 23: Fair Value of Encumbered Assets (Template A)

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Assets of the reporting institutions	10,230		28,364	
Equity instruments	-	-	6	6
Debt securities	388	388	932	932
Other assets	371		997	

Table 24: Encumbered Assets/ Collateral Received & Associated Liabilities (Template C)

	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	4,905	7,830

The Group has elected to apply the waiver available under PRA Supervisory Statement 11/14 regarding disclosure of details of collateral received (Template B).

9. Counterparty Credit Risk

9.1 Definition

As a result of hedging market risk with other financial counterparties and placing surplus liquidity with appropriate counterparties (including the Bank of England), the Group has credit exposures to counterparties. Counterparty Credit Risk ("CCR") is the risk that a counterparty to a transaction may default before the final settlement of the transaction's cash flows. This section describes the Group's approach to managing CCR concerning financial instruments, including derivatives and repurchase agreements.

9.2 Internal capital and credit limits

Counterparty credit limits for derivatives are approved and assigned by an appropriately authorised Delegated Commitment Authority ("DCA"). Limits are based on the credit quality of the counterparty and the appetite for the projected maximum potential future exposure of anticipated derivative transactions. They also reflect the nature of the relevant documentation. Credit exposures for each transaction are measured as the current mark-to-market value and the potential credit exposure which is an estimate of the future replacement cost. Limit excesses, whether they are active or passive, are subject to formal approval by a DCA.

9.3 Securing collateral and establishing credit reserves

The risk that counterparties could default is mitigated by offsetting the amounts due to the same counterparties (i.e. netting) and by cash collateral deposited by counterparties (i.e. collateralisation).

Collateralisation reduces the credit exposure recorded against market transactions. Counterparty credit exposures may be collateralised by an approved list of eligible collateral via market standard master agreements (such as CSAs to ISDA Master Agreements and GMRAs).

Counterparty credit risk policy governs types of acceptable collateral and that collateral which may be subject to haircuts depending on asset type, in line with industry norms. Systems support daily marking-to-market of net exposures and margin requirements, marking-to-market of collateral value and reconciliation of collateral receipt and holdings against collateral due.

9.4 Wrong way risk

Wrong way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty. The Group manages these risks through the effective implementation of a number of risk policies, including, but not limited to: single large exposure policy; credit concentration risk policies; aggregation policy; collateralisation policy; and various product restrictions.

9.5 Downgrade impact

The Group calculates, as part of its regular reporting, the amount of any additional collateral that would have to be posted in the event of a downgrade in its external rating. For transactions that would be affected by a downgrade clause, planning for, and the impact of, the event for the Group is managed by the Group's Treasury department.

9.6 Exposures

Counterparty credit risk exposures are first measured using the mark-to-market method and subsequently risk-weighted under the Standardised Approach. The Group calculates a CVA on external derivative transactions with financial counterparties.

9.7 Counterparty credit risk exposures

An analysis by measurement approach, by exposure class, by risk weight approach and by contract type is presented in the table below:

Table 25: Counterparty credit risk exposure

As at 30 September	2015		2014	
	Exposure	RWA	Exposure	RWA
Mark to Market Approach:	£'m	£m	£m	£m
Interest Rate Contracts	235	87	376	127
Foreign Exchange Contracts	38	22	73	43
Commodities Contracts	31	29	16	11
Securities Financing Transactions	-	-	-	-
	304	138	465	181

9.8 Net derivatives credit exposure

Details of the net derivatives credit exposure are set out below:

Table 26: Net derivatives credit exposure

As at 30 September	2015	2014
	£m	£m
Gross positive fair value of contracts	285	220
Potential Future Credit Exposure	446	380
Netting Benefits	(671)	(452)
Net Current Credit Exposures	60	148
Collateral Pledged	244	317
Net Derivative Credit Exposure	304	465

10. Market and Interest Rate Risk

10.1 Market risk

Market risk is the risk associated with adverse changes in the fair value of positions held by the Group as a result of movement in market factors such as interest rates, foreign exchange rates, volatility and credit spreads.

Interest Rate Risks arise through the provision of banking products and services to the Group's customers. The Group also offers a range of treasury risk management products to their customers, which include interest rate risk and foreign exchange risk products, to assist customers' with their management of risks. The Group does not operate a trading book. Market risk associated with treasury risk management products offered by the Group is hedged on a like-for-like basis so that, other than immaterial positions, market risk positions are not held on the balance sheet of the Group.

10.2 Interest rate risk in the banking book

IRRBB arises from changes in interest rates that adversely impact the Group's financial condition in terms of earnings (net interest income) or economic value of the balance sheet. This includes:

- repricing risk, arising from changes to the overall level of interest rates and inherent mismatches in the repricing term of the banking book items;
- yield curve risk, arising from a change in the relative level of interest rates for different tenors and changes in the slope or shape of the yield curve;
- basis risk, arising from differences between the actual and expected interest margins on banking book items over the implied cost of funds of those items; and
- optionality risk, arising from the existence of stand-alone or embedded options in banking book items, to the extent that the potential for losses is not included in the above risk types.

10.2.1 Management

The Group has a risk appetite for interest rate risk which is supported by a framework of limits. The Group's Treasury function is responsible for managing the interest rate risk profile of the balance sheet in line with the approved risk appetite. This includes development and execution of interest rate risk management strategies.

The Group has a Funds Transfer Pricing ("FTP") mechanism in place to transfer interest rate risk out of originating business units and into the Treasury function for the management of interest rate risk.

The Balance Sheet and Liquidity Risk Oversight team is responsible for IRRBB monitoring and oversight and is independent of Treasury. It maintains a risk framework for IRRBB covering the responsibility for the management of IRRBB measurement of exposures, compliance monitoring and reporting.

Key metrics are reported on a monthly basis to ALCO and to the Board. Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of ALCO.

10.2.2 Measurement

Interest rate risk is measured, managed and monitored under the risk management framework using both the market valuation and the earnings based approaches. Risk measurement techniques include: Value-at-risk ("VaR"), Earnings-at-Risk ("EaR"), interest rate risk stress testing, repricing analysis, cash flow analysis and scenario analysis.

The principal metrics used to measure and monitor IRRBB are as follows:

Measurement	Definition
VaR	The potential loss in economic value implied by the static balance sheet that arises from changes to the current yield curve based upon historical observations for a given holding period and confidence level.
EaR	The potential loss in earnings implied by the static balance sheet over a 12 month forecast period, that arises from changes in the current yield curve based on historical observations for a given holding period and confidence level.
Market Value	The present value of all known future cash flows implied by the static balance sheet on both a spot and historically cumulative basis.
Embedded Value	The economic gain or loss implied by the static balance sheet which equates to the market value less the book value, less accrued interest.
Economic Value Sensitivity ("EVS")	The potential impact of parallel and non-parallel changes in interest rates on the present value of all known future cash flows implied by the static balance sheet.
Net Interest Income Sensitivity ("NIIS")	The potential impact of parallel and non-parallel changes in interest rates on the earnings over a 12-month forecast period implied by the static balance sheet.

VaR and EaR are measured with a three-month holding period and 99% confidence level for internal reporting purposes.

Table 27: Interest Rate Risk in the Banking Book

This table provides the increase or decrease in economic value for upward and downward rate shocks.

As at 30 September	2015		2014	
	200bp parallel increase £m	200bp parallel decrease £m	200bp parallel increase £m	200bp parallel decrease £m
Change in economic value	36	(35)	11	(9)

Note: Assuming that rates are floored at zero, the impact of the downward rate shock as at 30 September 2015 is (£28) million.

11. Remuneration

This section relates to employees identified as a Material Risk Takers ("MRTs"), for the financial year ended 30 September 2015.

MRTs	Roles
Senior Management	Includes the Clydesdale and Yorkshire Bank Leadership team and senior management in the Group. Additionally this may include members of the NAB Group Executive Committee with specific responsibilities in relation to the Group.
Other MRTs	Includes non-executive directors of the Group's boards, employees performing Significant Influence Functions, employees who have responsibility and accountability for activities that could have a material impact on the Bank business' risk profile, and employees in independent risk management, compliance or internal audit function roles. Additionally this includes non-executive directors of the NAB Board with specific responsibilities in relation to the Group,

11.1 Remuneration Governance

The NAB Remuneration Committee has been established by the NAB Board. Its Charter (which is approved by the NAB Board) sets out the membership, responsibilities, authority and activities of the NAB Remuneration Committee. The full Charter is available online at www.nabgroup.com. As at 30 September 2015 the NAB Remuneration Committee was comprised of four independent non-executive directors. The NAB Remuneration Committee met 13 times during 2015.

The Group's Remuneration Committee ("RemCo") was established by the CYB Investments Limited Board in April 2015. Its Charter (which is approved by the Company's Board) sets out the membership, responsibilities, authority and activities of the RemCo.

The RemCo membership consists of three independent non-executive directors and an appointed NAB representative. The RemCo operates within approved NAB Group remuneration policies and frameworks and decisions are noted by the NAB Remuneration Committee on a regular basis. Any recommendations or inititatives outside the NAB Group's remuneration policies and frameworks must be approved by NAB Remuneration Committee. The primary purpose of the RemCo is to support the Company's Board in ensuring adherence to the NAB Group remuneration governance structures and frameworks and to perform the role of a UK governing body in relation to remuneration requirements.

11.2 Use of External Advisers

Where appropriate, the NAB Remuneration Committee and RemCo seek and consider advice directly from external advisers, independent of management to review and provide recommendations and advice on remuneration and governance matters. Advice was provided by 3 degrees consulting and PwC respectively.

11.3 Remuneration Framework

11.3.1 Scope of the Remuneration Policy

NAB Group operates a global remuneration policy ("the Policy") that applies to NAB and all its controlled entities. The Policy covers all employees, including MRTs. The NAB Group's overall philosophy is to adopt, where possible, a methodology which links remuneration directly to the performance and behaviour of an individual, the Group's results, NAB Group's results and shareholder outcomes. Further information regarding remuneration is available in the *Remuneration Report* section of NAB's 2015 Annual Financial Report.

11.3.2 Remuneration Policy

The Policy is designed to:

- attract, recognise, motivate and retain high performers;
- drive employee performance;
- align the interests of employees and shareholders through ownership of NAB securities; and
- comply with jurisdictional remuneration regulations and Group diversity, inclusion and pay equity commitments.

The Policy uses a range of components to focus employees on achieving NAB Group's strategy and business objectives. Each individual's actual remuneration will reflect:

- the degree of individual achievement in meeting performance measures and compliance obligations under the performance management framework;
- parameters approved by the Board based on NAB Group's financial and risk performance and other qualitative factors;
- NAB's share price performance and relative shareholder returns; and
- the timing and level of deferred awards.

Total Reward consists of both fixed and variable components:

- fixed remuneration provided as cash and benefits (including employer pension); and
- variable remuneration reflects both individual and business performance.

The mix of fixed and variable reward is balanced to ensure that fixed remuneration provides a sufficient level of remuneration so that the variable reward components can be fully flexible, including the possibility of paying no variable reward. The remuneration mix at target is based on market information and practices. In any year, the actual mix may vary from target, given the overlay of business performance and individual performance.

Other features of the Policy

Malus

The NAB Board has absolute discretion, subject to compliance with the law, to adjust any variable award and other performance-based components of remuneration downwards, or to zero, to protect the financial soundness of NAB Group. In addition, the NAB Board may vary vesting of deferred incentives if the NAB Group's financial performance or risk management have significantly deteriorated over the vesting period. A qualitative overlay may be applied that reflects the NAB Group's management of business risks, shareholder expectations and the quality of the financial results.

This discretion can be applied at any time and may impact unvested equity awards and performance-based rewards yet to be awarded, whether in cash or equity. In exercising its discretion, the NAB Board will consider whether the rewards are appropriate given later individual or business performance.
Malus may apply to any employees across the NAB Group, by division, by role and/or employee, depending on circumstances.

Clawback

From 1 January 2015, variable reward for MRTs, including retention awards, is subject to clawback for up to 7 years from the award date.

The employee will be required to repay, up to the full amount, any performance-based reward, where the NAB Board (in its absolute discretion) determines that one or more of the following circumstances have arisen before the seventh anniversary of the reward:

- the employee has participated in, or was responsible for, conduct which resulted in significant losses to the NAB Group or relevant business;
- the employee has failed to meet appropriate standards of fitness and propriety;
- the NAB Group has reasonable evidence of employee misbehaviour or material error; and
- the NAB Group or the relevant business suffered a material failure of risk management, taking into account the employee's level of responsibility.

Commencement, retention and guaranteed incentives

Commencement awards enable buy-out of unvested equity from previous employment. The amount, timing and performance hurdles relevant to any such awards are based on satisfactory evidence. The awards are primarily provided in the form of shares or performance rights, subject to performance hurdles, restrictions and certain forfeiture conditions, including forfeiture on resignation, unique to each offer.

Guaranteed incentives or bonuses do not support the NAB Group's performance-based culture and are not provided as part of the Policy.

The NAB Group provides retention awards for key employees in roles where retention is critical over a medium-term timeframe (generally two to three years). These are normally provided in the form of shares or performance rights, subject to regulatory requirements, a restriction period, achievement of individual performance standards and forfeiture conditions, including forfeiture on resignation.

Payments on early termination

The NAB Group does not support payments on termination where the employee has been terminated for performance or misconduct reasons.

Payments made to employees on termination (including redundancy) are provided in accordance with policy and contracts of employment and are not performance related. In addition, unvested amounts for all variable, commencement and retention rewards will generally be forfeited prior to the vesting (or milestone) date on:

- resignation from the Group;
- termination by the Group (except in circumstances of retrenchment or redundancy or where the Principal Board exercises its discretion, subject to compliance with the law, that the equity not be forfeited);
- failure of the Compliance Gateway (e.g. "Red" rating), including a determination that a former employee engaged in conduct that would have caused failure of the Compliance Gateway or equivalent if still employed by the Group; or
- NAB Board determination that all or some of the amount will be forfeited. Such a determination may be made at the NAB Group, Group, business unit, role or individual level.

Deferred amounts not forfeited on cessation of employment are retained, subject to initial performance and restriction hurdles.

Policy Changes

The NAB Remuneration Committee reviewed the Policy during 2015 and made a number of changes applicable to the Group:

- increased the maximum ratio of the variable component of total reward to the fixed component to 2:1, which was approved by NAB as the current sole shareholder;
- introduced a 'Clawback' policy for MRTs in line with UK regulatory requirements; and
- updated the Policy to reflect the NAB Group's commitment to pay equity.

11.3.3 Control Function Employees

Employees engaged in control functions (i.e. Risk, Internal Audit and Compliance employees) are critical to effective management of risk across the NAB Group. Independence from the business for these employees is assured through:

- setting the reward mix so that variable reward is not significant enough to encourage inappropriate behaviours while remaining competitive with the external market;
- the Risk or Finance function determining remuneration decisions, and not the business the employees support;
- performance measures and targets set align with the NAB Group and/or are specific to the function; and
- Group or NAB Group performance and/or function performance being a key component for calculating individual incentive payments.

The NAB Remuneration Committee or the RemCo, as appropriate, reviews remuneration structures for these employees and oversees the overall reward outcomes for employees in these roles at least annually.

11.3.4 Risk Adjustment

NAB Remuneration Committee decisions and recommendations are made as far as practicable to align remuneration with shareholder returns, in accordance with regulatory reguirements and global regulatory trends. NAB Remuneration Committee's remuneration decisions are based on a risk-adjusted view of NAB Group's financial performance. Variable reward outcomes reflect risk at a number of levels:

Individual scorecards – Individuals have specific risk related measures relevant to the individual's role and are aligned with the RAS where appropriate. The individual's performance against these risk measures is captured through the individual's short-term incentive ("STI") reward.

Compliance Gateway – Supports NAB Group's risk and compliance culture. Individuals who fail the compliance expectations of their role will have their variable reward reduced in part, or in full, depending on the severity of the breach and may not be eligible for variable reward.

STI pool measures – The financial measures used to determine the STI pool are selected to capture the impact of a number of material risks (see 11.3.6 for further discussion on how the financial measures take account of risk).

Risk adjustment of business outcomes – Whilst performance is assessed against compliance with the agreed risk measures and risk appetite, The RemCo may recommend to the NAB Remuneration Committee, adjustment of the financial outcomes upon which variable rewards are determined based on a qualitative overlay that reflects the Group's management of business risks, shareholder expectations and the quality of the financial results.

11.3.5 Deferral Arrangements

Variable rewards (STI, long-term incentive ("LTI") and retention awards) are subject to deferral and retention for all MRTs in line with UK regulation:

- at least 60% of total variable reward will deferred over 3 years where the total variable reward is £500,000 or more; and
- at least 40% of total variable reward will deferred over 3 years where the MRT does not meet de minimis conditions.

Deferred variable amounts are generally provided in either shares or performance rights. Deferred variable awards are subject to malus and, from 1 January 2015, clawback will also apply for senior management.

A further six month retention period applies to a proportion of deferred variable reward after performance conditions have been satisfied. In addition, half of any 'up-front' cash element of variable remuneration is provided in shares and / or other instruments, subject to a six month retention period. The retained amounts are restricted from being sold, transferred or exercised by the individual during the retention period. No further performance conditions apply to retention equity nor is the equity subject to any forfeiture conditions.

11.3.6 Variable Remuneration Arrangements

Short-Term Incentive
STI rewards are determined based on a combination of business and individual performance.

The Group's performance and STI pool is measured by a mix of growth in Group cash earnings and Return on Equity ("ROE"). These measures reasonably capture the effects of a number of material risks and minimise actions that promote short-term results at the expense of longer term business growth and success. The Group's STI pool is calculated using the following key performance measures; cash earnings and ROE.

An individual's performance is assessed against what they have delivered and how they have achieved the outcomes. Performance objectives are set as part of Group's strategy development process, which cascades to scorecard objectives for each individual supporting key business drivers. The objectives under each business driver are selected for their alignment to the Group's strategic direction. The key performance objectives used for senior executives of the Group in 2015 were:

Key Business Driver	Objectives
Customer	- Customer outcomes - Attraction and retention
Risk and Control	- Risk appetite
Sustainable Returns	- RoE - Cash earnings
People	- Employee engagement

STI plans link to NAB Group and Group performance by delivering smaller STI pools when performance is less than plan and larger STI pools when performance is above plan.

Long-Term Incentive

NAB Group long-term incentive awards are not expected be granted to Directors of the Group for the year ended 30 September 2015. Alternative long-term incentive awards in relation to the year are being finalised as part of the planned demerger and IPO.

Forms of Variable Remuneration

Generally, NAB Group aims to provide deferred variable remuneration as equity to align the interests of employees and shareholders. Performance rights are provided where NAB Group does not consider it appropriate to pay dividends during deferral or restriction periods.

The mix of different forms of variable remuneration is dependent on the individual's role and external market relativities.

All individuals are eligible to participate in an STI plan. STI awards will generally be provided in a combination of cash and equity as described above in Deferral Arrangements (see section 11.3.5).

LTI awards are provided at the discretion of the RemCo and not all MRTs would receive LTI. Retention, recognition and commencement awards may be provided to an individual depending on circumstances and are subject to regulatory requirements and restrictions. The quantum and form will vary depending on the specific circumstances at the time of the award.

Linking Performance and Remuneration

Performance is linked to remuneration through both fixed and variable remuneration components. Fixed remuneration is set based on a combination of market position, individual performance and NAB's ability to pay.

Poor performance, including non-compliance with Group and NAB Group policies, during a performance period will be reflected in the variable pay awarded or amount that vests at the end of the performance period. If performance is significantly weak, this may result in no variable pay being awarded, vesting and /or prior deferred awards being forfeited / lapsed.

Individual employees have a responsibility to ensure they comply with policies, including the NAB Group Securities Trading Policy and UK Code of Conduct. In particular, the NAB Group Securities Trading Policy specifically prohibits directors and employees from protecting the value of unvested securities (including unvested deferred variable remuneration) with derivative instruments. Directors and employees can protect the value of vested securities in limited circumstances. Any employee found to be in breach of policies will be subject to disciplinary action.

11.4 Quantitative Disclosures

These quantitative disclosures have been prepared in accordance with CRR article 450 for the year ended 30 September 2015, having regard to the PRA's Supervisory Statement LSS8/13 'Remuneration standards: the application of proportionality'. All monetary amounts are in GBP.

Table 28: Aggregate Remuneration of MRTs by business area:

	Banking	Independent Control Function[6]	Total
Number of MRTs	42	23	65
Total remuneration (£m)	14.5	4.2	18.7

Table 29: Total Value of Remuneration Awards

	Senior Management	Other MRTs	Total
Number of MRTs	19	46	65

	Senior Management £m	Other MRTs £m	Total £m
Fixed remuneration	5.9	6.2	12.1
Total variable remuneration	5.0	1.6	6.6
Total remuneration	10.9	7.8	18.7

Table 30: Other Remuneration

	Senior Management £m	Other MRTs £m	Total £m
Commencement awards	1.3	-	1.3
Number of beneficiaries	3	-	3
Highest award to a single beneficiary	0.6	-	
Termination payments	0.9	0.6	1.5
Number of beneficiaries	1	4	5
Highest award to a single beneficiary	0.9	0.3	-

Table 31: High earners

Remuneration band (£m)	Number of senior management	Number of other MRTs	Total number of MRTs
More than 2,196	-	-	-
1,830 – 2,196	-	-	-
1,464 - 1,830	-	-	-
1,098 - 1,464	1	-	1
732 - 1,098	2	-	2
Less than 732	16	46	62
Total	19	46	65

Total remuneration has been calculated including fixed remuneration, allowances, variable remuneration in relation to the performance year, and fees for non-executive directors. Variable remuneration includes the annual short-term incentive award in respect of the 2015 financial year. Bands have been converted using a rate of 1 Euro = £0.7321, consistent with the European Commission's currency converter for September 2015.

[6] Includes non-executive directors, Risk employees, Internal Audit and Compliance.

Appendix 1: Disclosures for Clydesdale Bank PLC

The following tables present the disclosures required for the Bank on an individual consolidated basis. The differences between the Group and the Bank relate primarily to reserves held by entities that sit outside of the scope of the Bank solo consolidation that are included in the Group consolidation, a small impact from the risk weighted assets of these entities and Additional Tier 1 capital issued by the Group.

Table 32: Capital composition

As at 30 September	2015	2014
Common Equity Tier 1 (CET1) capital: Instruments and reserves	£m	£m
Capital instruments and the related share premium accounts	2,812	2,285
Retained earnings	179	(116)
Accumulated other comprehensive income (and other reserves)	(1)	323
Common Equity Tier 1 (CET1) capital before regulatory adjustments	2,990	2,492
Common Equity Tier 1 (CET1) capital: regulatory adjustments		
Additional value adjustments	(2)	(2)
Intangible assets (net of related tax liability)	-	-
Deferred tax assets that rely on future profitability excluding those arising from temporary differences	(273)	(223)
Defined benefit pension fund assets	(42)	(39)
CET1 instruments of financial sector entities where the institution has a significant investment	(318)	-
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(635)	(264)
Common Equity Tier 1 (CET1) capital	2,355	2,228
Additional Tier 1 (AT1) capital: instruments		
Capital instruments and the related share premium accounts	450	-
Additional Tier 1 (AT1) capital	450	-
Tier 1 Capital	2,805	2,228
Tier 2 (T2) capital: Instruments and provisions		
Capital instruments and the related share premium accounts	300	300
Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	175	776
Credit risk adjustments	138	135
Tier 2 (T2) capital	613	1,211
Total Capital	3,418	3,439
Total risk weighted assets	17,795	18,292
Capital Ratios		
Common Equity Tier 1	13.2%	12.2%
Tier 1	15.8%	12.2%
Total Capital	19.2%	18.8%

The Bank's individually consolidated CET1 ratio increased from 12.2% in September 2014 to 13.2% in September 2015. In December 2014, a capital restructure was completed to strengthen the Bank's capital base and ensure that the PRA's prudential capital requirements continue to be met. As part of this restructure, the Group repaid £601m of Tier 2 capital in the form of subordinated loan debt and issued £350m of CRD IV compliant AT1 Perpetual Capital Notes to the Group's immediate parent. A further £100m of AT1 Perpetual Capital Notes were issued to the Group's immediate parent in September 2015. Between June and September 2015, ordinary shares of £770m were issued as part of the preparation for the demerger and IPO. These actions led to a strengthening of the CET1 ratio. Further capital benefits from balance sheet optimisation resulted in a reduction in credit risk-weighted assets. These actions were partially offset by the impact of conduct charges incurred in the year.

The table below shows movements in the Bank's capital during 2015.

Table 33: Capital flow statement

	2015 £m	2014 £m
CET1 capital		
CET1 capital at 1 October	2,228	2,078
Share capital: ordinary share new issuance	770	600
Share premium transfer	(243)	-
Retained earnings and other reserves	(29)	(187)
Prudent valuation adjustment	-	1
Intangible assets	-	-
DTA relying on future profitability	(50)	(223)
Defined benefit pension fund assets	(3)	(39)
Pension fund deficit adjustment	-	(2)
CET1 instruments of financial sector entities where the institution has a significant investment	(318)	-
	2,355	2,228
Tier 1 capital		
Tier 1 capital at 1 October	-	300
Share capital repurchased: perpetual non-cumulative preference shares	-	(300)
Share capital issued: Additional Tier 1 capital perpetual notes	450	-
	450	-
Total Tier 1 capital	2,805	2,228
Tier 2 capital		
Tier 2 capital at 1 October	1,211	1,209
Subordinated debt repurchase	(601)	-
Credit risk adjustments	3	(20)
Asset revaluation reserve	-	(2)
Qualifying and material holding Tier 2 deductions	-	24
	613	1,211
Total capital at 30 September	3,418	3,439

Tier 1 capital

The Bank's Tier 1 capital comprises:

- ordinary shares;
- retained earnings;
- accumulated other comprehensive income (and other reserves);
- Additional Tier 1 ("AT1") Instruments; and
- adjustments as set out by the regulatory requirements governing capital resources.

Regulatory adjustments are made where appropriate. These are made on a consistent basis as the Group, described at section 3.

Tier 2 capital

Tier 2 capital comprises:

- subordinated loan debt;
- general and collective provisions; and
- adjustments as set out by the regulatory requirements governing capital resources.

Table 34: CRD IV end-point vs transitional comparison

	Current Rules 2015	Current Rules 2014	Full Impact 2015	Full Impact 2014
	£m	£m	£m	£m
Common Equity Tier 1 (CET1) capital: Instruments and reserves				
Capital instruments and the related share premium accounts	2,812	2,285	2,812	2,285
Retained earnings	179	(116)	179	(116)
Accumulated other comprehensive income (and other reserves)	(1)	323	(1)	323
Common Equity Tier 1 (CET1) capital before regulatory adjustments	2,990	2,492	2,990	2,492
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments	(2)	(2)	(2)	(2)
Intangible assets (net of related tax liability)	-	-	-	-
Deferred tax assets that rely on future profitability excluding those arising from temporary differences	(273)	(223)	(273)	(223)
Defined benefit pension fund assets	(42)	(39)	(42)	(39)
CET1 instruments of financial sector entities where the institution has a significant investment	(318)	-	(318)	-
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(635)	(264)	(635)	(264)
Common Equity Tier 1 (CET1) capital	2,355	2,228	2,355	2,228
Additional Tier 1 (AT1) capital: instruments				
Capital instruments and the related share premium accounts	450	-	450	-
Additional Tier 1 (AT1) capital	450	-	450	-
Tier 1 Capital	2,805	2,228	2,805	2,228
Tier 2 (T2) capital: Instruments and provisions				
Capital instruments and the related share premium accounts	300	300	300	300
Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	175	776	-	-
Credit risk adjustments	138	135	138	135
Tier 2 (T2) capital	613	1,211	438	435
Total Capital	3,418	3,439	3,243	2,663
Total risk weighted assets	17,795	18,292	17,795	18,292
Capital Ratios				
Common Equity Tier 1	13.2%	12.2%	13.2%	12.2%
Tier 1	15.8%	12.2%	15.8%	12.2%
Total Capital	19.2%	18.8%	18.2%	14.6%

Table 35: Reconciliation of statutory equity to regulatory capital

	2015 £m	2014 £m
Statutory total equity[7]	3,443	2,502
Less pension regulatory adjustments	(42)	(39)
Less deductions from capital	(2)	(2)
Less share option reserve	(3)	(2)
Less available for sale reserve	-	(8)
Less deferred tax asset relying on future profitability	(273)	(223)
Less CET1 instruments of financial sector entities where the institution has a significant investment	(318)	-
Regulatory Tier 1 capital	2,805	2,228

Table 36: Leverage Ratio

The Bank's individual consolidated leverage ratio is calculated on a basis consistent with that of the Group, as set out in section 3.4. The table below shows the calculation of the leverage ratio for the Bank as at 30 September 2015.

	2015 £m	2014 £m
Total Tier 1 capital for the leverage ratio		
Total Common Equity Tier 1 (CET1) capital	2,355	2,228
Additional Tier 1 (AT1) capital	450	-
Total Tier 1	2,805	2,228
Exposures for the leverage ratio		
Total statutory assets per the statement of financial position[8]	40,548	38,619
Off balance sheet items	2,034	2,163
Derivative exposures adjustment	23	118
SFT exposure adjustment	-	58
Other regulatory adjustment	(635)	(264)
Leverage ratio exposure	41,970	40,694
Leverage ratio	6.7%	5.5%

[7] Of which £3,430m relates to Clydesdale Bank PLC (2014: £2,475m).
[8] Of which £40,591m relates to Clydesdale Bank PLC (2014: £38,601m).

Table 37: CB Minimum capital requirement - Pillar 1

The following table shows the Bank's individual consolidated capital resources requirement under Pillar 1 as at 30 September 2015.

	2015		2014	
	RWA	Capital	RWA	Capital
Pillar 1 Capital Requirements	£m	£m	£m	£m
Central Governments or Central Banks	-	-	-	-
Regional Government or Local Authority	22	2	22	2
Public Sector Entities	3	-	3	-
Multilateral Development Banks	-	-	-	-
Institutions	131	11	61	5
Corporates	3,287	264	3,755	300
Retail	930	74	994	79
Secured by Mortgages on Immovable Property	10,862	869	10,552	845
Exposures in Default	427	34	611	49
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	-	-	-
Claims in the Form of CIU	3	-	3	-
Equity Exposures	6	-	27	2
Other Items	337	27	463	37
Total Credit Risk	16,008	1,281	16,491	1,319
Credit Counterparty Risk	128	10	166	13
Credit Valuation Adjustment	135	11	86	7
Operational Risk	1,524	122	1,549	124
Market Risk	-	-	-	-
	17,795	1,424	18,292	1,463

Appendix 2: Main Features of Regulatory Capital Instruments

1	Issuer	Clydesdale Bank PLC	Clydesdale Bank PLC	Clydesdale Bank PLC	Clydesdale Bank PLC	CYB Investments Limited	CYB Investments Limited
2	ISIN	XS0584870660	n/a	n/a	n/a	n/a	n/a
3	Governing law	English	English	English	English	English	English
	Regulatory treatment						
4	Transitional CRR rules	Tier 2	Tier 2	Additional Tier 1	Additional Tier 1	Additional Tier 1	Additional Tier 1
5	Post-transitional CRR rules	Tier 2	Tier 2	Additional Tier 1	Additional Tier 1	Additional Tier 1	Additional Tier 1
6	Eligible at Group or Bank	Holding Company, CB Consolidated, CB Solo Consolidated	Holding Company, CB Consolidated, CB Solo Consolidated	CB Consolidated, CB Solo Consolidated	CB Consolidated, CB Solo Consolidated	Holding Company	Holding Company
7	Instrument type (type to be specified by each jurisdiction)	Subordinated Debt	Subordinated Debt	Additional Tier 1 – Perpetual Capital Note	Additional Tier 1 – Perpetual Capital Note	Additional Tier 1 – Perpetual Capital Note	Additional Tier 1 – Perpetual Capital Note
8	Regulatory capital value	175,000,000	300,000,000	350,000,000	100,000,000	150,000,000	300,000,000
9	Nominal value (£)	175,000,000	300,000,000	350,000,000	100,000,000	150,000,000	300,000,000
9a	Issue price (£)	175,000,000	300,000,000	350,000,000	100,000,000	150,000,000	300,000,000
9b	Redemption price (£)	175,000,000	300,000,000	350,000,000	100,000,000	150,000,000	300,000,000
10	Accounting classification	Liability – amortised cost	Liability – amortised cost	Equity	Equity	Equity	Equity
11	Original date of issue	25-Jan-11	20-Dec-13	29-Dec-14	30-Sep-15	29-Dec-14	20-Dec-13
12	Perpetual or dated	Dated	Dated	Perpetual	Perpetual	Perpetual	Perpetual
13	Original maturity date	25-Jan-21	20-Dec-23	n/a	n/a	n/a	n/a
14	Issuer call subject to prior supervisory approval	Yes	Yes	Yes	Yes	Yes	Yes
15	First call date	25-Jan-16	20-Dec-18	29-Dec-19	20-Dec-20	29-Dec-19	20-Dec-18
16	Subsequent call dates	Any interest payment date thereafter	Any interest payment date thereafter	Any Distribution payment date thereafter	Any Distribution payment date thereafter	Any Distribution payment date thereafter	Any Distribution payment date thereafter
	Coupons / dividends						
17	Fixed or floating dividend/coupon	Floating	Floating	Floating	Floating	Floating	Floating
18	Coupon rate and any related index	3month GBP LIBOR + 442bps	3month GBP LIBOR + 341bps	6month GBP LIBOR + 690bps	6month GBP LIBOR + 655bps	6month GBP LIBOR + 690bps	6month GBP LIBOR + 763bps
19	Existence of a dividend stopper	No	No	No	No	No	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Mandatory	Mandatory	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary

20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Mandatory	Mandatory	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary
21	Existence of step up or other incentive to redeem	No	No	No	No	No	No
22	Non-cumulative or cumulative	n/a	n/a	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion triggers	n/a	n/a	n/a	n/a	n/a	n/a
25	If convertible, fully or partially	n/a	n/a	n/a	n/a	n/a	n/a
26	If convertible, conversion rate	n/a	n/a	n/a	n/a	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	n/a	n/a	n/a	n/a	n/a
28	If convertible, specify instrument type convertible into	n/a	n/a	n/a	n/a	n/a	n/a
29	If convertible, specify issuer of instrument it converts into	n/a	n/a	n/a	n/a	n/a	n/a
30	Write-down feature	None contractual, statutory via bail-in	None contractual, statutory via bail-in	Yes - full permanent	Yes - full permanent	Yes - full permanent	Yes - full permanent
31	If write-down, trigger(s)	n/a	n/a	Issuer or Group CET1 < 7%	Issuer or Group CET1 <7%	Group CET1 < 7%	Issuer or Group CET1 < 7%, Issuer or Group is, or would in the near term be, in breach of Capital Resources Requirement, the Issuer's or the Group's losses lead to a significant reduction of its retained earnings or other reserves which causes a significant deterioration of the Issuer's or the Group's financial and solvency conditions, or it is reasonably

							foreseeable that such events will occur; or the Regulator notifies the Issuer that it has determined, in its sole discretion, that the foregoing paragraphs (b) or (c) of this definition would apply in the near term.
32	If write-down, full or partial	n/a	n/a	Full	Full	Full	Full
33	If write-down, permanent or temporary	n/a	n/a	Permanent	Permanent	Permanent	Permanent
34	If temporary write-down, description of write-up mechanism	n/a	n/a	n/a	n/a	n/a	n/a
35	Instrument type immediately senior	Senior Unsecured	Senior Unsecured	Tier 2	Tier 2	Tier 2	Tier 2
36	Non-compliant transitioned features	Yes	No	No	No	No	No
37	If yes, specify non-compliant features		n/a	n/a	n/a	n/a	n/a

The Group also has 2,232,012,512 Ordinary Shares in issue with a nominal value on £0.10. These are included within CET1 capital.

Tables

Glossary

Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision ("BCBS") in June 2006 in the form of the "International Convergence of Capital Measurement and Capital Standards".
Basel III	In December 2010, the BCBS issued final rules "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring". Together these documents present the BCBS's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements are being phased in starting 1 January 2014 with full implementation by 1 January 2019.
Capital conservation buffer	A buffer to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred.
Capital Requirements Directive IV ("CRD IV")	The European Union's ("EU") proposal to implement Basel III, the international agreement on bank capital standards agreed at G20 level. It replaces the EU's earlier capital requirements directives with a revised package consisting of a new Capital Requirements Directive ("CRD") and a new Capital Requirements Regulation ("CRR"). The CRD IV package raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision.
Cash Ratio Deposit	A non-interest bearing deposit lodged with the Bank of England ("BoE"), which are then invested in interest-yielding assets to fund BoE operations.
Clawback	Clawback provision permits NAB to require an individual to repay all or part of a variable pay award after payment has been made. Awards are subject to clawback for up to seven years from when the award is made. This requirement will continue to apply if the individual leaves employment with the Group.
Collateral	The assets of a borrower that are used as security against a loan facility.
Common Equity Tier 1 ("CET1") capital	The highest quality form of regulatory capital that comprises total shareholders' equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Common Equity Tier 1 ratio	CET1 capital as a percentage of risk weighted assets.
Compliance Gateway	All employees must satisfy threshold measures for compliance which reflect a range of internal and external regulatory requirements.
Countercyclical capital buffer	A capital buffer to ensure eligible firms have a sufficient capital base to absorb losses in stressed periods.
Counterparty credit risk	Counterparty credit risk ("CCR") is the risk that a counterparty to a transaction may default before the final settlement of the transaction's cash flows. This risk concerns financial instruments, including derivatives and repurchase agreements.
Covered Bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the

	bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
Credit conversion factor ("CCF")	Credit conversion factors ("CCF") are used in determining the exposure at default in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn and off-balance sheet commitments expected to be drawn down at the point of default.
Credit quality steps	A credit quality assessment scale as set out in CRD IV.
Credit risk	The potential that a customer or counterparty will fail to meet its obligations to the Group in accordance with agreed terms and arises from both the Group's lending activities and treasury operations, including hedging activities.
Credit risk mitigation	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set-off or netting.
Earnings at risk ("EaR")	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
EBA Implementing Technical Standard on Disclosure for Own Funds	Commission Implementing Regulation (EU) No 1423/2013 of 20 December 2013 laying down implementing technical standards with regard to disclosure of own funds requirements for institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council.
Encumbrance	Denotes those assets on a bank's balance sheet which have been pledged as security, collateral or legally 'ring-fenced' in some other way which prevents the firm from being able to transfer, pledge, sell or otherwise use/dispose of these assets.
External Credit Assessment Institutions ("ECAI")	External Credit Assessment Institutions ("ECAIs") include external credit rating agencies such as Moody's, Fitch, and Standard and Poor's.
FCA	Financial Conduct Authority.
The Group	CYB Investments Limited and its controlled entities.
Group cash earnings	Cash earnings is defined as net profit attributable to owners of the Group, adjusted for the items the Group considers appropriate to better reflect the underlying performance of the Group. In September 2015 cash earnings has been adjusted for the following: • ☐ distributions; • ☐ treasury shares; • ☐ fair value and hedge ineffectiveness; • ☐ life insurance economic assumption variation; • ☐ amortisation of acquired intangible assets; and • ☐ sale and demerger costs.
Interest rate risk in the banking book ("IRRBB")	IRRBB arises from changes in interest rates that adversely impact the Group's financial condition in terms of earnings (net interest income) or economic value of the balance sheet.

Internal Capital Adequacy Assessment Process ("ICAAP")	The Bank's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Leverage Ratio	This is a regulatory standard ratio proposed by the Basel III reforms and is Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The BCBS has proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.
Malus	A malus arrangement permits NAB to prevent vesting of all or part of deferred remuneration. Malus adjustments to remuneration may be done at NAB's discretion, or may be controlled by a pre-set formula. Malus arrangements do not reverse vesting after it has already occurred, so they have no force after the end of the deferral period.
Market risk	The risk associated with adverse changes in the fair value of positions held by the Group as a result of movement in market factors such as interest rates, foreign exchange rates, volatility and credit spreads.
Material Risk Takers	Comprises categories of employees, including senior management, risk takers, employees engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the Bank's risk profile. MRTs are identified in accordance with the criteria set out in articles 3 to 5 of the Material Risk Takers Regulation (Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014).
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of CYB Investments Limited (formerly known as National Australia Group Europe Limited).
NAB Group	NAB and its controlled entities.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
Performance rights	A performance right is a right to acquire one NAB ordinary share, once the performance right has vested based on achievement of the related performance hurdle or at the Board's discretion. Each performance right entitles the holder to be provided with one NAB ordinary share subject to adjustment for capital actions. The performance right is issued at no charge to the employee. To acquire a share, the holder must exercise the right but there is no exercise price to be paid. Shares are issued on exercise of performance rights. Performance rights may be used instead of shares due to jurisdictional reasons, including awards such as deferred STI and commencement and other retention programs. The terms and conditions, including lapsing, will vary for each particular grant. Performance rights are issued by NAB. No dividend income is provided to the employee until the end of the restriction period and the performance conditions have been met and the performance rights are exercised.
Pillar 1	The quantitative elements of the Basel III framework including the minimum regulatory capital requirements for credit, operational and market risks.

Pillar 2	The qualitative expectations of the Basel III framework to be met through the supervisory review process. This includes the ICAAP, governance process and the supervisory review and evaluation process.
Pillar 3	The final pillar of the Basel III framework which aims to encourage market discipline by improving the information made available to the market. The pillar sets out disclosure requirements for banks on their capital, risk exposures and risk assessment processes.
PPI	Payment Protection Insurance
PRA	Prudential Regulation Authority
PRA Buffer	A capital buffer to ensure a firm is able to meet its minimum capital requirements under stress in line with the PRA's risk appetite.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA.
Repurchase agreement	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counter-party (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Residential mortgage-backed securities ("RMBSs")	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Return on equity ("ROE")	ROE is calculated as cash earnings divided by average shareholders' equity, excluding non-controlling interests and other equity instruments and adjusted for treasury shares. It allows for risk to the extent that actual equity aligns with target equity and RWAs. ROE also measures inorganic growth.
Risk appetite	The amount and type of risk that the Group is prepared to seek, accept or tolerate.
Risk weighted assets (RWAs)	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding that can achieve a reduction in funding costs by offering typically AAA rated securities secured by the underlying financial asset.
Standardised Approach	In relation to credit risk, a method for calculating credit risk capital requirements requiring the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by ECAIs to assign risk weights to exposures. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Stress testing	The term used to describe techniques where plausible events are

	considered as vulnerabilities to ascertain how this will impact the own funds which a bank requires to hold.
Systemic Risk Buffer	A buffer for the financial sector to prevent, or mitigate, long-term non-cyclical systemic or macroprudential risks.
Tier 1 capital	A component of regulatory capital which is able to absorb losses, is permanent and available when required, ranks for repayment upon winding up/administration or similar procedures after all other debts and liabilities, and has no fixed inescapable costs. It comprises core Tier 1 and other Tier 1 capital, which includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A component of regulatory capital which includes forms of capital that do not meet the requirements for permanency and absence of inescapable fixed servicing costs that apply to Tier 1 capital. It comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.
Z notes	Subordinated notes which provide credit enhancement to the securitisation structures and increase the excess spread available to the rated Class A notes. Losses on the mortgage portfolio are borne first by the Z notes.

INDUSTRY OVERVIEW

The following information relating to the banking industry in the United Kingdom has been provided for background purposes only. The information has been extracted and derived from a variety of sources released by public and private organisations. The information has been accurately reproduced and, as far as CYBG PLC is aware, and is able to ascertain from information published by such sources, no facts have been omitted which would render the reproduced information inaccurate or misleading. In this document references to CYBG Group are references to CYBG PLC, CYB Investments Limited and its consolidated subsidiaries.

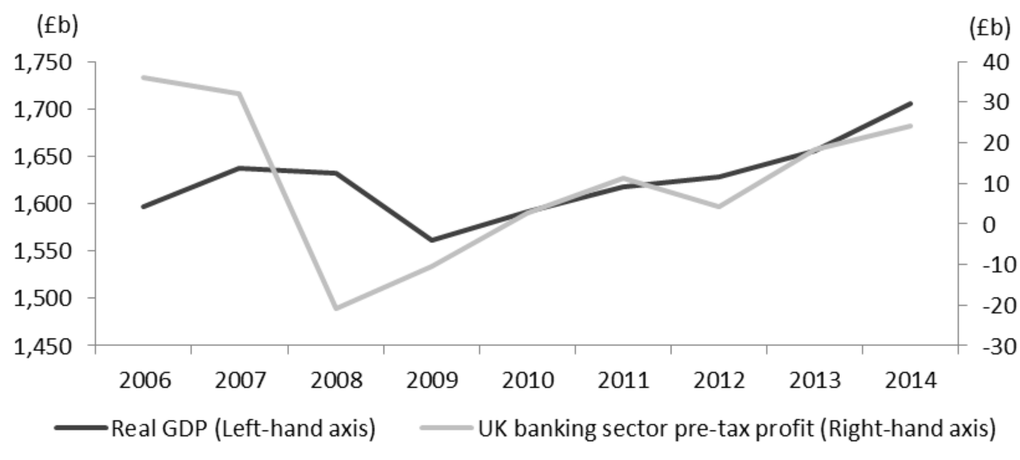
1. UK Economic Context and Overview of the Banking Industry

1.1 *UK economic context*

The financial services industry, encompassing banks, investment funds, insurance companies, credit unions and a range of other organisations, is an important part of the UK economy. As at March 2015, the industry employed approximately 1 million people in the UK, with UK banks directly employing over 400,000 people. In 2014, the industry represented 7.9 per cent. of UK gross domestic product ("**GDP**"), compared to 4.5 per cent. in France, and 4.0 per cent. in Germany. The financial services sector accounted for 11.5 per cent. of total UK tax receipts in 2013/2014.

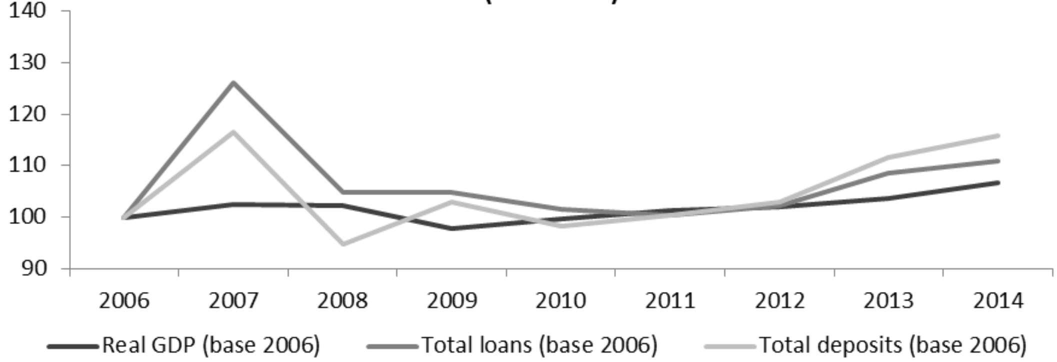
UK banking performance is correlated with the health of the UK economy. In 2008, the first year of the financial crisis, the UK banking sector collective pre-tax profits decreased from a sector-wide £32 billion in 2007 to a loss of £21 billion. Real GDP in the UK decreased by 4.3 per cent. between 2008 and 2009 from £1.63 trillion to £1.56 trillion, as shown in Exhibit 1.1 below. However, there has been a considerable period of recovery between 2009 and 2014 with real GDP growing by a compound annual growth rate ("**CAGR**") of 1.8 per cent. and the UK banking sector achieving collective pre-tax profits of £24 billion in 2014. UK GDP growth, which has been increasing ahead of European peers, further grew by 3.0 per cent. in 2014, and real GDP is forecast to grow 2.6 per cent. in 2015 (*Source: Office for National Statistics*, *HM Treasury*). This trend is reflected in the trends in total loans in the UK banking sector, which have increased by a CAGR of 1.1 per cent. since 2009, and total deposits in the UK banking sector, which have increased by a CAGR of 2.4 per cent. since 2009, in line with GDP growth.

Exhibit 1.1: UK real GDP and UK banking sector pre-tax profits



Source: Office for National Statistics, The Economist Intelligence Unit, Bank of England.

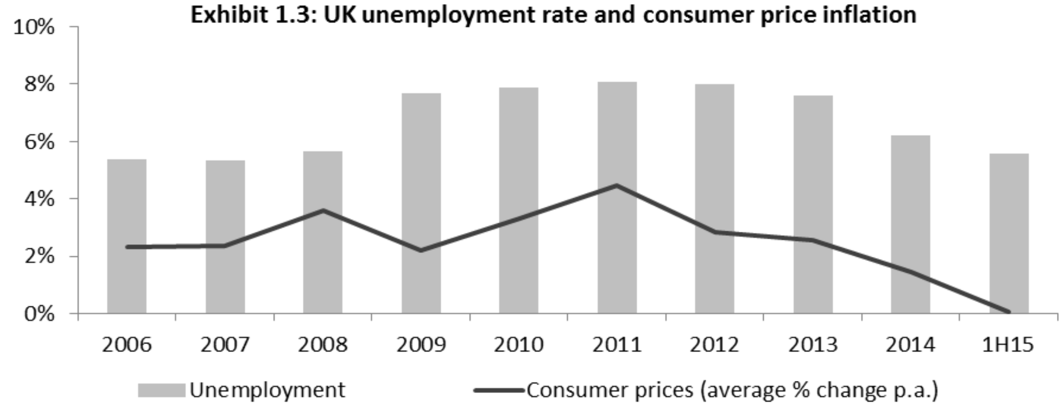
Exhibit 1.2: Real GDP compared to total loans and total deposits index (base 2006)



Source: Eurostat, The Economist Intelligence Unit.

Other UK macro-economic indicators have also shown improvements. Unemployment decreased from 2.7 million in November 2011, representing 8.5 per cent. of the working age population in the UK to 1.9 million by June 2015, representing 5.6 per cent. of the working age population in the UK. The total number of people in employment increased from 29.3 million to 31 million over the same period, from November 2011 to June 2015. Between 2012 and 2014, inflation remained within the Monetary Policy Committee's target of 2 per cent. ±1 per cent. However over the first six months of 2015, average inflation has been flat, which is below the Committee's target range. The Bank of England forecasts that inflation will return to the target range in two years and rise slightly above the target in the third year.

Exhibit 1.3: UK unemployment rate and consumer price inflation



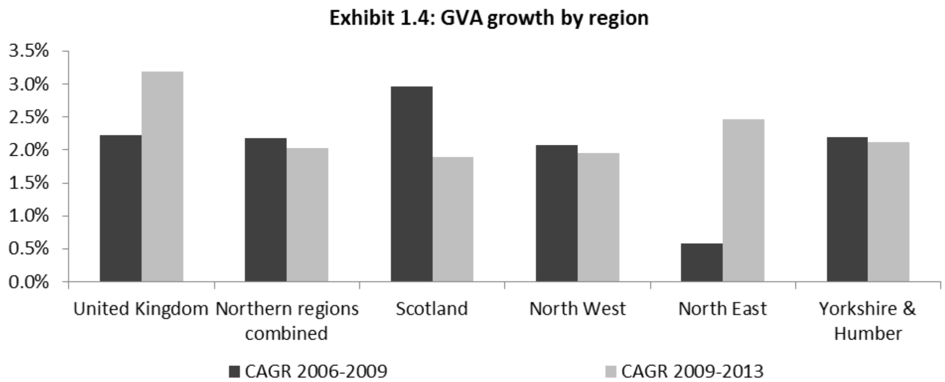
Source: The Economist Intelligent Unit, Office for National Statistics.

In July 2015 the UK Government announced its intention to charge a surcharge on profits of banks. A phased reduction of the existing rate and change in scope of the bank levy was also announced.

1.1.1 *Regional economic context*

The UK government reports on economic data from twelve regions, including CYBG Group's core regions: Scotland, North East England, North West England and Yorkshire and the Humber. The data reveals diverse demographics and macro-economic performances.

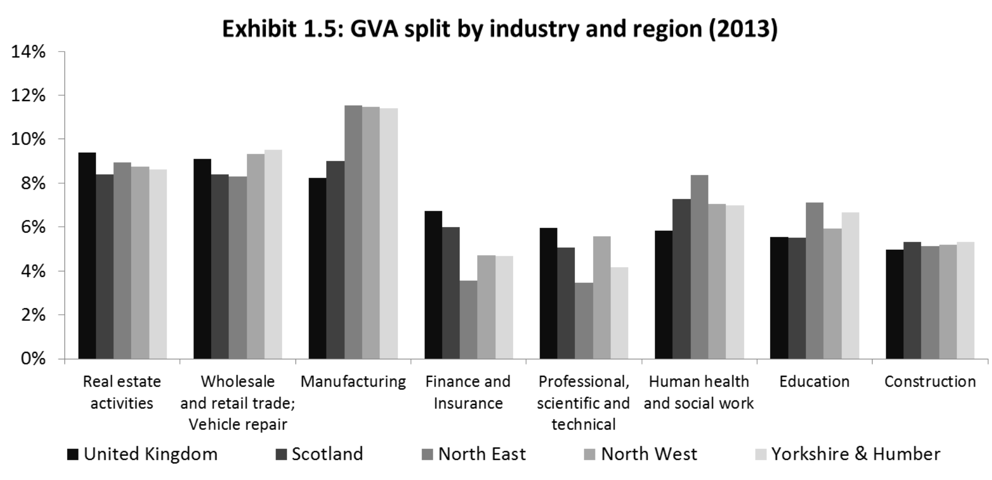
By 2013, in general the UK had recovered from the financial crisis to reach a higher nominal level of output (measured as gross value added ("**GVA**")), compared to 2006. Between 2006 and 2009, GVA in the North West and Yorkshire and the Humber grew in line with the UK average of 2 per cent. CAGR and 3 per cent. CAGR in Scotland. In Scotland, the North West and Yorkshire and the Humber GVA continued to grow at broadly a 2 per cent. CAGR between 2009 and 2013, although at a slower rate than the UK average of 3 per cent. CAGR, as shown in Exhibit 1.4 below. In the North East, GVA grew at 0.6 per cent. between 2006 and 2009, but accelerated between 2009 and 2013, growing at 2.5 per cent. The Northern regions combined remained around 27 per cent. of the UK total GVA throughout this period.



Source: Office for National Statistics.

Note: Northern regions combined is the combination of Scotland, North West, North East and Yorkshire & Humber.

Exhibit 1.5 shows the GVA per industry in the UK and in each of the four core regions and for the UK as a whole. The output per industry, for the eight largest industries representing 56 per cent. of total GVA, in each region is broadly similar to the UK average. Manufacturing GVA in three of the core regions is an exception, producing outputs of approximately 11 per cent., compared to the UK average of 8 per cent. (*Source: Office for National Statistics*).



Source: Office for National Statistics.

Note: 'Other' (which is not shown) comprises: 'Agriculture, forestry and fishing'; ' Mining and quarrying'; 'Electricity, gas, steam and air-conditioning supply'; 'Transportation and storage'; 'Accommodation and food service activities'; 'Administrative and support service activities'; 'Public administration and defence'; 'Arts, *entertainment and recreation'; 'Other service activities'; 'Activities of households'; 'Information and communication'; 'Public admin and defence' Chart displays available data as at 31 December 2013.*

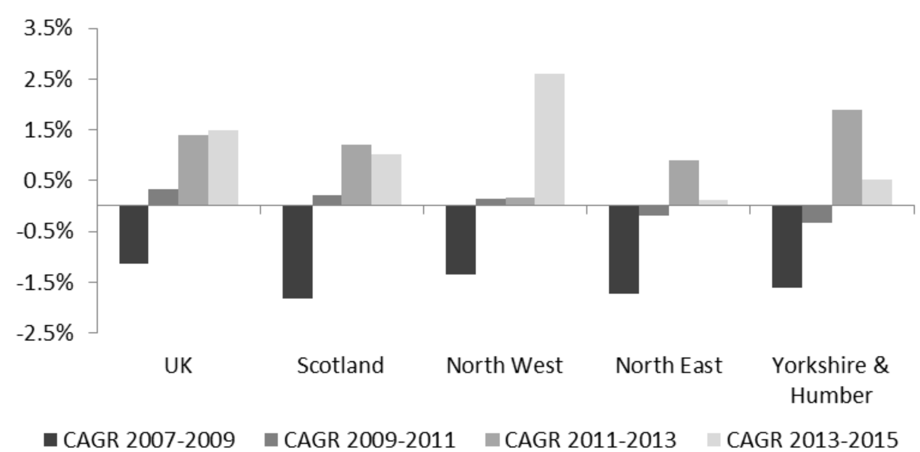
The demographics of the population differ between London and the rest of the UK. Whilst the average age of the UK population, including in CYBG Group's core regions, is 40, London's population is notably younger, averaging 36 years of age, as shown in Exhibit 1.6 below (*Source: Office for National Statistics*).

Exhibit 1.6: Total population and average age by region

Source: Office for National Statistics; chart displays data as at mid-2014.

Employment increased by a CAGR of 2.6 per cent. between 2013 and the first half of 2015 in the North West outpacing UK growth of 1.5 per cent., even outpacing London which grew at 1.8 per cent. over the same period. However, between 2011 and 2015, employment growth in Scotland was below the UK average of 1.4 per cent., increasing by 1.1 per cent. per annum between 2011 and the first half of 2015, while Yorkshire and the Humber grew at a CAGR of 1.3 per cent. over the same period, broadly in line with the UK (*Source: Office for National Statistics*).

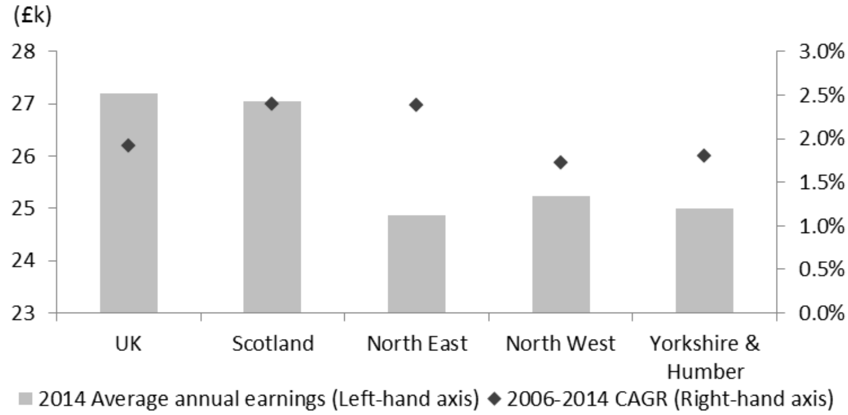
Exhibit 1.7: Employment growth by region



Source: Office for National Statistics.

Exhibit 1.8 shows that average earnings also differ between regions. Average earnings in Scotland are approximately £27,000, reflecting the UK national average, while average earnings in CYBG Group's other core regions are slightly lower at approximately £25,000. Although London is an outlier with average earnings of £35,000, earnings growth rates in the core regions have almost equalled or surpassed earnings growth rates in London since 2006. London earnings grew by a CAGR of 1.8 per cent. between 2006 and 2014, whilst average earnings in the North West grew by a CAGR of 1.7 per cent. and Yorkshire and the Humber grew by a CAGR of 1.8 per cent., Scotland and the North East both grew by a CAGR of 2.4 per cent. over the same period (*Source: Office for National Statistics*).

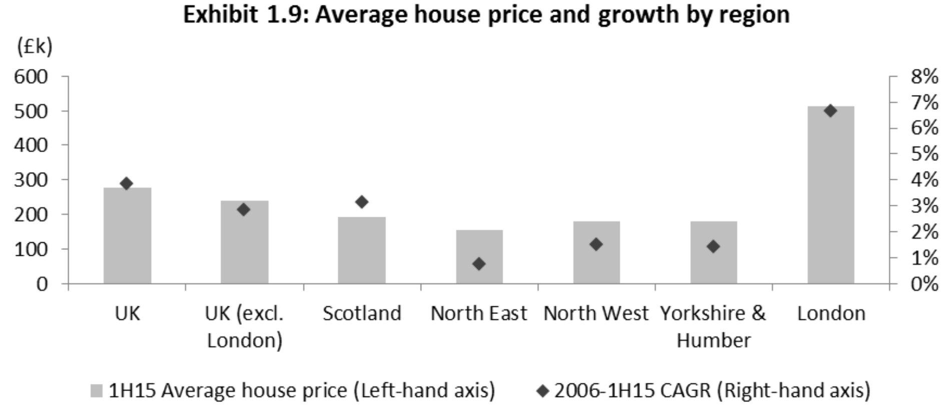
Exhibit 1.8: Average annual earnings and growth by region



Source: Office for National Statistics.

UK residential property prices have continued to differ significantly by region, as shown in Exhibit 1.9. Between 2006 and the first half of 2015, average UK property prices increased by a CAGR of 3.8 per cent. Over the same period, London average property prices increased by a CAGR of 6.7 per cent., resulting in average house prices reaching £513,000. Property prices outside of London increased by a CAGR of 2.8 per cent., reaching an average of £238,000. In CYBG Group's core regions, the increase in property prices varied from 0.7 per cent. CAGR in the North East England to 3.1 per cent. CAGR in Scotland, resulting in average house prices ranging from £156,000 in North East England to £192,000 in Scotland (*Source: Office for National Statistics*).

Exhibit 1.9: Average house price and growth by region



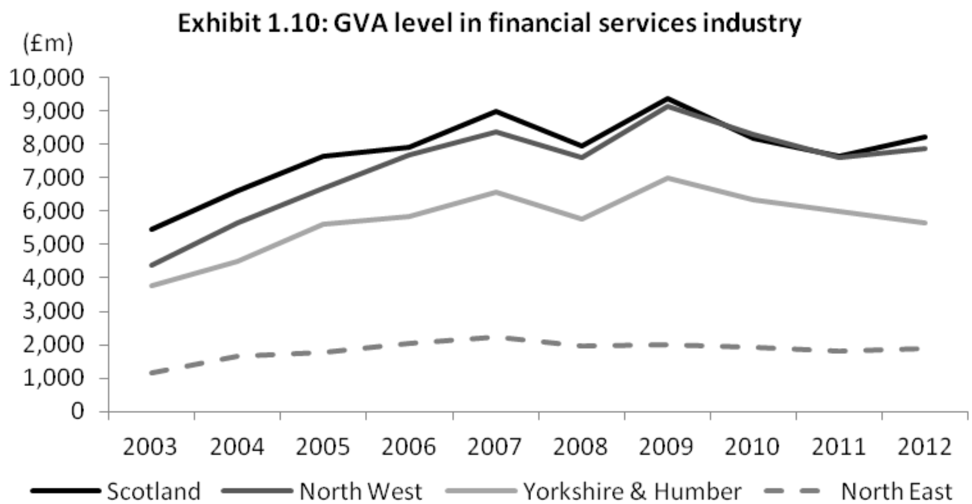
Source: Office for National Statistics.

The UK government is seeking to stimulate growth in the north of England through its 'Northern Powerhouse' agenda. The aim is to improve economic growth in the regions of the North East, North West and Yorkshire and the Humber. Part of this initiative is to invest in infrastructure projects designed to improve rail and road connectivity.

1.1.2 *Regional financial sector importance*

The financial services industry is significant across CYBG Group's core regions, representing 4 per cent. of GVA in North East England to 6 per cent. of GVA in Scotland. The industry employs over half a million people in CYBG Group's core regions and provides a pool of experienced personnel for banks that operate in those regions (*Source: TheCityUK*).

GVA growth in the financial services industry has been consistent across CYBG Group's core regions, and grew by 60 per cent. as a whole between 2003 and 2012. In 2012, total GVA of the financial services industry in the four regions was £24 billion, contributing 20 per cent. of the total UK financial services GVA (*Source: Office for National Statistics*).

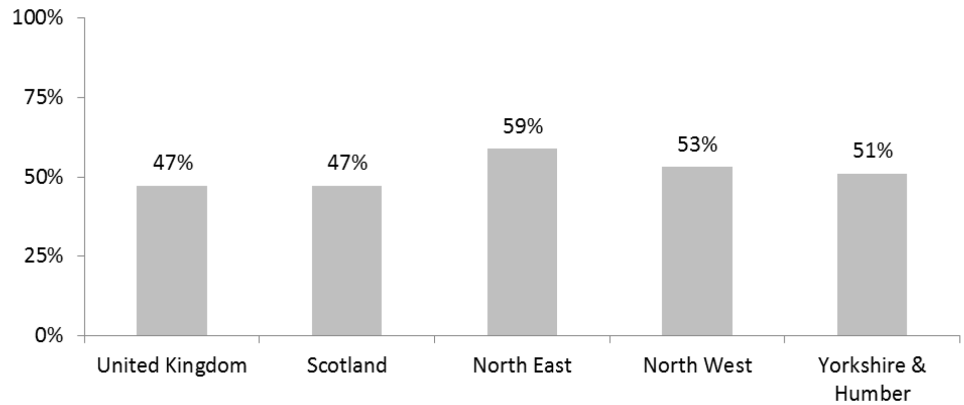


Source: Office for National Statistics.

1.1.3 *Regional Small and Medium size business importance*

Whilst the Department for Business Innovation and Skills ("**BIS**") considers micro, small and medium-sized enterprises ("**SMEs**") as businesses which employ up to 250 employees, the British Banking Association ("**BBA**") segments SMEs by categorising smaller-sized businesses as those with bank account debit turnover of up to £1 million/£2 million and medium-sized ones having turnover up to £25 million, consistent with the Bank of England's definition of SME's having a turnover of up to £25 million. SMEs represent a large part of the UK economy, including 99 per cent. of all businesses; 60 per cent. of all employees; and 47 per cent. of turnover. See "*Introduction to SME Banking*" below for further information. SMEs in CYBG Group's core regions contribute a larger proportion of private sector turnover relative to the UK average. This trend is more notably pronounced in the North East where SMEs represent 59 per cent. of turnover as compared to 47 per cent. for the UK (*Source: Department for Business Innovation and Skills - Business population estimates for the UK and regions 2015: detailed tables*).

Exhibit 1.11: Proportion of all business turnover from SMEs 2015



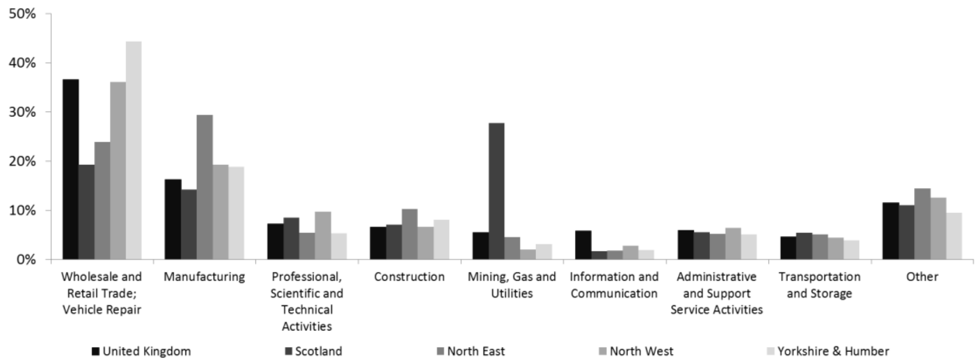
Source: UK Department for Business, Innovation and Skills.

Over the last decade, between 2005 and 2015, the number of SMEs has increased from 3.9 million to 5.4 million (*Source: UK Department for Business, Innovation and Skills - Business Population Estimates: 2015 statistical release*). There are positive indications of further growth as 16 per cent. of SMEs plan to increase staff in 2015 and 43 per cent. expect revenue growth (*Source*: *FSB Voice of Small Business Survey 2013-14*, *BDRC Continental SME Finance Monitor*).

A 2014 European Commission study found the UK to be among the most competitive environments for SMEs in the European Union, with a positive outlook for future growth. The UK scored particularly high in business environment, public procurement, and conditions for international business (*Source: European Commission for Enterprise and Industry*). Recently, the UK government has introduced a range of measures to stimulate SME success (*Source: House of Commons*). These include advice to boost exports, changes in public sector procurement to include more SMEs, improved broadband access and business rate relief. See "*Introduction to SME Banking*" below for further information.

SMEs are represented across all sectors of the economy. CYBG Group's core regions broadly reflect the wider UK economy. There are some regional differences in Scotland, where turnover from SMEs in mining and gas utilities is significantly higher than the UK average as a result of the North Sea oil and gas industry, and in the historically industrial North East and North West where manufacturing remains strong (*Source: UK Department for Business, Innovation and Skills - Business Population Estimates*).

Exhibit 1.12: Proportion of SME turnover by region and by sector 2015



Source: UK Department for Business, Innovation and Skills.

Note: 'Other' comprises: 'Arts, Entertainment and Recreation'; 'Accommodation and Food Service Activities'; 'Human Health and Social Work Activities'; 'Real Estate Activities'; 'Agriculture, Forestry and Fishing'; 'Other Service Activities' and 'Education'.

1.2 *Structure of the UK banking industry*

Banks and other lenders play a vital role in the UK economy. This is reflected in the type of customers they serve, ranging from the general public and small businesses to sophisticated corporations and investors. Banks' services are essential in facilitating day-to-day financial transactions as customers interact with their banks as the centre of non-cash transactions, such as direct debit payments and salary deposits. Their services are also essential in providing capital for short to long-term purposes, they organise foreign exchange and provide sophisticated financial products that help consumers and businesses plan for the future.

The main players in the UK banking market can be grouped into six broad categories:

- *Large national banks*: These banks have national coverage and a full retail bank offering including current accounts, mortgages, savings, credit cards, and other personal banking services. Due to consolidation over the last ten to fifteen years, there are currently only five large national banks in the UK banking sector (the "**Big Five**"); Barclays plc ("**Barclays**"), HSBC Bank plc ("**HSBC**"), Lloyds Banking Group, which includes the Lloyds Bank, Halifax and Bank of Scotland brands ("**Lloyds**"), Royal Bank of Scotland Group plc, which includes the RBS, NatWest and Ulster Bank brands ("**RBS**") and Santander UK plc ("**Santander**") (*Source: Bank of England: Evolution of the UK banking system*).

- *Challenger banks*: The Independent Commission on Banking defines challenger banks as banks that are large enough to be a threat to incumbents and have a strong incentive to compete with them to increase market share (*Source: Independent Commission on Banking*). Challenger banks can be grouped into three sub-categories: (i) mid-sized banks that are branch-led, full service banks with an established customer base with the ability to compete with the Big Five; (ii) small and specialised banks with total assets of under £20 billion that focus on differentiating themselves through either customer service and/or specific product offerings; and (iii) retailer banks where retailers typically leverage their large customer base to cross-sell financial products, including savings accounts, loans, mortgages, credit cards, and in some cases, personal current accounts ("**PCAs**").

- *Building societies:* These are usually small lending institutions which are owned by their members. These mainly offer mortgages and savings products, although many now provide a broader range of retail banking products, such as current accounts and credit cards.

- *Credit unions:* These are usually small lending institutions which are owned by their members. They typically serve those customers who are unable to access standard retail bank products through the established high street banks.

- *Monoline product providers:* These providers focus on the provision of specific products, such as credit cards, rather than a full range of retail banking services.

- *Other lenders*: These include payday lenders, online specialists, peer-to-peer lending facilitators, and specialist mortgage lenders.

The Big Five have 82 per cent. market share of the retail PCA market and 59 per cent. market share of the mortgage market (*Source: Mintel Mortgages and Mintel Current Accounts*). According to an October 2015 report, in England and Wales the four largest banks account for 80 per cent. of active business current accounts ("**BCAs**"), with these banks having a similar market share in Scotland. Many foreign banks are also active in the UK, typically serving multi-national companies which operate in the UK, but with activities across the globe.

1.2.1 *Increasing competition in the UK banking sector*

The UK government has emphasised the need to introduce more competition into the SME and retail banking market, in response to poor customer satisfaction. In a study conducted by YouGov as at April 2013, retail banking customers rated large banks, namely the Big Five, negatively for customer satisfaction. On the other hand, smaller and mid-sized banks enjoyed a much higher customer satisfaction score. Similarly, a study conducted into the SME banking market as at July 2014 revealed that only 13 per cent. of SMEs believe that their bank acts in their best interest (*Source: FCA and CMA market study - Banking services to small and medium sized enterprises*). The studies identify high levels of market concentration amongst the Big Five as one of the key drivers for dissatisfaction.

Many smaller and mid-sized banks have become popular with customers by focusing on strong customer service with minimal brand damage from the financial crisis. This has been complemented by greater interest in the banking sector from the business and investor community. In 2010, Metro Bank, a new bank, was awarded a full service banking licence. This was the first time a new full banking licence had been granted to a new High Street bank in over 100 years (*Source: Metro Bank*). A number of banks are expected to launch initial public offerings ("**IPOs**") by 2016 in addition to the IPOs of TSB, Virgin Money, OneSavings, Shawbrook and Aldermore, which have already taken place.

(a) *The landscape of banks outside the Big Five*

Banks outside of the Big Five typically compete by providing a specialised offering to clients, either in terms of product range, service level, regional focus, pricing or a combination. These are outlined further below:

- *Product range focus*: banks that provide a subset of products and services to their clients. For example, banks such as M&S Bank have carved out a niche in travel related banking services via their "M&S Travel Money" offer (*Source: M&S Bank*).

- *Service focus*: banks that seek to differentiate on the quality of their customer service. For example, Metro Bank emerged on the promise of customer-focused retail business, offering convenience and simplicity in the form of 7-day opening hours (*Source: Metro Bank*).

- *Regional focus*: banks with a long-standing UK banking history that largely focus on a subset of UK regions. CYBG Group is an example of a bank with a long-standing market position, focusing on the markets in Scotland and Northern England. Additionally, newly emerging banks and traditionally localised banks are expanding across different regions. For example, TSB has leveraged a pre-existing network of former Lloyds TSB branches, while Bank of Scotland which has a regional concentration, now sit within Lloyds (*Source: Bank of England*).

- *Pricing focus*: some smaller and mid-sized banks are also offering lower rates for customers compared to incumbents. This is particularly notable for fixed-term savings products, where some banks such as Charter Savings, are offering a superior interest rate as they seek to build up their deposit book.

(b) *Competing with the Big Five*

Although the brand reputation of the major banks has weakened, the Big Five continue to have a significant national presence and established customer base, allowing them to enjoy high volume, scale efficiencies and benefits from customer inertia. The market share for PCAs and BCAs has remained largely stable over the last ten years, inhibiting the ability of smaller participants to compete effectively (*Source: CMA - Retail Banking Market Investigation*).

Due to the continued dominance of the Big Five, smaller and mid-sized banks are encouraged to meet some or all of the requirements set out in a letter to the Chancellor from the Office of Fair Trading in September 2013 in order to become an effective competitor. The requirements include: a branch network for PCA and SME banking services; a wide breadth of products; a strong base of PCAs; an established brand and reputation; ability to generate and reinvest profits; ability to innovate and differentiate the offering and a strong management team (*Source: Office of Fair Trading - Letter to Chancellor, September 2013*).

1.2.2 *Key trends in distribution*

(a) *Digitisation of the banking model*

The UK banking industry is experiencing a significant shift towards digitisation. Banking has become increasingly omni-channel, as digital channels such as online and mobile banking are increasingly complementing traditional customer channels such as branches and call centres.

Retail banking customers tend to use digital functionality for speed and convenience, while using human interaction at key decision points such as obtaining a mortgage. Digital functionality is typically used to conduct routine transactions and to purchase simple products such as savings accounts and credit cards (*Source: Mintel - Deposit and Savings Accounts UK*). Internet banking remains the main driver of digital channel usage, with an average of 9.6 million log-ins per day, compared to 10.5 million mobile log-ins per day in the UK in 2015 (*Source: BBA - The Way We Bank Now*). Additionally, 81 per cent. of SME customers interact with their banks online, with 39 per cent. using online banking services on a daily basis in 2014 (*Source: BBA - Promoting Competition*).

Mobile payments systems were introduced by a group of banks in the UK in 2014. They launched a mobile payments service, where payments can be sent and received using a mobile number, called "Paym", which allows users to link their bank accounts to their mobile phones. Sixteen UK banks participate - including the Big Five, Clydesdale Bank and Yorkshire Bank - and as at August 2015 nearly 2.6 million UK customers signed up for the service (*Source: Paym*).

In general, the rate of growth in customers using digital channels has been significantly faster than the rate of decline in the number regularly using branches (*Source: BCG - Distribution 2020: The Next Big Journey for Retail Banks*).

Digitisation has enabled banks to reduce cost and improve efficiency. Banks are increasingly leveraging tools such as e-forms and digital workflow systems to automate servicing and fulfilment processes (*Source: McKinsey & Co - The Rise of the Digital Bank*). Digital data and analytics systems have increasingly been used to tailor and personalise product offerings to different customer segments and expand banks' share of wallet (*Source: BCG - Winning Share of Wallet in Wholesale Banking*).

Price comparison websites, also known as aggregator websites, have emerged as another channel through which consumers purchase retail banking products. In 2014, 20 per cent. of UK internet users used a price comparison website to compare savings account products, with 7 per cent. of those using the price comparison website to apply for a savings account (*Source: Mintel - Web Aggregators in Financial Services UK*).

(b) *Importance of branch network and visible footprint*

A strong branch network remains an important part of the banking model in both the retail and SME markets. 92 per cent. of retail current account customers use branches to access financial services, and over 67 million transactions are carried out each week in UK bank branches. Branches are particularly important in the sale of core customer products, such as current accounts and mortgages. 42 per cent. of current account customers use their branch at least once per month (*Source: Mintel Current Accounts UK*), and 42 per cent. of customers prefer to arrange a mortgage face-to-face (*Source: Mintel Mortgages UK*). In the SME market, 47 per cent. of SME customers visit a branch at least once a month (*Source: Mintel Packaged and Current Accounts UK*).

The bricks-and-mortar presence of a branch network is an advantage that banks leverage in order to compete against purely digital payment providers. However, most major UK banks are repurposing their branches from being transaction centres into product showrooms and conversation points. Branch employees are being trained to not only assist customers with everyday transactions, but also to offer face-to-face advisory services that digital channels cannot provide.

(c) *Regional variations in CYBG Group's distribution channels*

Consumers' preferred channels for purchasing retail banking products varies by both product and region. On a national level, consumers prefer to apply online for products with a simpler application process, such as savings accounts, credit cards and personal loans, while products with longer application processes, such as mortgages, are more frequently arranged in a branch. Preferences for branches to online channels of consumers in CYBG Group's core regions relative to the average UK consumer, varies by product (*Source: Mintel*).

According to a survey conducted in February 2015, the proportion of customers looking to apply for savings accounts in a branch in CYBG Group's core regions was significantly lower than the UK average. In Yorkshire and the Humber, 34 per cent. of those surveyed were looking to apply for a savings accounts in a branch compared to the UK average of 43 per cent. (*Source: Mintel Deposit and*

Savings Accounts UK). However the preference for online channels in CYBG Group's core regions was in line with the UK average of 63 per cent. Similarly, 49 per cent. of UK customers surveyed in May 2015 prefer online channels to branches when applying for a credit card, in line with the average of CYBG Group's core regions. However, there is a differential at the regional level, with Scotland and the North having greater preference than the UK average for online channels; while in Yorkshire and the Humber the preference is lower. In a national survey conducted in October 2014, 27 per cent. of respondents preferred to arrange a personal loan face-to-face with a bank or loan provider, compared to 40 per cent. who preferred to arrange the loan directly online (*Source: Mintel*).

1.3 ***Banking sector financial statements***

1.3.1 *Revenue*

Revenue consists of net interest income and other operating income. Net interest income is primarily derived from loans, deposits, and other sources of funding. It is generated through the differential between the rate charged to borrowers and the cost of funds. Other operating income is primarily earned from customer fees and commissions.

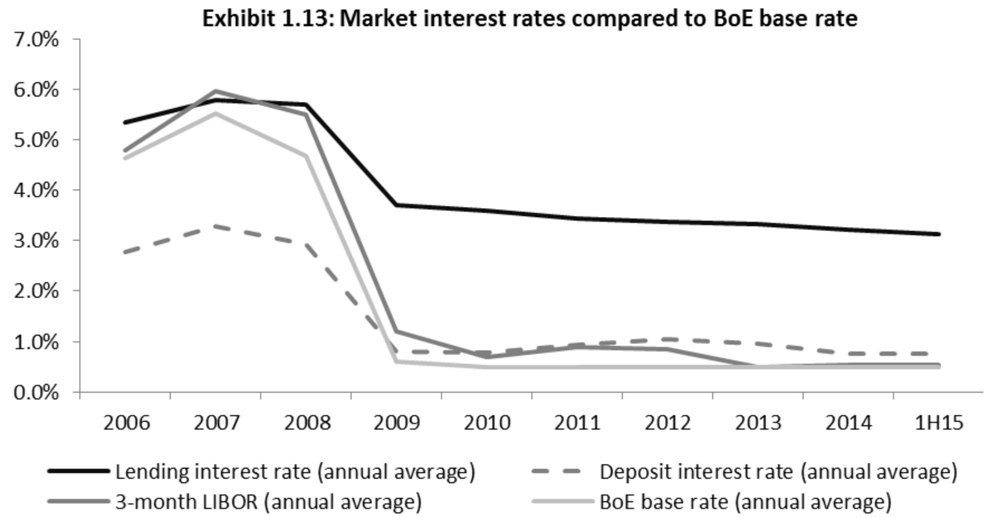
For retail-centric businesses, net interest income is the main driver of revenue, focusing on core lending and deposit products. Business banks offer more fee-based products, such as transaction banking or trade finance.

1.3.2 *Cost of funds*

Banks have four main sources of funding: (i) customer deposits; (ii) borrowing from the Bank of England; (iii) borrowing from other banks; and (iv) borrowing from other institutions (e.g. pension funds or insurance firms).

The cost of funding to a bank is a combination of the four sources. The cost differs across banks due to differences in weighting of each source by the banks and is not generally disclosed at the product level.

The base rate, set by the Bank of England, is one of the key determinants of all other market rates. Other market interest rates which track the Bank of England's base rate include both the monthly lending and deposit sterling weighted average interest rates of UK resident monetary financial institutions (excluding the Bank of England).



Source: Bank of England, British Bankers Association.

1.3.3 *Base rate used for this section*

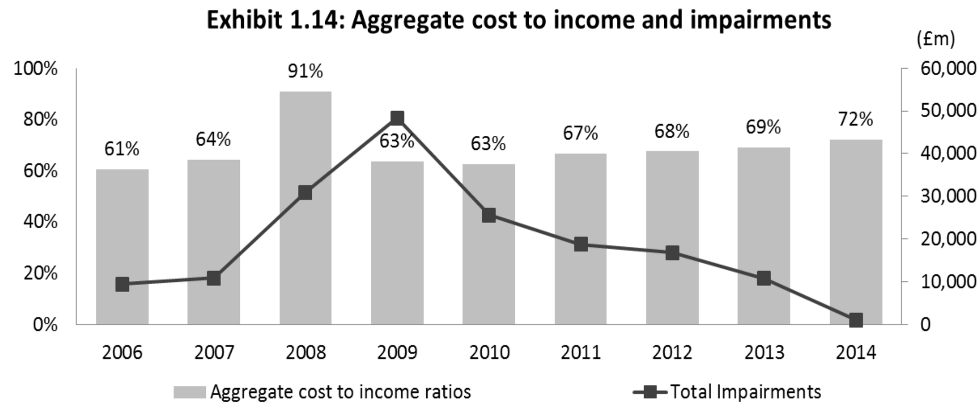
This section uses the base rate as a constant point of comparison for different product interest rates. Any individual bank's cost of funds will vary, depending on their internal allocation methodology, and cannot be readily stated on a product-by-product basis.

1.3.4 *Cost*

A bank usually incurs two types of non-interest costs based on its ordinary activities: operating costs and impairments.

(i) The main components of operating costs are IT, property and salaries. The cost to income ratio measures the efficiency of a bank's operating model. Following a sharp increase in 2008, cost income ratios of banks have been steadily rising in the UK market, reflecting downward pressure on revenue, as shown in Exhibit 1.14.

(ii) Impairments represent a provision against current and potential losses on the stated value of assets on a bank's balance sheet. Impairments rose steeply for UK financial institutions during the financial crisis. Between 2009 and 2014, the value of impairments has decreased to below pre-crisis levels as of 2014, as shown in Exhibit 1.14.



Source: Based on Bank of England data.

Note: Following the transition of building societies' statistical reporting from the Financial Services Authority ("FSA") to the Bank of England on 1 January 2008, the above includes building society data from the year 2008 onwards.

1.3.5 *Profitability*

A bank's profit after tax is based on the sum of revenues earned (net interest income and other operating income) less operating costs, impairments, one-off charges, taxes and other provisions for future losses.

1.3.6 *Capital structure*

A bank's assets can be unsecured, for example credit cards, or secured, such as mortgages. Banks apply two different risk weighting methods in calculating their total risk-weighted assets ("**RWAs**"):

- *The Standardised Approach*, as followed by CYBG Group, uses standardised risk weightings in accordance with the European Union's Capital Requirements Directive. These are more explicit rules which aim to remove subjectivity from the risk weighting.

- *The Internal Ratings Based Approach* ("**IRB**") permits banks to use their own empirical models to best assess the appropriate risk weightings. Banks are permitted to use this approach in the UK, subject to approval from the Prudential Regulation Authority ("**PRA**"). The two IRB approaches to risk weighting, foundation and advanced, usually generate lower risk-weighted assets.

In the UK, the minimum capital required for each bank is established through discussion with the PRA, which sets each bank an individual capital guidance ("**ICG**"). The ICG is typically a multiple of the underlying required Tier 1 ratio. In the UK, all banks are required to meet a minimum 6 per cent. Tier 1 capital ratio, which is calculated as Tier 1 capital / RWAs. The major UK banks are required to meet a minimum of 7 per cent. (*Source: Bank of England*).

2. Retail Banking

2.1 *Summary of the retail banking market in the UK*

2.1.1 *The role of retail banks*

Retail banks offer a range of banking products which include PCAs, savings accounts, mortgages, personal loans, credit cards, and insurance and investment products. Banks offer these products through a number of bank-owned distribution channels such as branches, telephone and digital channels as well as through third party distribution channels such as mortgage intermediaries, known as "brokers".

Retail banks in the UK serve three main customer segments: (i) mass affluent customers, typically customers who have investible assets between £50,000 and £1,000,000 ("**Mass Affluent Customers**") - above which they generally become private banking clients; (ii) retail banking customers in the UK who are mass market customers, with investible assets below £50,000; and (iii) customers with few to no assets, for example students and youth customers.

Traditionally, retail banks in the UK have operated a "full-service" model offering a broad suite of products to a diverse customer base. The major full-service banks have a large base of current account holders, a national branch network, as well as complementary channels. The combination of a large customer base, extensive channel reach and a broad product suite allows these banks to address the varying needs of their customers. For example, 57 per cent. of PCA holders also hold a savings account with their PCA provider (*Source: Mintel - Consumers and Retail Banking*).

2.1.2 *Regional view on retail banking*

At a regional level, demand for retail banking products varies according to local economic and competitive conditions.

Employment growth in CYBG Group's core regions has contributed to increased demand for credit. Between 2006 and first half of 2015, these four core regions experienced year-on-year house price growth of 0.7 per cent. to 3.1 per cent., and in December 2014, approximately 18 per cent. of residents in these regions planned to take out a mortgage or re-mortgage their homes (*Source: Mintel - Mortgages UK*).

Retail banking markets in Scotland and Yorkshire include a number of smaller participants whose presence in those regions is larger than their presence in the national market. In Scotland, the top four brands with the highest branch network concentrations are Bank of Scotland, RBS, TSB, and Clydesdale Bank. In Yorkshire, the top four brands by branch concentration are Yorkshire Bank, HSBC, NatWest, and Lloyds. For example, as at 31 December 2013, while the Barclays brand had the largest network of branches in the UK, it had less than 30 branches in Scotland, while Bank of Scotland, RBS, TSB, and Clydesdale Bank each had more than 100 in Scotland (*Source: SNL*).

2.1.3 *Distribution channels*

Consumers more frequently purchase simpler products online than in branches. For example, according to a March 2014 report, 42 per cent. of consumers prefer mortgage application processes, which are longer and more detailed, to be entirely face-to-face compared to 29 per cent. who prefer the process to be entirely online, whereas a higher percentage of customers surveyed applied for products with simpler application processes, such as savings accounts, online (*Source: Mintel - Mortgages UK).* See "*Key trends in distribution - Regional variations in distribution channels*" above for further information.

Retail banking customers are also increasingly turning to online channels to service their accounts. 78 per cent. of PCA customers in the UK surveyed in May 2015 used online banking at least once per month to access their accounts, compared to 42 per cent. who used branch counter services. However, branches continue to be an important channel as 92 per cent. of PCA customers report using branch services at least once per year, compared to 86 per cent. who use online banking (*Source: Mintel - Packaged and Current Accounts UK*). Furthermore, a survey conducted in June 2014 reported that 57 per cent. of banking customers agreed that branches were necessary for discussing banking issues (*Source: BBA - Promoting Competition in the UK Banking Industry*).

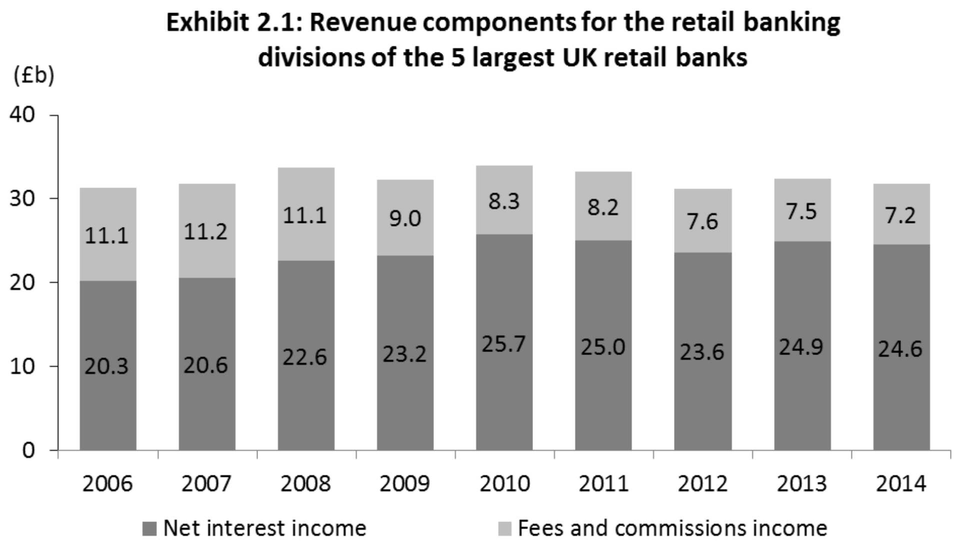
2.1.4 *Customer sentiment*

The financial crisis significantly impacted customer attitudes towards the banking sector and the way in which consumers interact with banks. Attitudes towards the banking sector vary between large and small banks. A 2013 YouGov survey of over 4,000 people found that 73 per cent. considered the banking sector to have a bad reputation, scoring lower than any of the other 25 industries included in the survey. This negative view is largely associated with the Big Five, which scored lowest in the survey. A July 2014 market report by the UK Competition and Markets Authority ("**CMA**") found an inverse relationship between the size of a retail bank's customer base and its customer satisfaction scores, with the five highest-scoring brands in customer satisfaction being amongst the UK's smaller institutions, including Clydesdale Bank and Yorkshire Bank.

Retail banks have experienced declining levels of customer retention. Between 2012 and 2014, the proportion of UK banking customers who had been with their bank for more than 10 years decreased from 72 per cent. to 59 per cent. Customer service quality is an important factor in customers' decisions to switch account providers. A May 2014 survey found that 20 per cent. of UK adults who changed current account providers in the past five years changed providers due to a better reputation for customer service from the new provider. A similar proportion of 21 per cent. cited poor customer service from their previous provider as the factor that persuaded them to switch providers (*Source: Mintel - Packaged and Current Accounts UK*).

2.2 ***Retail Banking performance***

The profitability of a retail bank is determined by the relative levels of its income and expenses. The two primary streams of income for a retail bank are net interest income and other operating income. Fees and commissions income are the primary source of other operating income and is reflected in Exhibit 2.1 below. The primary costs are operating costs and impairments. Banks often look at impairment costs as a factor in determining profitability. Exhibit 2.1 below shows these revenue streams for the Big Five between 2006 and 2014.



Source: Annual reports.

2.2.1 *Net interest income*

Net interest income for the Big Five rose steadily between 2006 and 2010, from £20.3 billion to £25.7 billion, before stabilising at around £25 billion. In 2014, net interest income accounted for 77 per cent. of total banking income for the Big Five.

2.2.2 *Fees and commissions income*

Retail banks charge customers fees for a variety of services, such as overdraft facilities, credit cards, and international transfers of funds. They also receive commissions from distributing products such as insurance. Taken together, these make up income from fees and commissions.

Exhibit 2.1 illustrates how both regulatory scrutiny and other market conditions have impacted fee and commission income in the retail divisions of the Big Five between 2007 and 2014, leading to a decline from £11.2 billion to £7.2 billion over this period.

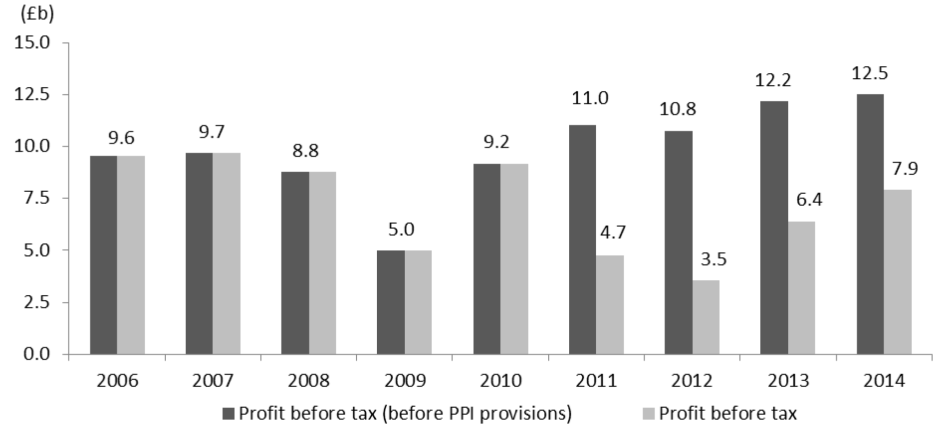
2.2.3 *Impairments*

As shown in Exhibit 1.14, banks have experienced rising impairments during the financial crisis. Impairments tend to be higher on unsecured assets than on secured assets since the bank is able to realise security of the asset in order to repay part of, or the entire loan. Impairments have since fallen to below pre-crisis levels as unemployment has fallen and interest rates have remained low.

2.2.4 *Profitability*

Exhibit 2.2 shows the underlying and reported profits of the Big Five. Underlying profitability fell sharply in 2009 as a consequence of the financial crisis, but has since rebounded, growing at a rate of 20.2 per cent. per annum between 2009 and 2014. However, fines and repayments for the mis-selling of payment protection insurance ("**PPI**") have impacted banks' profits, reducing 2014 headline profits of £12.5 billion to £7.9 billion. Between 2011 and 2014, PPI mis-selling led to the Big Five making total provisions of £23.9 billion, equivalent to 51 per cent. of pre-tax profits. As a result, reported profits decreased at a CAGR of 3.6 per cent. between 2010 and 2014.

Exhibit 2.2: Calculated profit before tax for the retail banking divisions of the 5 largest UK retail banks



Source: Annual reports.

2.3 ***Key products: personal current accounts***

2.3.1 *Introduction*

A PCA is central to most retail customers' personal finances, and typically defines their primary relationship with a bank.

The PCA market can be divided into: (i) primary PCA, where the customer uses the PCA for everyday transactions, usually where there is a direct deposit of salary and the use of direct debits for regular bills; and (ii) secondary PCA, where the customer opens a second PCA with another provider. It is estimated that 32 per cent. of PCA holders in the UK have PCAs with more than one provider; this figure is 30 per cent. in the North East and Scotland, 26 per cent. in the North West and 25 per cent. in Yorkshire (*Source: Mintel - Current Accounts UK*).

Retail banks compete to be the primary PCA provider, since primary PCA customers are likely to hold further products, such as mortgages, credit cards and loans, and are generally more loyal customers (*Source: CMA - Personal Current Accounts*). Due to competition, many UK banks have explicit strategies to generate 'main banking relationships', i.e. using the primary PCA as an anchor to secure multi-product holdings and omni-channel usage (*Source: BCG - Retail Banking: Winning Strategies and Business Models Revisited*).

PCAs also provide a valuable source of stable, long-term funding. The cost for banks is typically lower than savings deposits or wholesale funding (*Source: Office of Fair Trading - Review of Personal Current Account Market*).

2.3.2 *Competitive landscape*

PCA market concentration is expected to decrease as a consequence of three developments. The first is the divestment by Lloyds of 631 branches and their accounts into TSB Bank. TSB Bank was established as a separate business from Lloyds in September 2013, with more than 4.6 million former Lloyds customers and over £20 billion in both loans and customer deposits. TSB Bank became a stand-alone bank through an initial public offering in June 2014. A similar but smaller divestment is underway for RBS, where 314 branches have been partially divested to a consortium of investors in anticipation of a full high street re-branding towards SME and mid-corporate customers.

The second development is the rise of new challenger banks, some of which have sought to capture market share from top PCA providers.

The third development was the UK Payments Council introduction of the Current Account Switch Service ("**CASS**") in September 2013. The intention was to increase competition amongst retail banks and support the entry of new banks into the PCA market. The scheme provides a guarantee that an account can be switched from one provider to another within seven working days. Currently, forty banks and building societies participate, accounting for most of the UK PCA market, including Clydesdale Bank and Yorkshire Bank. In October 2014, the Financial Conduct Authority ("**FCA**") and Payment Systems Regulator announced that they intend to explore the introduction of full bank account portability in order to facilitate the CASS. UK Payments Council data indicated over an annual period ending 30 June 2015 there were 1,109,381 switches and since the new service launched in September 2013 it has successfully processed 2,021,066 switches. As at May 2015, the top seven PCA providers and their estimated market shares of primary PCAs, defined as a customer's main current account, were Barclays (16 per cent.), Lloyds (13 per cent.), Halifax (12 per cent.), Santander (12 per cent.), NatWest (11 per cent.), HSBC (9 per cent.), and Nationwide (7 per cent.). Clydesdale Bank and Yorkshire Bank were each estimated to hold 1 per cent. of the UK primary PCA market (*Source: Mintel Current Accounts*).

2.3.3 *Key metrics*

There are approximately 80 million PCAs in the UK, of which 65 million are active (*Source: CMA - Personal Current Accounts Market Study*). As at 30 of June 2015, there were £7 billion of outstanding PCA overdraft balances, a decrease of 4 per cent. since June 2014 (*Source: BBA - High Street Banking Statistics*).

2.3.4 *How banks make money from PCAs*

PCAs are a low cost source of funds for banks and as such, they are able to generate net interest income on customer deposits. Net interest income, overdraft balances, and fee and commission income from associated banking services make up the principal sources of income generated by PCAs.

Added value accounts, or 'Packaged Accounts', bundle additional products with the PCA for a fixed monthly fee. These products often include mobile phone insurance and auto breakdown coverage (*Source: Office of Fair Trading - Review of the PCA Market*).

2.4 ***Key products: cash savings products***

2.4.1 *Introduction*

Cash savings products allow customers to deposit cash funds and to receive interest on those funds at rates which are typically higher than funds held in a PCA. There are two main types of cash saving products: fixed rate term deposits and variable rate savings accounts.

2.4.2 *Competitive landscape*

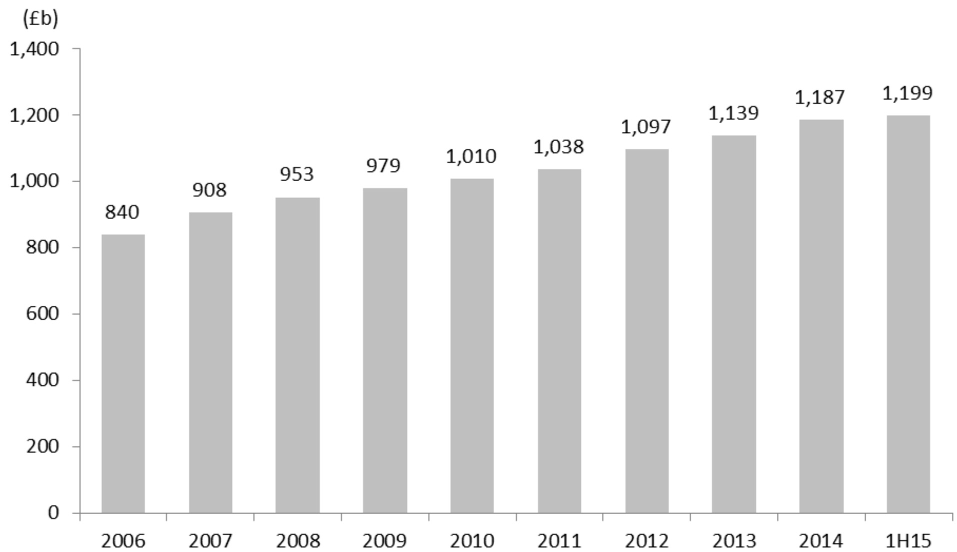
As at October 2014, 109 banks, building societies, and credit unions offered cash savings products in the UK, with the six largest providers holding approximately 68 per cent. of all cash savings balances. Estimates of market concentration show that while the cash savings products market has remained relatively concentrated for a number of years, the divesture of TSB Bank from Lloyds and the entrance of new providers such as Tesco Bank decreased market concentration in 2014 (*Source: FCA - Cash savings market study report: Part I: Final findings Part II: Proposed remedies*).

In compliance with EU Deposit Guarantee Scheme Directive for the protection of deposits, the UK Government established the Financial Services Compensation Scheme which pays compensation to eligible customers of authorised financial services firms.

2.4.3 *Key metrics*

As shown in Exhibit 2.3, total UK household cash savings products deposits stood at £1,199 billion as at 30 June 2015. Over the preceding 12 months to June 2015, household cash savings products deposit balances increased at a rate of 3.3 per cent.

Exhibit 2.3: Sterling deposits from households

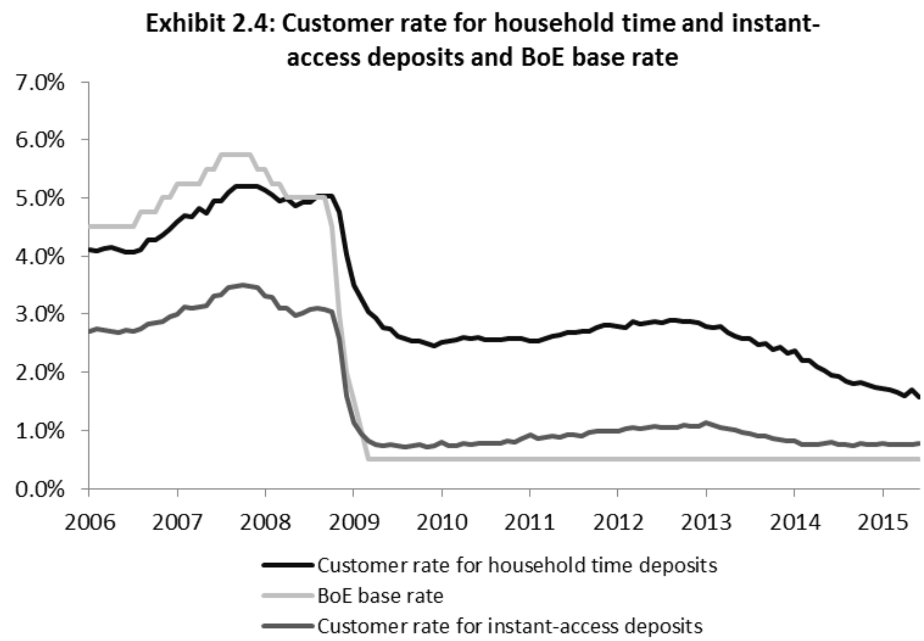


Source: Based on Bank of England data.

Despite the fall in interest rates between 2008 and 2009, cash savings deposits increased steadily. It is estimated that in 2013, around £160 billion of instant-access savings deposits earned an interest rate equal to, or lower than, the Bank of England base rate of 0.5 per cent. Approximately £145 billion of these balances were held in accounts with more than £5,000.

2.4.4 *Cash savings products*

Exhibit 2.4 displays trends in the customer rates for time deposits and instant-access savings deposits, as well as the official rate set by the Bank of England. The gap between the interest rates paid on time deposits compared to instant-access deposits reflects the premium banks attach to time deposits, which are held for longer periods.



Source: Based on Bank of England data.

Between 2008 and 2009, the decline in the Bank of England base rate was sharper than the decline in interest rates offered for customers' deposits. This has resulted in savings deposits becoming a relatively more expensive source of funding compared to the official rate than before the financial crisis.

2.5 ***Key products: mortgages***

2.5.1 *Introduction*

The most common form of financing used by individuals in the UK to purchase residential property is a loan secured by using the property as collateral. There are three principal types of mortgage products:

- Variable rate mortgages have interest rates that broadly follow the Bank of England base rate but are determined by the lender and can change at any time;
- Fixed-rate mortgages offer a constant rate that typically lasts for a two to five-year period before reverting to a variable interest rate; and
- Tracker mortgages track the Bank of England base rate at a set margin.

As at first half of 2015, 56 per cent. of total outstanding mortgage balances were subject to a variable rate, while 44 per cent. were subject to a fixed rate. 37 per cent. of mortgage balances were subject to a fixed rate in June 2014 and 29 per cent. as at June 2013 (*Source: Financial Conduct Authority - Statistics on Mortgage Lending*), an increase suggesting mortgage customers are increasingly capitalising on low interest rates by purchasing or refinancing to fixed rate mortgages.

In addition to differentiating mortgages based on the interest rate, mortgage products can be further categorised by the type of repayment made by the customer:

- Capital repayment mortgages require the full value of the loan and the interest to be repaid by the end of the term;
- Interest-only mortgages require the borrower to repay only the interest on the loan; at the end of the term, the borrower still owes the full value of the original loan. These mortgage products are therefore often dependent on rising house prices or other forms of repayment plans to pay back the capital repayment at the end of the term or a separate repayment vehicle; and
- Part capital repayment/part interest-only mortgages have only part of the mortgage payment being made towards the capital, with the remainder of the borrower's regular payment made towards the interest.

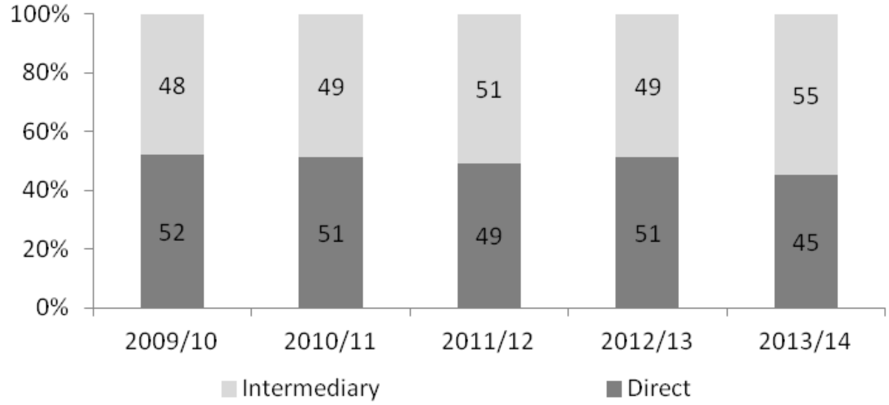
In 2013, the FCA required mortgage lenders to contact all borrowers with interest-only mortgages due to mature before the end of 2020 due to concerns about the borrowers' ability to repay the original loan at the end of the term. As a result, the Council of Mortgage Lenders reports that the number of interest-only mortgages fell 12 per cent. between 2012 and 2013 as borrowers converted to capital repayment mortgages.

2.5.2 *Competitive landscape*

The UK mortgage market has become increasingly competitive since 2009. The six largest lenders accounted for 72 per cent. of gross mortgage advances in 2014 compared to 86 per cent. in 2009 (*Source: Council of Mortgage Lenders*). The decrease in market share of the top six lenders, which includes the Big Five and Nationwide Building Society, is due to the increasing shares of smaller lenders which have entered the top ten. The ten largest lenders and their respective shares of gross advances are Lloyds (19.8 per cent.), Santander (13.5 per cent.), Nationwide (13.2 per cent.), Barclays (10.0 per cent.), RBS (9.7 per cent.), HSBC (6.2 per cent.), Yorkshire Building Society (3.7 per cent.), Coventry Building Society (3.6 per cent.), Virgin Money (2.9 per cent.), and Clydesdale Bank (2.5 per cent.) (*Source: Council of Mortgage Lenders*). The competitiveness of the UK mortgage market is reinforced by an estimate by the BBA that 23 per cent. of current account customers had a mortgage from a lender other than the provider of their PCA (*Source: BBA - Promoting Competition in Mortgage Lending*).

Intermediaries play a significant and growing role in the UK mortgage market. As shown in Exhibit 2.5, intermediaries accounted for 55 per cent. of mortgage sales in 2013/14, rising from 48 per cent. in 2009/10. As a result, intermediaries enable smaller banks to compete for mortgage business on a national scale.

Exhibit 2.5: Proportional distribution of regulated mortgage sales by channel



Source: Mintel.

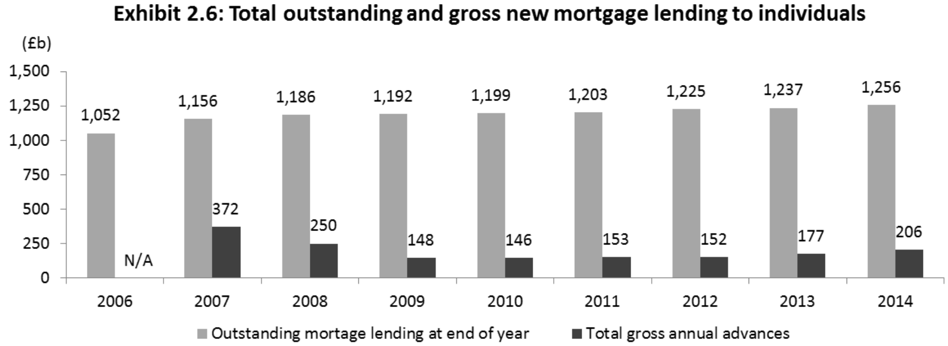
Note: Data covers the period 1 April to31 March in each year.

The increased proportion of intermediaries as a key channel in 2013-2014 can be explained by two factors. First, an increase in mortgage lending throughout 2013 and 2014, combined with an increasingly diverse range of mortgage products offered by lenders, has fuelled demand for the advisory services offered by brokers. Second, the 2014 Mortgage Market Review shifted the responsibility for verifying income and assessing affordability for customers to the lender and has prohibited non-advised mortgage sales. As a result, lenders without sufficient in-house advisory capabilities have turned to intermediaries to provide such services (*Source: Mintel - Mortgages Intermediary Focus*).

2.5.3 *Key metrics*

The total value of outstanding mortgage balances in the UK was £1.3 trillion as at 31 December 2014, as shown in Exhibit 2.6. This figure has remained relatively stable over recent years, with a CAGR of 1.5 per cent. for the three years to 31 December 2014.

Exhibit 2.6: Total outstanding and gross new mortgage lending to individuals



Source: Based on Bank of England and FCA data.

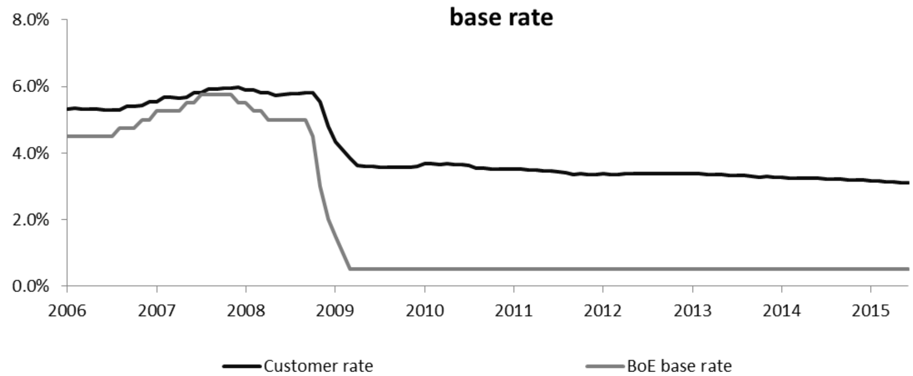
The slowdown in growth of total mortgage stock in the UK following the financial crisis can be explained by two factors. First, levels of gross new lending remained relatively stable between 2009 and 2012, as shown in Exhibit 2.6. Second, the Bank of England reports that a fall in the official bank rate from 5 per cent. to 0.5 per cent. between October 2008 and March 2009, with the rate since remaining at 0.5 per cent., may have caused households to repay more of their mortgage principal (*Source: Bank of England*). This increase in repayments would effectively counter-balance some of the gross new mortgage loans extended since 2009 (*Source: PRA and FCA - Mortgage Lenders and Administrators Statistics*).

The market for first-time buyers has seen a significant increase, with the number of first-time buyers rising to more than 300,000 in 2014, the highest since 2007 (*Source: Council of Mortgage Lenders).* This is partly the result of the UK Government's "Help to Buy" scheme which was launched in April 2013 and provides a shared-equity scheme (up to 20% of the property value) for first-time buyers with at least a 5 per cent. deposit. In March 2014 the scheme was extended until 2020.

2.5.4 *How banks make money from mortgages*

The key source of income for mortgage providers is the interest rate spread on mortgage loan balances. As shown in Exhibit 2.7, this spread has widened significantly since 2008 as the interest rate charged to customers has decreased at a significantly slower rate than the base rate, which is directly correlated to the funding cost for banks, suggesting an improvement in the overall profitability of mortgage lending. However, this spread has been under pressure more recently as banks seek to grow their mortgage portfolios. During the financial crisis, a proportion of revenue from this increased spread has been used in addressing the significant impairment charges incurred on loans during this period. The total UK financial institutions' mortgage impairments are shown in Exhibit 2.8.

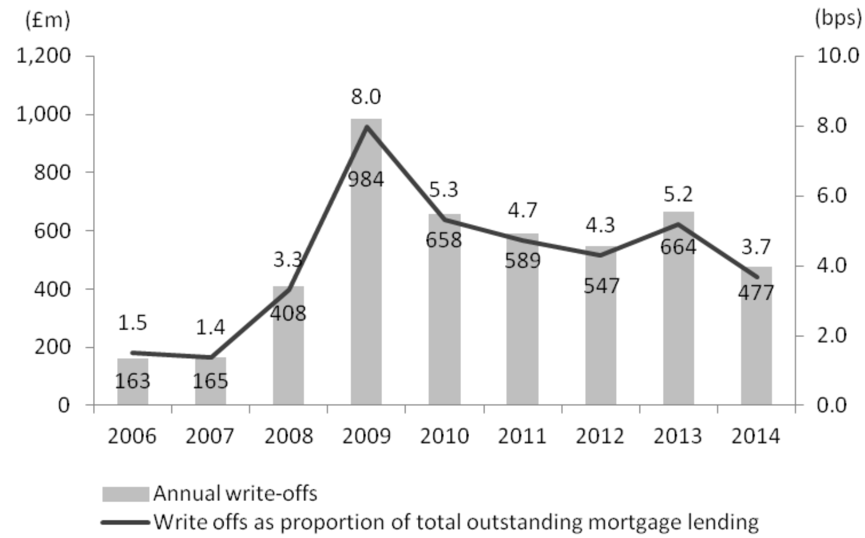
Exhibit 2.7: Customer rate for household mortgages and BoE base rate



Source: Based on Bank of England data.

There has been an overall improvement in both the annual amount of mortgage loans written-off and their proportion of total outstanding mortgage lending between 2009 and 2014, reflecting improved macroeconomic conditions and a more risk-adverse approach to mortgage lending.

Exhibit 2.8: Total annual amounts of write-offs for mortgage lending to individuals

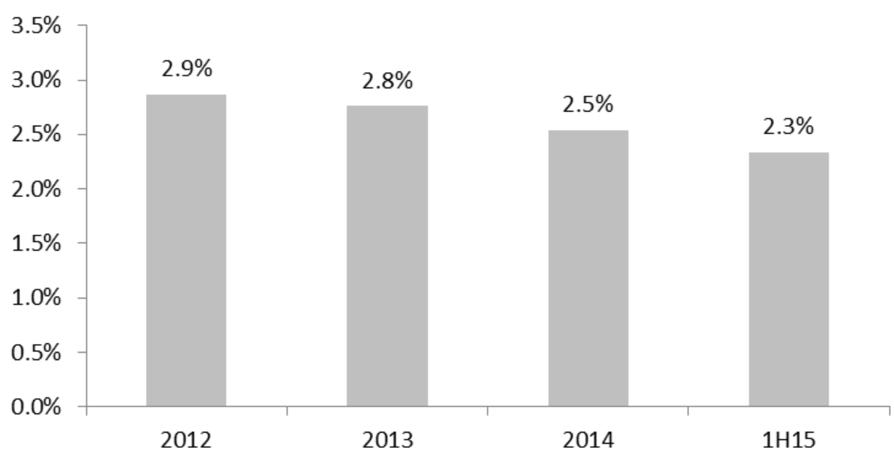


Source: Based on Bank of England data.

2.5.5 *Fixed rate mortgages*

The market average margin on fixed rate mortgages in the UK has gradually declined over the period from 2012 to the first half of 2015 as shown in Exhibit 2.9 below.

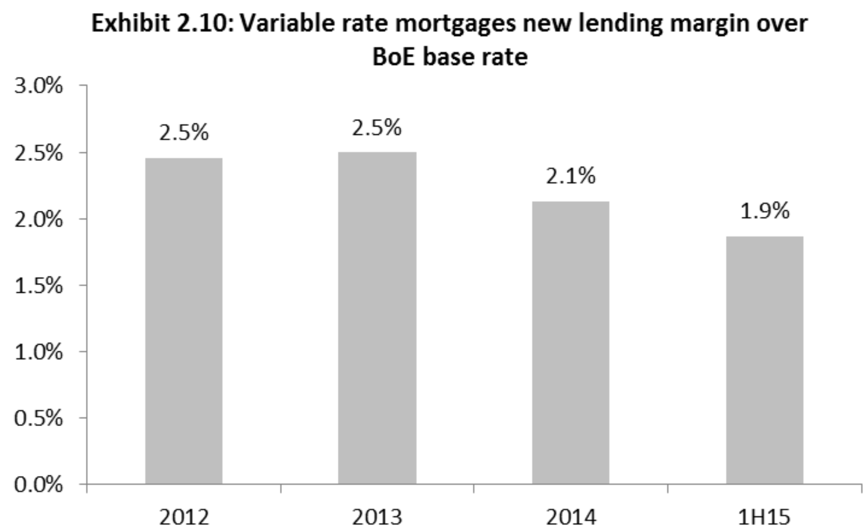
Exhibit 2.9: Fixed rate mortgages new lending margin over 2 year swap rate



Source: Based on Bank of England, Reuters and Bloomberg data.

2.5.6 *Variable rate mortgages*

The market average margins on variable rate mortgages in the UK have also gradually declined between the period from 2013 to the first half of 2015, as shown in Exhibit 2.10 below.



Source: Based on Bank of England data.

2.6 ***Key products: personal loans***

2.6.1 *Introduction*

Personal loans allow customers to borrow a sum of money for a specified period of time without providing any collateral. The interest rate varies with loan value and term, as well as customer credit quality. As at June 2015, the average interest rate charged by UK banks for a £5,000 personal loan was 8.8 per cent. and 4.3 per cent. for a £10,000 personal loan (*Source: Bank of England).*

2.6.2 *Competitive landscape*

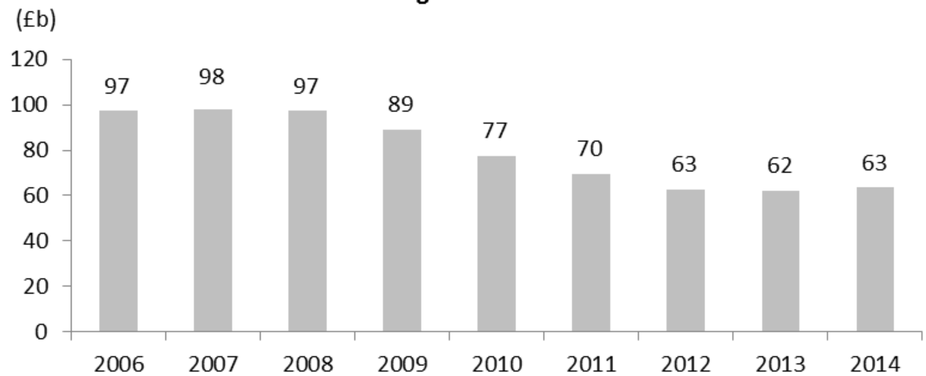
The UK personal loan market is relatively fragmented. The leading providers of personal loans, consisting of the Big Five, Clydesdale Bank, Yorkshire Bank, and Nationwide, account for approximately 60 per cent. of the personal loan market, with smaller lenders and specialist lenders accounting for the remainder (*Source: BBA - Unsecured Personal Loans*).

The ability to cross-sell personal loans from a PCA is an important factor in determining a bank's competitive position within the personal loan market. 42 per cent. of personal loan holders purchase the product from their PCA provider. New market entrants such as Sainsbury's Bank caused the Big Five to lose share of personal lending (*Source: Mintel - Personal Loans*).

2.6.3 *Key metrics*

The personal loan market can be measured in terms of total outstanding loan balances, as shown in Exhibit 2.11. Outstanding loan balances, including PCA overdrafts, dropped 35 per cent. from the average outstanding peak of £98 billion in 2007 to £63 billion in 2014.

Exhibit 2.11: Average outstanding personal lending to individuals including PCA overdrafts



Source: Based on Bank of England data.

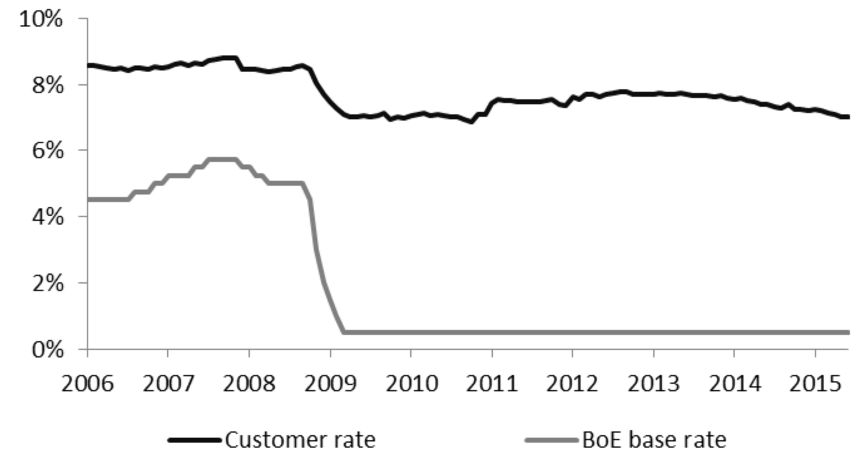
The decline in outstanding personal loan balances in 2008-2013 can be explained by changes in both consumer and lender preferences. As consumers sought to shift from consumption to savings amidst an uncertain macroeconomic environment, their appetite for personal loans decreased. At the same time, banks tightened their lending criteria as they sought to reduce their credit losses and to reduce the size of their balance sheets.

2.6.4 *How banks make money from personal loans*

Unsecured personal loans are associated with higher risk as there is no corresponding collateral and therefore they have higher interest rates than mortgages. As shown in Exhibit 2.12, customer rates (interest rates charged to customers) for unsecured loans fell from 8.57 per cent. in September 2008 to 7.02 per cent. in June 2015. Given the drop in the Bank of England base rate (which is directly correlated to the funding cost for banks) from 5 per cent. to 0.5 per cent. over the same period, banks have experienced an increased interest spread on personal loans between 2008 and 2015.

Although now a less common source of income, personal loans also generate a small amount of fee income, predominantly from penalties for late payments and, to a lesser extent, fees for early repayment.

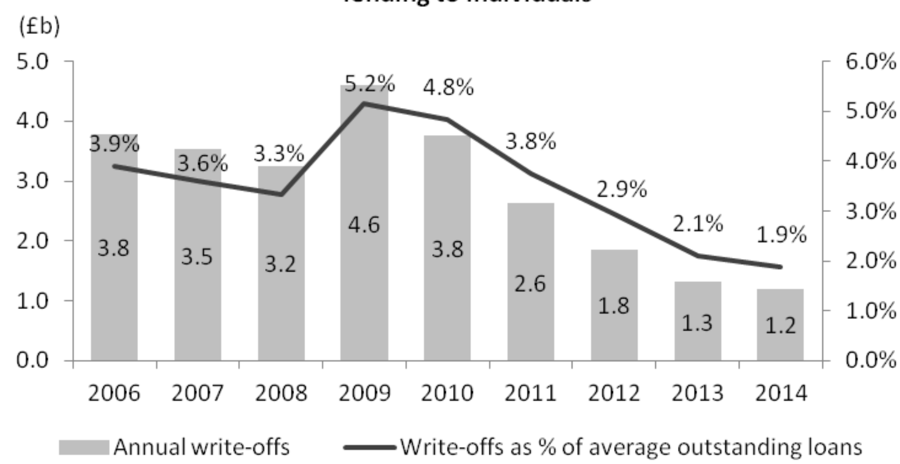
Exhibit 2.12: Customer rate for personal loans and BoE base rate



Source: Based on Bank of England data.

Between 2008 and 2009, there was an increase in impairments on unsecured personal loans. The total amount of UK financial institutions' impairments is illustrated in Exhibit 2.13. Between 2009 and 2014, there has been a steady decline in both the annual amount of write-offs and their proportion of total outstanding personal loans. This reflects both improved macroeconomic conditions and the tightening of lending criteria by personal loan issuers.

Exhibit 2.13: Total annual amounts of write-offs for personal lending to individuals



Source: Based on Bank of England data.

2.7 ***Key products: credit cards***

2.7.1 *Introduction*

Credit cards provide customers with a means of executing transactions along with an unsecured revolving credit facility. The main stakeholders in the credit card business are the card issuer (i.e. the issuing bank), card scheme (i.e. clearers of card payments), acquirer (e.g. arrangers of card transaction settlement), and merchant (i.e. retailer).

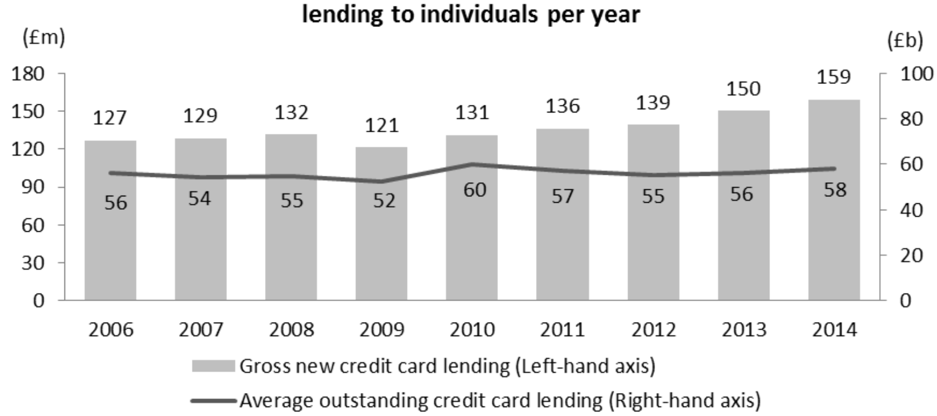
2.7.2 *Competitive landscape*

The wide range of participants in the UK credit card market includes high street banks, building societies, and monoline card issuers. Estimates from May 2015 show that five providers account for 57 per cent. of the UK credit card market: Barclays (17 per cent.), Lloyds (17 per cent.), HSBC (11 per cent.), RBS (6 per cent.), and Santander (6 per cent.). The remainder of the market is fragmented between monoline providers such as Capital One, card issuers such as American Express, and retailer banks such as Tesco Bank, M&S Bank, and Sainsbury's Bank. Market share also varies widely by region: 10 per cent. of card holders in Greater London have an American Express card compared to 5 per cent. of the whole of the UK, while in Yorkshire and the Humber, Yorkshire Bank has 2 per cent. share compared to 0.5 per cent. across the UK (*Source: Mintel - Credit Cards*).

2.7.3 *Key metrics*

There are nearly 60 million credit cards in issue in the UK, relating to 51 million accounts, of which 67 per cent. have outstanding balances (*Source: BBA - Statistics High Street Banking*). In December 2014, average outstanding balances stood at £58 billion, as shown in Exhibit 2.14.

Exhibit 2.14: Average outstanding and gross new credit card lending to individuals per year



Source: Based on Bank of England data.

Consumers in the UK have greater appetite to take on credit as the economy recovers. Exhibit 2.14 shows the annual amount of gross new lending extended to credit card holders (in millions of pounds sterling). While outstanding credit card lending reflects the amount of revolving balances on existing lines of credit, gross new lending reflects the expansion or contraction of lines of credit, driven by the number of credit cards issued and their respective credit limits.

Both outstanding and gross new credit card lending declined between 2008 and 2009 as banks sought to reduce their loan-to-deposit ratios and restrict capital commitments.

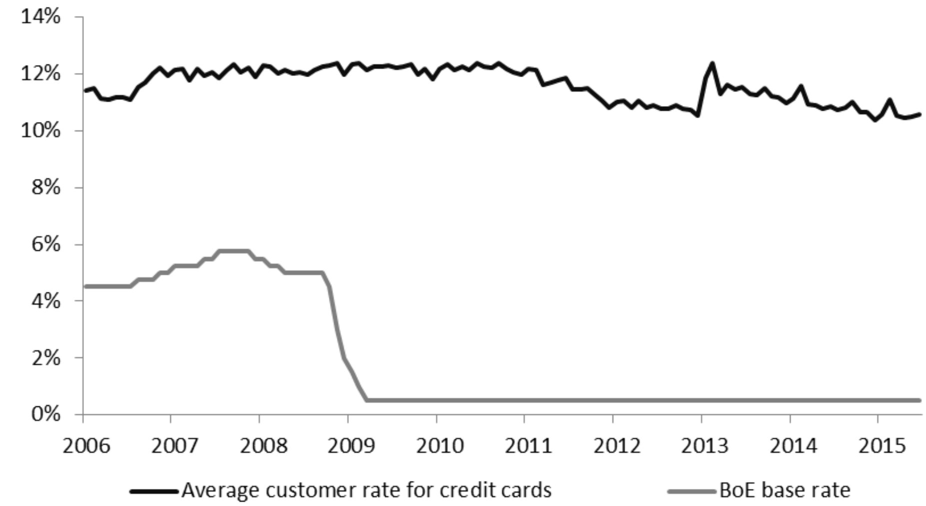
However, new lending increased by a CAGR of 5 per cent. between 2010 and 2014 as providers re-entered the market to benefit from attractive margins and the improving economic environment.

2.7.4 *How banks make money from credit cards*

The primary source of income for credit cards is the spread between interest rates charged to customers and the funding cost for banks. In addition, issuers generate fees and commissions through interchange fees, late payment penalties, and card fees charged to consumers periodically.

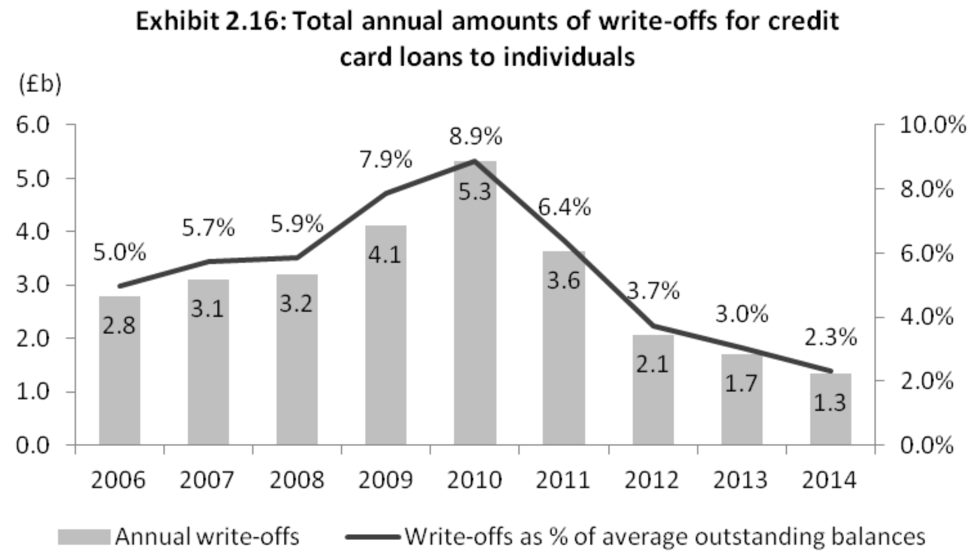
Interest rate spreads on credit cards have increased as the average interest rate charged to customers on credit card balances fell from 12.1 per cent. in June 2008 to 10.6 per cent. in June 2015, at a slower rate of decline compared to the Bank of England base rate.

Exhibit 2.15: Customer rate for household credit card lending and BoE base rate



Source: Based on Bank of England data.

During the financial crisis, banks incurred significant impairments on credit card loans. Impairments, as a percentage of total balances outstanding stood at nearly 9 per cent. of all credit card lending made in 2010. However, since 2010 there has been a steady decline in both the annual amount of write-offs and their proportion of total outstanding credit card loans, reflecting improved macroeconomic conditions, as shown in Exhibit 2.16 below.



Source: Based on Bank of England data.

3. **Introduction To SME Banking**

SMEs are a large and vital part of the UK economy, constituting an important target segment for many UK banks. The traditional relationship between SMEs and their banks has been affected by the financial crisis as banks have become more risk adverse and businesses look for alternative forms of credit. Bank lending to SMEs continues to fall and new forms of lending will compete to regain the ground left behind by conventional bank financing. In addition to the liquidity squeeze, some SMEs choose not to seek financing from banks due to a combination of risk-aversion and the belief that lending is unavailable.

3.1 ***The role of banks for SMEs***

Banks and other lenders provide financial products and services to organisations and businesses of all varieties and sizes. Customer needs in this segment vary by the size and type of businesses.

To address these needs, CYBG Group segments their business customers according to size and turnover:

- Micro, including sole proprietorships: CYBG Group defines these as businesses with no loans outstanding, with turnover less than £120,000. Many sole proprietorships and small businesses use PCAs for business purposes and therefore function similarly to a retail customer.

- Business Direct: CYBG Group defines these as businesses with outstanding lending of less than £0.1 million and turnover of less than £750,000.

- Small: CYBG Group defines these as businesses with loans of £0.1 million up to £0.25 million with turnover greater than £750,000 and up to £2 million.

- Commercial: CYBG Group defines these as businesses with loans of £0.25 million to £10 million, with turnover greater than £2 million.

There are many reasons why SMEs borrow. In 2014, 54 per cent. of loans were carried out to ensure adequate working capital, 27 per cent. to buy equipment and 25 per cent. to inject working capital (*Source: FSB - Voice of Small Business Report*). Products used by SMEs are principally current accounts, overdrafts, loans and credit cards.

Generally, banks generate a larger proportion of their revenue from fees in the commercial banking sector than in the retail sector.

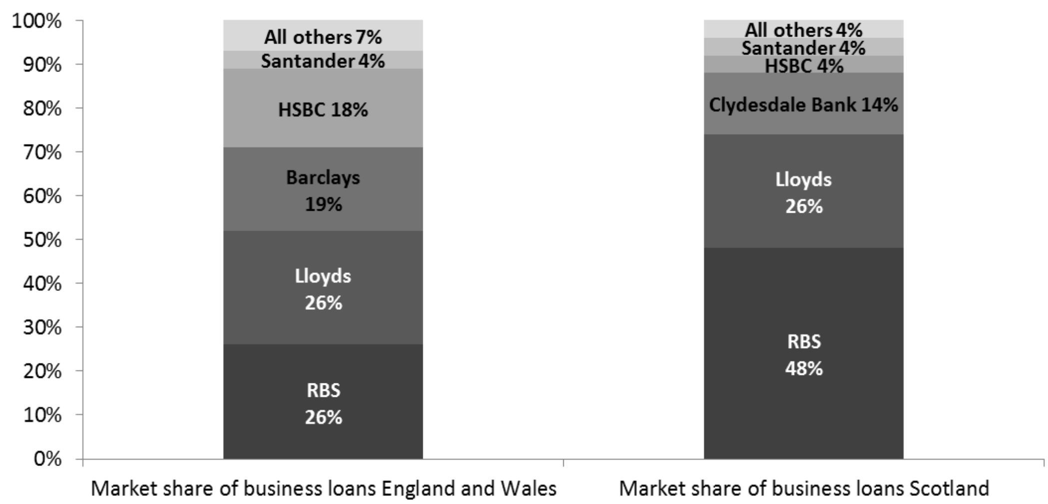
3.2 ***Main market participants***

The market for SMEs generates annual revenue of over £2 billion for banks and other lenders in the UK. It is highly concentrated, with the Big Five accounting for 93 per cent. of volume of business lending to SMEs in England and Wales in 2013. According to an October 2015 report, BCA market share is similarly concentrated, with the four largest banks accounting for 80 per cent. of active accounts. This concentration has been broadly stable for the last 5 years (*Source: CMA - Retail Banking Market Investigation*).

In Scotland, three banks (RBS, Lloyds and Clydesdale Bank) have accounted for 88 per cent. of lending to SMEs and accounted for 80 per cent. of SME BCAs in 2013. The market shares in England and Wales, and Scotland have remained stable since 1999 (*Source: FCA and CMA market study - Banking Services to small and medium-sized enterprises*).

Although the UK market is generally stable, there have been successful entrants, such as Handelsbanken, which emphasises its branch network and local, face-to-face relationships. It now has 200 branches and £10 billion of business loans, the majority of which are to SMEs.

Exhibit 3.1: SME business loans market share 2013



Source: CMA FCA Banking Services to Small and Medium-Sized Enterprises.

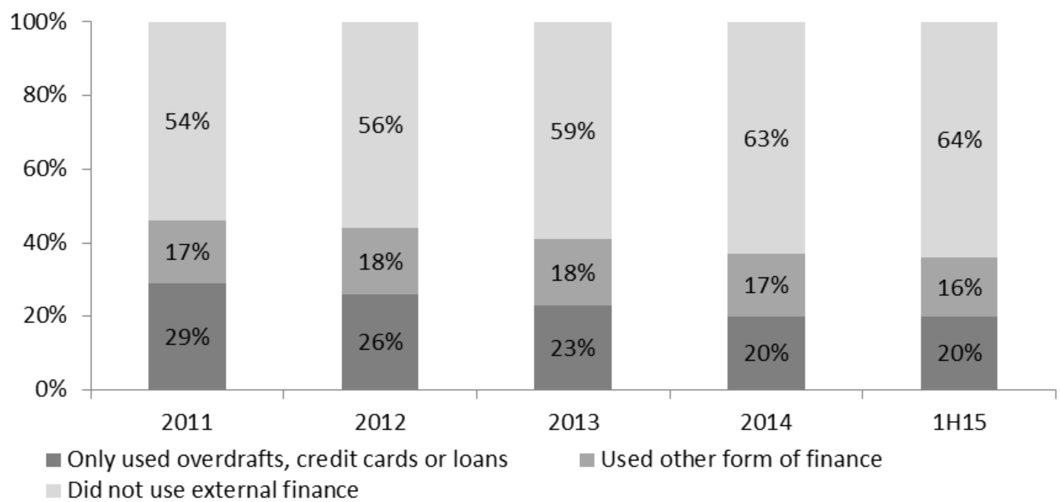
3.3 ***Access to finance***

The use of traditional banking products available to SMEs has declined. Overall, the use of any form of finance, referred to as "external finance", has declined in recent years across sectors, from 46 per cent. in 2011 to 36 per cent. in the first half of 2015. The decline in overdrafts, credit cards and loans is particularly significant (*Source: BDRC Continental SME Finance Monitor*).

Economic pessimism during the years following the financial crisis was reflected in fewer investment opportunities for businesses, which held more of their cash in deposits. Despite signs of economic recovery, some SMEs wanting to borrow were discouraged by the difficulty of applying for loans, or a perception that they would not be approved. In the fourth quarter of 2014, 79 per cent. of SME loans were approved, but only 33 per cent. of applicants assumed they would be successful (*Source: BBA*).

Due to the perception of loans being harder to obtain, fewer SMEs turned to external sources of finance. The use of traditional banking products such as overdrafts, term loans and credit cards has declined from 39 per cent. to 28 per cent. between 2011 and the first half of 2015.

Exhibit 3.2: How SMEs use finance 2011-1H15



Source: BDRC Continental SME Finance Monitor.

3.4 ***Use of bank financing***

SMEs also use non-banking sources of finance. Informal sources include loans from friends and family or personal savings. Formal sources include vendor financing, amongst others and recent innovations such as peer-to-peer lending, driven by digital technology. Although these newer channels remain small, they are growing (*Source: BBA - Promoting competition Report*).

49 per cent. of SMEs in the UK are considered "permanent non-borrowers", having neither borrowed for 5 years nor looking to borrow currently.

In a YouGov survey conducted in 2014, the most common reason cited from the options given for choosing not to borrow was the economic climate. One potential contributing factor is a deficit of trust. A survey by the Federation of Small Businesses found that only 16 per cent. considered banks to "care about small businesses". Excessive charges were the largest source of concern for SMEs in relation to their bank.

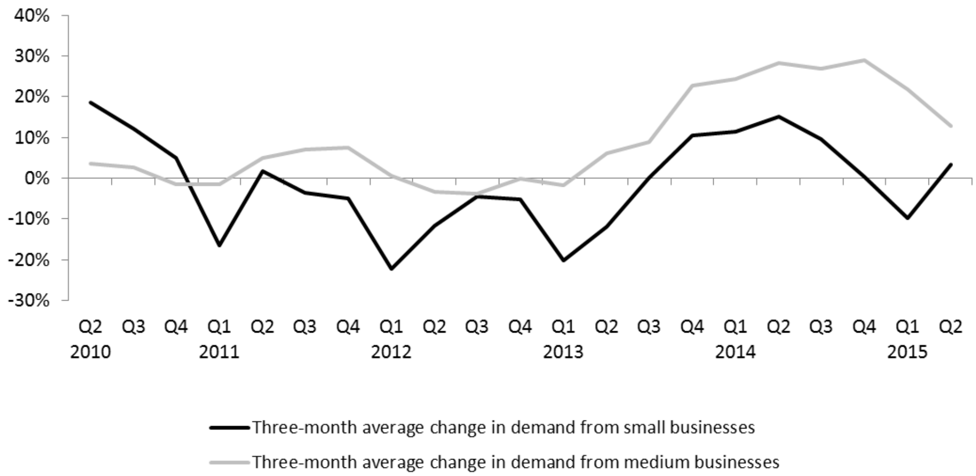
3.5 ***Trends in banking for SMEs***

Although demand for finance has increased since 2013, lending has been falling since 2011. This decline is in spite of the 2012 Funding for Lending Scheme, in which the Bank of England attempted to boost lending to households and companies by providing funding to banks and building societies at a lower cost.

3.5.1 *SME demand*

After a period of decline, demand for lending from medium sized enterprises has grown since the second quarter of 2013. This demand has gone largely unmet, representing a gap in the market for lenders. Demand from small businesses has also grown over this period, with the exception of the first quarter of 2015. Unlike medium-sized businesses, small businesses have reported that their demand has mostly been met since 2011 (*Source: YouGov - SME Banking Report*).

Exhibit 3.3: Reported change in demand for loans

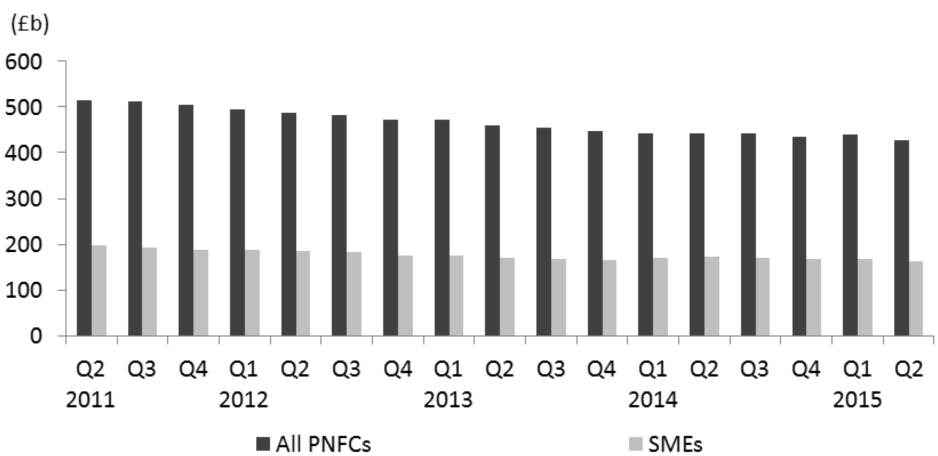


Source: Based on Bank of England data.

3.5.2 *Lending to SMEs*

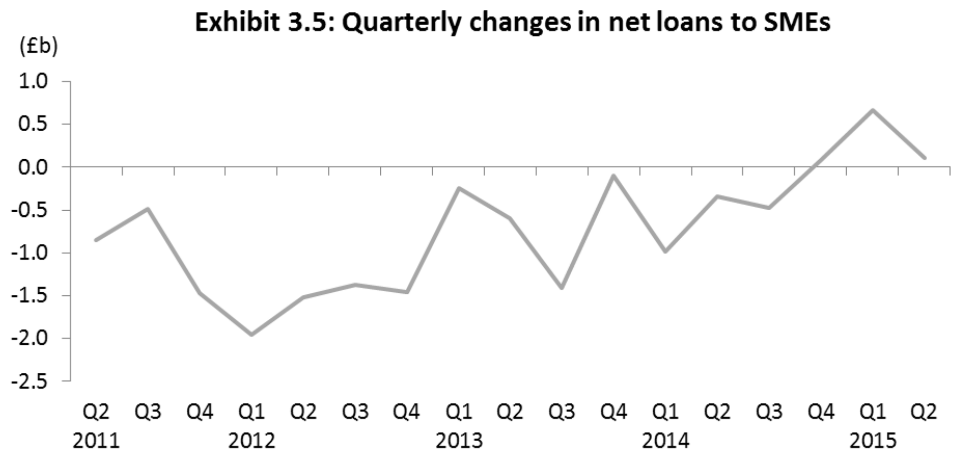
Lending to all private non-financial companies ("**PNFCs**") in the UK has declined since the second quarter of 2011 by a total of 17 per cent. Lending to SMEs has also experienced a downward trend, as shown in Exhibit 3.4.

Exhibit 3.4: Total outstanding loans to UK PNFCs

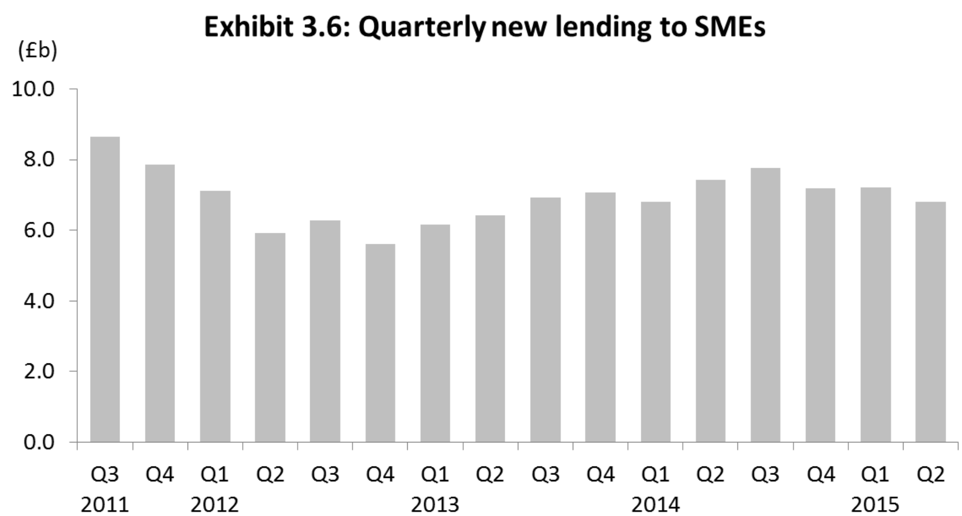


Source: Bank of England.

There are tentative signs of market recovery. First, the decline in loans outstanding slowed in the final three quarters of 2014 and began expanding in 2015, as shown in Exhibit 3.5. Secondly, total new lending to SMEs has remained broadly stable over the last two years, as shown in Exhibit 3.6.

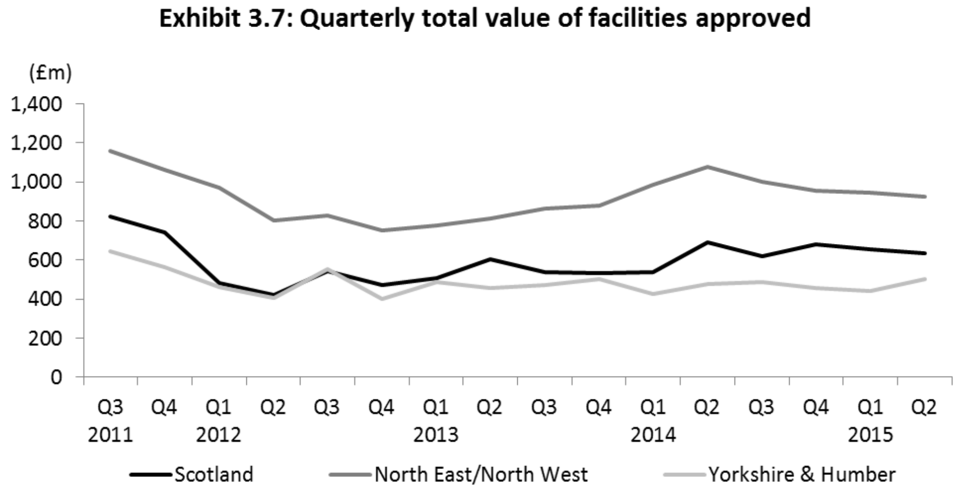


Source: Bank of England.



Source: British Banking Association.

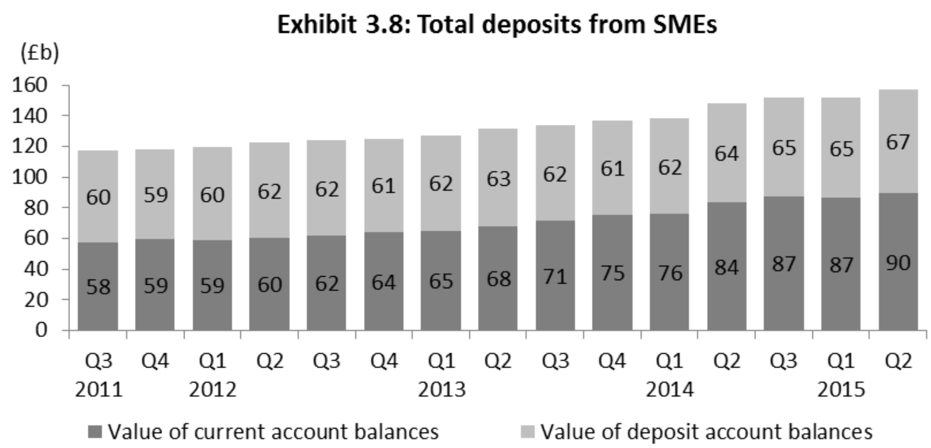
As shown in Exhibit 3.7, the core regions reflect a tentative improvement in the value of new lending to SMEs. More positive trends in Scotland, the North East and North West have emerged since 2011, with a less buoyant new lending market in Yorkshire and the Humber.



Source: British Banking Association.

3.5.3 *Deposits from SMEs*

During the challenging economic period post 2011, deposits from both small and medium-sized businesses grew.



Source: British Banking Association.

3.6 ***Distribution channels***

The main distribution channels used by SMEs are branches, online channels and by telephone (*Source: YouGov*). Relationship managers, who have an understanding of each business, provide a single point of contact for larger SMEs (*Source: YouGov - SME Banking*). SME customers use multiple channels, preferring digital options for simple interactions and using personal interaction for more complex banking needs (*Source: YouGov*).

Personal contact and branch banking are important to SMEs. The largest SMEs place significant value on personal service and face-to-face contact from banks. 54 per cent. of SME customers visit a branch at least once a month and SMEs' most preferred means of communication with a bank is over the telephone with a branch employee. 31 per cent. of SME customers in Northern England and 30 per cent. of customers in Scotland conduct business at a branch at least once a week. On average, SME customers in both regions consider that branches will continue to be important to a greater extent than customers in other regions in the UK (*Source: YouGov - SME Banking Data*).

A strong digital presence is important for SME customers. They make frequent use of online banking, with 81 per cent. of them interacting with their banks online, 39 per cent. on a daily basis. SMEs overwhelmingly consider digital banking to be the channel most likely to grow in importance in the next year (*Source: YouGov - SME Banking Data*).

3.7 ***Customer behaviour***

85 per cent. of SMEs prefer to receive all of their banking services from a single provider (*Source: YouGov - SME Banking Data*).

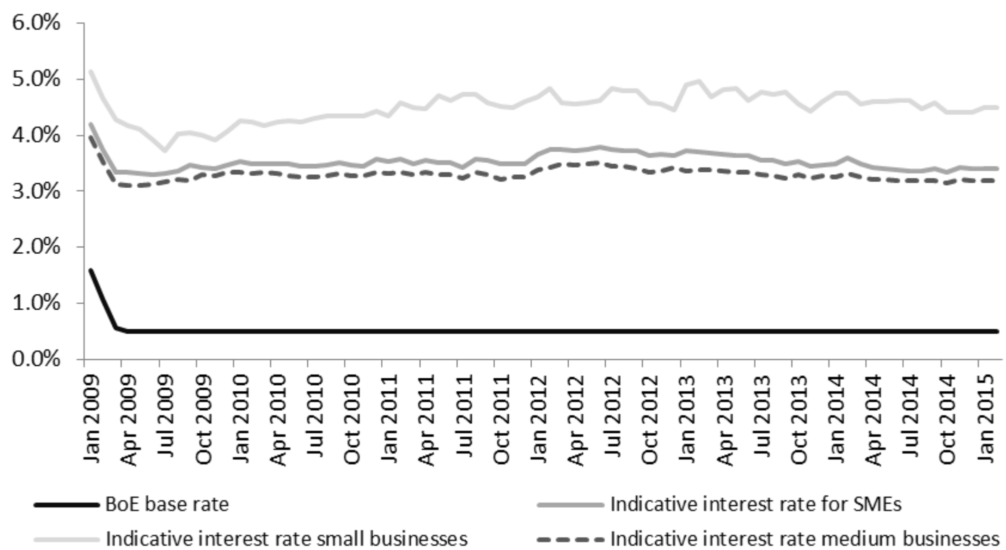
Satisfied customers are generally loyal to their banks, remaining with them for many years, with many new entrants in the provision of BCAs having higher satisfaction scores relative to their larger and longer-established peers. However, when changing providers, SMEs are most concerned about price and the availability of free banking and also consider a good relationship and the ability to speak to an employee as the most important factors (*Source: YouGov - SME Banking Data*).

There is considerable correlation between PCAs and BCAs. 31 per cent. of SMEs use a PCA as their main bank account and SMEs commonly open a BCA account with the bank they hold a PCA, benefitting banks with strong retail and SME propositions (*Source: YouGov - SME Banking Data*).

3.8 ***Spreads on lending***

The spread between average interest rates for SME lending and the Bank of England base rate (which has a direct correlation to a bank's funding cost) has been steady since mid-2009 at an average of 3 per cent. Medium-sized enterprises have a lower spread at 2.8 per cent. while smaller enterprises are higher, at an average of 4 per cent.

Exhibit 3.9: Spread of indicative interest rate to SMEs over BoE base rate



Source: Based on Bank of England data.

Spreads for SMEs are higher than for retail mortgages reflecting the more complex risk factors and higher cost to serve. A 2013 Bank of England study found that secured household loans in the retail sector have a rate of forbearance of approximately 5 to 8 per cent. of their total value, whereas SMEs had a rate of 14 per cent.

Research suggests that banks and other lenders perceive SMEs to be higher risk than they actually represent. A 2013 UK government study found that rejection rates for low and medium risk firms increased at a faster rate after 2009 than for high risk firms (*Source: BIS Evaluating Changes in Bank Lending to UK SMEs*).

3.9 ***Asset and invoice finance***

Asset and invoice finance are fast-growing banking products. Unlike the BCA market, challenger banks have a considerable market share of these products, particularly in asset finance.

3.9.1 *Asset finance*

Asset finance typically involves a business paying a regular charge for the use of an asset over an agreed period of time. The most common types of asset finance are: (i) leasing, where the customer rents new equipment without owning the asset; and (ii) hire purchase, which allows the customer to buy equipment on credit.

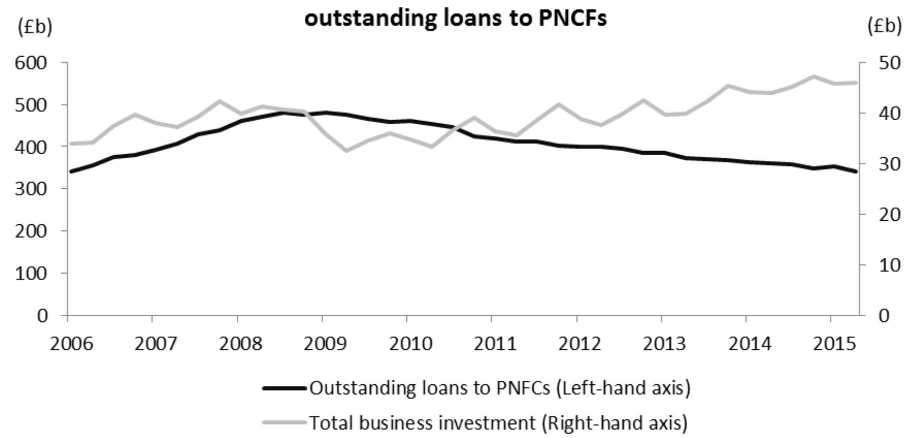
3.9.2 *Invoice finance*

Invoice finance involves businesses raising cash against as yet unpaid customer invoices. The most common types of invoice finance are: (i) factoring, where the provider interacts with a business' customers to receive payments owed, takes over the sales ledger and manages the credit control whilst receiving a percentage of the value in return; and (ii) discounting where the provider maintains the sales ledger and invoice processing but does not directly interact with the business' customers. Invoice finance typically earns a greater proportion of its income from fees than does asset finance.

3.9.3 *Background to growth of asset and invoice finance*

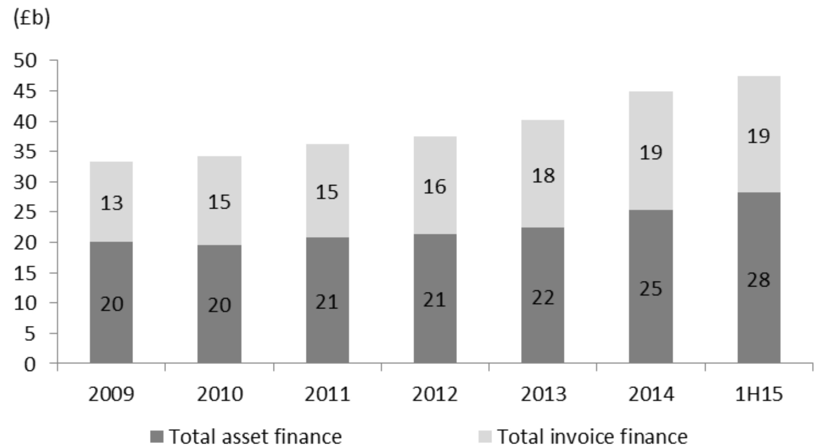
Since 2009, lending to PNFCs has consistently fallen each year, as shown in Exhibit 3.10. BIS forecasts a cumulative credit funding gap, the gap in businesses' access to funds, of £84 billion to £191 billion between 2013 and 2018 (*Source: Department for Business Innovation and Skills Boosting Finance Options for Businesses*). In addition, UK business investment has been steadily rising since 2009 albeit moderately seasonal. Alternative sources of financing such as asset and invoice finance have expanded over 2009 to the first half of 2015, growing by a CAGR of 6 per cent. and 7 per cent. respectively as shown in Exhibit 3.11.

Exhibit 3.10: Comparison of business investment and outstanding loans to PNCFs



Source: Office of National Statistics, Bank of England.

Exhibit 3.11: Loan balances for asset and invoice finance



Source: FLA and ABFA.

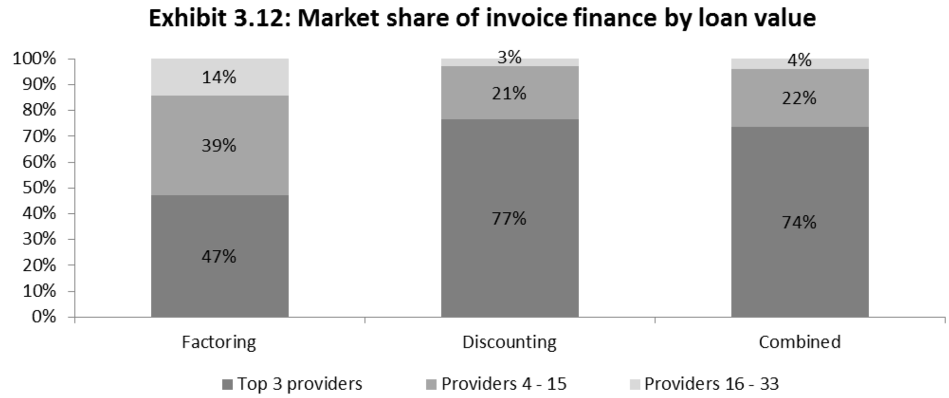
3.9.4 *Structure of the asset and invoice finance industry*

The asset and invoice finance industry comprises of three different types of participants:

- *Big Five high street banks*: these banks typically focus on larger business customers.
- *Original equipment manufacturers and vendors*: examples are General Electric and Siemens. They offer financing as part of their sales process and typically to large customers.
- *Challenger banks and niche specialists*: other banks such as Aldermore and Close Brothers, as well as specialists such as Bibby or Lombard. They focus on SME customers, and some on certain product types only.

For asset finance, there are 66 companies registered with the Finance and Leasing Association ("**FLA**"). The market overall is relatively fragmented, with the four largest banks having a 65 per cent. share of the market by value of loans. As a result smaller banks have a greater prominence in asset finance than in traditional lending.

In contrast to asset finance, the Big Five have a leading market share for invoice finance. Of the 33 invoice finance providers registered with the Asset-Based Finance Association ("**ABFA**"), the top three banks of the Big Five who provide invoice financing (RBS, Lloyds and Barclays) occupy 47 per cent. market share for factoring and 77 per cent. for discounting. Combined, they have 74 per cent. market share. In the overall market, the next 12 providers (including Santander with 2.2 per cent. of the market) have 22 per cent. market share, and the remaining providers have only 4 per cent. share. Some providers such as Clydesdale Bank and Yorkshire Bank only operate in the discounting market, of which they have a combined market share of 2 per cent., whilst other such as Pulse Cashflow Finance or Ashley Commercial Finance only operate in factoring.



Source: Business Money.

3.9.5 *Asset finance market*

Asset finance is predominantly used to finance vehicles, with car and commercial vehicle equating to 54 per cent. of the market. The next significant segment is plant and machinery which equates to 20 per cent., while the other key categories, namely business equipment finance, IT equipment finance, aircraft ships and rolling stock finance constitute 8, 7 and 2 per cent. of the market respectively.

3.9.6 *Invoice finance market*

The number of invoice finance clients has remained relatively stable in recent years, witnessing a slight decline since 2006.

By industry, the main market segments (manufacturing, distribution and services) have grown at a rate of 1.1 per cent. per annum since 2010.

When segmenting customers by turnover, there is a divergence in customer growth trends. On aggregate the number of customers with turnover of less than £10 million has grown by 1 per cent. per annum since 2010, whereas customers with turnover of greater than £10 million grew at an annual rate of 9 per cent. This pattern of divergence in growth rates is also apparent in the aggregate balances by turnover bandings. However, the growth rates in advances at the individual customer level were relatively flat or reducing; the exception being customers in the £50 million to £100 million turnover bracket, who increased borrowings on average by 4 per cent. per annum.

Definitions

“ABFA”	Asset-Based Finance Association
"Barclays"	Barclays plc
"BBA"	British Banking Association
"BCAs"	business current accounts
"Big Five"	Barclays, HSBC, Lloyds, RBS and Santander
"BIS"	the Department for Business Innovation and Skills
"CAGR"	compound annual growth rate
"CASS"	Current Account Switch Service
"CMA"	UK Competition and Markets Authority
"FCA"	Financial Conduct Authority
"FLA"	Finance and Leasing Association
“FSA”	Financial Services Authority
"GDP"	gross domestic product
"GVA"	gross value added
"HSBC"	HSBS Bank plc
"ICG"	individual capital guidance
"IPOs"	initial public offerings
"IRB"	internal ratings based approach
"Lloyds"	Lloyds Banking Group, which including the Lloyds, Halifax and Bank of Scotland brands
"Mass Affluent Customers"	customers who have investible assets between £50,000 and £1,000,000
"PCAs"	personal current accounts
"PNFCs"	private non-financial companies
"PPI"	payment protection insurance
"PRA"	Prudential Regulation Authority
"RBS"	Royal Bank of Scotland Group plc, which includes the RBS, NatWest and Ulster Bank brands
"RWAs"	risk-weighted assets
"Santander"	Santander UK plc
"SMEs"	micro, small and medium-sized enterprises