# INTERIM FINANCIAL REPORT 2019

**BASIS OF PRESENTATION**

CYBG PLC (the 'Company'), together with its subsidiary undertakings (which together comprise the 'Group'), operate under the Clydesdale Bank, Yorkshire Bank, B and Virgin Money brands. It offers a range of banking services for both retail and business customers through retail branches, business banking centres, direct and online channels, and brokers. This release covers the results of the Group for the six months ended 31 March 2019.

**Statutory basis:** Statutory information is set out on pages 43 to 79. The IFRS 9 accounting standard replaced IAS 39 ('Financial Instruments: Recognition and Measurement'), introducing changes to the classification and measurement of financial instruments and the impairment of financial assets. Virgin Money adopted IFRS 9 on 1 January 2018 and CYBG on 1 October 2018.

**Pro forma results:** On 15 October 2018, the Company acquired all the voting rights in Virgin Money Holdings (UK) plc (Virgin Money) by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006, with the transaction being accounted for as an acquisition of Virgin Money. We believe that it is helpful to also provide additional information which is more readily comparable with the historic results of the combined businesses. Therefore we have also prepared Pro forma results for the Group as if CYBG PLC and Virgin Money had always been a Combined Group, in order to assist in explaining trends in financial performance by showing a full 6 months performance for the Combined Group for both the current period and prior period, as well as a full 12 month performance of the Combined Group for the most recent year end results. A reconciliation between the results on a Pro forma basis and a statutory basis is included on page 17. The pro forma results are also presented on an underlying basis as there have been a number of factors which have had a significant effect on the comparability of the Group's financial position and results.

**Underlying basis:** The pro forma results are adjusted to remove certain items that do not promote an understanding of historical or future trends of earnings or cash flows, and therefore allows a more meaningful comparison of the Group's underlying performance. A reconciliation from the underlying pro forma results to the pro forma basis is shown on pages 15 to 16 and management's rationale for the adjustments is shown on page 80.

**Alternative performance measures:** the financial key performance indicators (KPIs) used by management in monitoring the Group's performance and reflected throughout this report are determined on a combination of bases (including statutory, regulatory and alternative performance measures), as detailed at 'Measuring financial performance – glossary' on pages 246 to 247 of the Group Annual Report and Accounts for the year ended 30 September 2018.

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

**FORWARD LOOKING STATEMENTS**

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

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

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# Interim financial report

For the six months ended 31 March 2019

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# CYBG PLC Interim Results 2019

Our new, enlarged group delivered a resilient underlying financial performance in H1, with integration progressing well. We are now developing customer propositions that leverage our differentiated brand, digital capability and full product suite, and we will set out our ambitions at our Capital Markets Day on 19 June.

***Note: this summary is on a pro forma basis as if Virgin Money was acquired on 1 October 2017 (actual completion 15 October 2018)***

**Resilient underlying financial performance; statutory profit impacted by acquisition and integration costs**

- Pro forma underlying profit before tax of £286m is 5% lower year on year due to the anticipated increase in impairments, but up 2% on H2 18; underlying Return on Tangible Equity (RoTE) was 10.4%
- Pro forma profit before tax of £9m impacted by significant acquisition and integration costs; statutory profit after tax was £29m due to the tax charge and acquisition timing impact
- Total underlying income of £843m in the first six months was in line with both H1 18 and H2 18:
  - Net interest income was down 1% on H1 18 with a lower Net Interest Margin (NIM) of 171bps due to the mortgage pricing pressures seen in 2018, although up 1% on H2 18 after pricing started to stabilise
  - Non-interest income was up 11% year on year due to growth in Virgin Atlantic credit card fee income
- Underlying costs down 3% year on year to £480m; underlying cost to income ratio was 2%pts lower at 57%
- Impairments increased to £77m; cost of risk of 21bps. In line with expectations reflecting the adoption of IFRS 9, a return to more normal levels in SME, as well as the growth and seasoning of our credit card portfolio

**Continued delivery of sustainable customer growth**

- Customer lending growth of 2.4% to £72.7bn driven by:
  - Disciplined mortgage balance growth of 2.5% to £60.5bn
  - SME growth of 1.1% to £7.6bn; strong new business drawdowns of £1.1bn offset by higher redemptions
  - Unsecured balances up 4.2% to £4.5bn with strong growth from the Virgin Atlantic credit cards
- Customer deposits up 1.2% to £61.7bn with an increase in relationship savings balances as we optimise mix

**Integration progressing well; significant acquisition and integration costs incurred during the period**

- Integration programme progressing well with the top two layers of management rationalisation complete
- Cost synergies being delivered in line with expectations; £33m of annual run-rate synergies realised to date
- Acquisition and integration costs of £214m includes integration costs of £45m, VM transaction costs of £55m, capital neutral intangible asset write-offs of £127m and other accounting adjustments

**Strong capital position maintained; acquisition costs, conduct and distributions impacted capital in H1 19**

- CET1 capital ratio of 14.5%; c.60bps reduction compared to the 30 Sep 2018 pro forma ratio of 15.1% reflects acquisition and integration costs, a small conduct provision top-up, as well as dividend and AT1 distributions
- Conduct provision top-up of £33m primarily due to increased processing costs from speculative PPI claims

***David Duffy, Chief Executive Officer of CYBG PLC commented:***

"I am pleased to report that the Group has delivered a resilient underlying financial performance during the first half of the year and our three year integration programme is making good progress. As previously announced we have also increased our forecast of the total cost synergies available by £30m to a minimum of £150m by the end of FY 2021. We have already realised £33m of annual run-rate cost synergies in the first six months. As expected, profit before tax has been impacted by the significant Virgin Money acquisition and integration costs.

Our number one priority remains offering our customers attractive products and quality service, and we are pleased to have maintained strong Net Promoter Scores for both our B and Virgin Money brands, while our Clydesdale and Yorkshire Bank NPS continue to improve.

Despite sustained competition in the mortgage market and a continued uncertain economic backdrop, we have delivered solid growth in our mortgage book and we have seen signs that mortgage pricing has started to stabilise. In our SME business, we have maintained momentum in the origination of new customer facilities and we are also seeing good growth from our Virgin Atlantic credit card proposition.

We remain on track to deliver 2019 performance in line with guidance and look forward to updating the market in June on our refreshed strategy and the significant opportunities for our combined business."

*Enquiries:*


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CYBG PLC will be hosting a presentation for analysts and investors covering the interim results at the London Stock Exchange, 10 Paternoster Square, London, EC4M 7LS, starting at 08:30 BST today (17:30 AEST). The meeting will be webcast live and available at www.cybg.com/investor-centre/financial-results. Webcast participants will be able to send questions into the meeting. A recording of the webcast and conference call will be made available on the website www.cybg.com/investor-centre/financial-results shortly after the meeting.

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**Participant Access Code - 016428**

# Chief Executive Officer's statement

**"I am pleased with our first six months as a combined business which has seen both clear progress in our integration programme and the delivery of a resilient underlying financial performance in challenging market conditions. With a strong platform on which to build, we now look forward to our Capital Markets Day in June where we will lay out our Group strategy as the first true national competitor to the status quo."**

Our business performance has been resilient during the period against a challenging backdrop and we have made a good start to the integration work following the acquisition of Virgin Money. We have been working hard to refine our strategy and to explore the opportunities we have, including those available through the Virgin brand, to create leading propositions for Retail and SME customers in the marketplace. We look forward to sharing more about our longer term ambitions on 19 June.

The UK economic outlook remains uncertain, as it has done for some time, and the delay to the resolution of the UK's negotiations with the EU is likely to extend this. While this has caused some customers to pause investment and consumption, demand has remained robust. Strong competition continues in several of our key markets, although we have seen signs that pricing in the mortgage market has started to stabilise.

Despite these uncertainties, our focus on customer proposition and service has enabled us to continue to grow our business and attract new customers. SME drawdowns in the half were our strongest so far at £1.1bn, and with a strong pipeline into the second half, we remain on track to deliver our commitment to provide at least £6bn of new lending to SMEs over three years by the end of 2019. Although we were surprised to have not received an award from the BCR's Capability and Innovation Fund, we are excited about the prospects for our SME business and will update in June on our plans for delivering a differentiated SME proposition.

In mortgages, we have leveraged our two differentiated propositions to respond to market conditions and achieve disciplined balance growth, underpinned by strong customer retention. Although the unsecured personal lending market is showing signs of more muted activity, our new propositions in partnership with Virgin Atlantic Airways (VAA) and Salary Finance, as well as an improved digital unsecured loan offering, have enabled us to grow within our risk appetite. The success of the VAA cards in particular demonstrates the opportunities available through partnership models with other Virgin Group companies.

We have delivered solid deposit growth during the period, with continued success in attracting relationship savings deposits, partly offset by a reduction in more costly term deposits as we optimise our mix of funding. We also continue to ensure appropriate funding diversification through our secured wholesale programmes, with over £1bn of successful issuance across mortgage-backed securities and covered bonds in the first half.

On a pro forma basis, the financial results for the first half show a resilient performance, with underlying profit of £286m 5% lower than the first half of 2018, but up 2% on the second half. We have continued to reduce costs in line with plan, down 3% year on year, benefitting from previous restructuring activity and initial integration cost synergies. Income has been resilient as we focus on optimising our balance sheet to mitigate some of the competitive margin pressures and other income generation has been supportive. As expected, impairments have increased following the adoption of IFRS 9, a return to more normal impairment levels in our SME book following an unusually benign 2018, and the seasoning of our credit card portfolio. However, our cost of risk is in line with our expectations at 21bps. Underlying return on tangible equity was 10.4% in the first half and we remain on track to deliver full year performance in line with our NIM and cost guidance.

As expected, largely due to the significant upfront costs related to the acquisition of Virgin Money, we have reported a small pro forma profit before tax of £9m. This also reflects a small additional PPI provision top-up due to the processing costs of managing a higher volume of speculative claims and our expectation for slightly higher complaint levels ahead of August's time bar. Our capital position remains strong with a CET1 ratio at 14.5%. This has reduced c.60bps from the pro forma position reported for 30 September 2018, due to acquisition and integration costs incurred, the conduct charge, as well as ordinary dividend and AT1 distributions.

# Chief Executive Officer's statement

We are progressing well with our integration programme, with £33m of annual run-rate cost synergies already realised through addressing senior management duplication and the initial harmonisation of some central cost activities. Six months into our three year integration process we have already increased our expected cost synergies to £150m, from the £120m announced at the time of the acquisition. The two businesses are coming together well and we have rolled out our new purpose for the Group. I have been delighted to see colleagues getting behind this and using it to drive better outcomes for our customers and stakeholders.

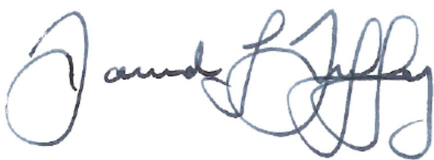
We continue to make progress in improving the service we offer our 6.4m customers. Virgin Money remains one of the best rated retail banks in the UK for customer advocacy in comparison to our peers and NPS has increased for all of our historic CYBG brands since September 2018, including an NPS on the B account of +35 in Q2.

Our digital transformation is also continuing. Our iB platform has been further extended with the launch of Business Internet Banking. Our open architecture allowed us to go live with the B store on the web and in-app, creating a new product platform for the bank to launch and test concepts with real customers in a live B app environment. We also launched B currency in the App Store helping customers take the hassle out of currency conversion. With a 4.8 rating in the App Store, it also won Most Innovative Product of the Year at the FSTech Awards.

In our Clydesdale Bank mortgage franchise we were pleased to have been awarded the 'Best Large Loan Lender' at the 2019 Mortgage Strategy Awards demonstrating our continued customer focus through our differentiated mortgage propositions. In SME, we opened our new state-of-the-art SME hub, B Works, in the heart of Manchester during January, further underlining our track record of supporting SMEs across the UK. Finally, our sponsorship of the Virgin Money London Marathon in April enabled c.18k runners to donate a record £27m through Virgin Money Giving, an increase of 15% compared to 2018.

The Virgin Money acquisition was a landmark moment for the Group and the combination will create the first true national competitor to the status quo in UK banking. Everything we have seen since completing the transaction, including our exciting engagement with the Virgin Group, has given us further confidence that we can achieve our ambitions. We have an opportunity to create a more efficient, fully digitally-enabled bank and believe the Virgin brand and potential Virgin Group partnerships will provide a strong competitive advantage. The completion of the FSMA part VII process is therefore a key milestone for us and we are progressing well towards that and continue to expect completion by the end of calendar year 2019.

Finally, I want to thank our colleagues and the Board for their support and willingness to engage positively at a time of considerable change for the Group. I look forward to sharing our plans with you at the Capital Markets Day on 19 June and continuing the exciting progress we have made so far.



**David Duffy, Chief Executive Officer - 14 May 2019**

# Overview of Group results - Statutory basis

The following tables present the Group on a statutory basis. That is, they include the results of Virgin Money from the date of acquisition on 15 October 2018. The acquisition has had a significant impact on the Group's statutory results and financial position as shown below. Accordingly, we believe that it is helpful to also provide additional historical information which is more readily comparable with the results of the combined businesses. This information, described as the pro forma results, is covered in detail on pages 7 to 14.

## Summary income statement

| | 6 months to | | |
|---|---|---|---|
| | **31 Mar 2019 £m** | 31 Mar 2018 £m | 30 Sep 2018 £m |
| Net interest income | **820** | 426 | 425 |
| Non-interest income | **106** | 77 | 79 |
| **Total operating income** | **926** | 503 | 504 |
| Operating and administrative expenses | **(711)** | (576) | (554) |
| **Operating profit/(loss) before impairment losses** | **215** | (73) | (50) |
| Impairment losses on credit exposures[1] | **(173)** | (22) | (19) |
| **Statutory profit/(loss) on ordinary activities before tax** | **42** | (95) | (69) |
| Tax (expense)/credit | **(13)** | 19 | - |
| **Statutory profit/(loss) after tax** | **29** | (76) | (69) |

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.3 to the financial statements) and exclude 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 note 2.3 to the financial statements). Impairment losses on credit exposures for the current period are calculated on an expected credit loss (ECL) basis under IFRS 9, which the Group adopted on 1 October 2018. For all other periods, impairment losses are calculated under the incurred loss basis as required by IAS 39.

The Group has recognised a statutory profit after tax of £29m (31 March 2018: loss of £76m). The increase in profit year on year primarily reflects the acquisition of Virgin Money and a substantial reduction in conduct charges. Together, these have more than offset a number of one-off charges that have arisen principally in connection with the acquisition of Virgin Money.

## Summary balance sheet

| | As at | |
|---|---|---|
| | **31 Mar 2019 £m** | 30 Sep 2018 £m |
| Customer loans | **72,670** | 33,281 |
| Other financial assets | **16,027** | 9,234 |
| Other non-financial assets | **1,458** | 941 |
| **Total assets** | **90,155** | 43,456 |
| Customer deposits | **(61,688)** | (28,854) |
| Wholesale funding | **(19,754)** | (8,095) |
| Other liabilities | **(3,355)** | (3,321) |
| **Total liabilities** | **(84,797)** | (40,270) |
| Ordinary shareholders' equity | **(4,239)** | (2,736) |
| AT1 equity | **(697)** | (450) |
| Non-controlling interests | **(422)** | - |
| **Equity** | **(5,358)** | (3,186) |
| **Total liabilities and equity** | **(90,155)** | (43,456) |

# Overview of Group results - Statutory basis

## Key performance indicators[1]

| | **6 months to 31 Mar 2019** | 6 months to 31 Mar 2018 | 12 months to 30 Sep 2018[2] |
|---|---|---|---|
| **Profitability:** | | | |
| Statutory return on tangible equity (RoTE) | **0.1%** | (7.0)% | (6.9)% |
| Statutory cost to income ratio (CIR) | **77%** | 115% | 112% |
| Statutory return on assets | **0.06%** | (0.36)% | (0.34)% |
| Statutory basic earnings/(loss) per share (EPS) | **0.2p** | (10.2)p | (19.7)p |

| **As at:** | **31 Mar 2019** | 31 Mar 2018 | 30 Sep 2018 |
|---|---|---|---|
| **Regulatory Capital:** | | | |
| CET1 ratio | **14.5%** | 11.3% | 10.5% |
| Tier 1 ratio | **18.6%** | 13.5% | 12.7% |
| Total capital ratio | **21.9%** | 16.7% | 15.9% |
| Capital Requirements Directive (CRD IV) leverage ratio | **4.7%** | 6.0% | 5.6% |
| UK leverage ratio | **5.3%** | 7.0% | 6.5% |
| Tangible net asset value (TNAV) per share | **260.1p** | 276.7p | 262.3p |
| **Funding and Liquidity:** | | | |
| Loan to deposit ratio (LDR) | **118%** | 115% | 115% |
| Liquidity coverage ratio (LCR) | **158%** | 131% | 137% |
| Net stable funding ratio (NSFR) | **125%** | 119% | 119% |

(1) For a definition of each of the KPIs, refer to 'Measuring financial performance – glossary' on pages 246 to 247 of the Group Annual Report and Accounts for the year ended 30 September 2018. The KPIs include statutory, regulatory and alternative performance measures. Where applicable certain KPIs are calculated on an annualised basis for the periods to 31 March.
(2) Profitability KPIs are provided with a full year to 30 September 2018 comparative in line with the statutory income statement presentation in the financial statements and as previously reported in the 2018 Group Annual Report and Accounts.

# Overview of Group results - Pro forma basis

The pro forma information in this section presents the Group results as if CYBG PLC and Virgin Money had always been a Combined Group. This assists in explaining trends in financial performance by showing a full 6 month performance for the Combined Group for both the current period and prior periods of the Combined Group for the most recent year end results. A reconciliation between the results on a pro forma basis and a statutory basis is included on page 17.

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

| | 6 months to | | |
|---|---|---|---|
| | **31 Mar 2019 £m** | 31 Mar 2018 £m | 30 Sep 2018 £m |
| Underlying net interest income | **728** | 738 | 719 |
| Non-interest income | **115** | 104 | 124 |
| **Total underlying operating income** | **843** | 842 | 843 |
| Underlying operating and administrative expenses | **(480)** | (493) | (505) |
| **Underlying operating profit before impairment losses** | **363** | 349 | 338 |
| Underlying impairment losses on credit exposures[2] | **(77)** | (48) | (58) |
| **Underlying profit on ordinary activities before tax** | **286** | 301 | 280 |
| Acquisition and integration costs | **(214)** | - | (39) |
| Legacy conduct | **(33)** | (220) | (176) |
| Restructuring and separation | **(2)** | (28) | (18) |
| Other[3] | **(28)** | (7) | (9) |
| **Pro forma profit on ordinary activities before tax** | **9** | 46 | 38 |

(1) The summary income statement is presented on an underlying and pro forma basis as explained in the Basis of Presentation.
(2) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.3 to the financial statements) and exclude 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 note 2.3 to the financial statements).
(3) Other includes a £17m charge in relation to SME transformation, including preparations to participate in the RBS Incentivised Switching remedy, and a charge of £11m for Guaranteed Minimum Pension (GMP) equalisation in the Group's defined benefit scheme.

On a pro forma basis, the Group has reported underlying profit before tax of £286m (31 March 2018: £301m). Operating income is flat year on year and operating costs reduced from £505m in the 6 months to 30 September 2018 to £480m in the current period due to cost savings delivered through the Group's cost efficiency and integration programmes. Impairment losses increased to £77m primarily due to the combination of the adoption of IFRS 9, a return to more normal levels of SME impairments following a benign 2018, and the growth and seasoning of the Retail unsecured portfolios. The increase in impairment charges is the primary driver of the reduction in underlying RoTE from 11.8% to 10.4%, and underlying basic EPS from 16.1p to 13.4p.

The Group recorded pro forma profit before tax of £9m, after allowing for a number of items, principally costs, that are exceptional in nature and have therefore been removed from the underlying performance of the business. These include acquisition and integration costs of £214m, including integration costs of £45m and acquisition costs of £169m. Acquisition costs comprise a charge of £67m (net) in relation to the unwind of acquisition accounting adjustments, a (capital neutral) charge of £127m in relation to the rationalisation of the Group's software estate following the Virgin Money acquisition; an effective interest rate (EIR) adjustment of £80m relating to the mortgage portfolio following the harmonisation of accounting policies across the Group; and £55m of transaction costs incurred as part of the acquisition of Virgin Money. The Group has also incurred further costs of £33m in respect of dealing with legacy conduct matters. The majority of the legacy conduct charges related to PPI (£30m) albeit the scale of PPI charges has substantially reduced compared to prior periods (£202m for the 6 months to 31 March 2018 and £150m for the 6 months to 30 September 2018). Due to the size and nature of these adjustments they are not shown within the underlying performance of the Group.

# Overview of Group results - Pro forma basis

## Summary balance sheet

| | As at | |
|---|---|---|
| | **31 Mar 2019 £m** | 30 Sep 2018 £m |
| Customer loans | **72,670** | 70,939 |
| Other financial assets | **16,027** | 16,202 |
| Other non-financial assets | **1,458** | 1,407 |
| **Total assets** | **90,155** | 88,548 |
| Customer deposits | **(61,688)** | (60,963) |
| Wholesale funding | **(19,754)** | (18,675) |
| Other liabilities | **(3,355)** | (3,726) |
| **Total liabilities** | **(84,797)** | (83,364) |
| Ordinary shareholders' equity | **(4,239)** | (4,312) |
| AT1 equity | **(697)** | (450) |
| Non-controlling interests | **(422)** | (422) |
| **Equity** | **(5,358)** | (5,184) |
| **Total liabilities and equity** | **(90,155)** | (88,548) |

# Overview of Group results - Pro forma basis

## Key performance indicators[1]

| | **6 months to 31 Mar 2019** | 6 months to 31 Mar 2018 | 6 months to 30 Sep 2018 |
|---|---|---|---|
| **Profitability:** | | | |
| NIM | **1.71%** | 1.84% | 1.72% |
| Underlying RoTE | **10.4%** | 11.8% | 10.2% |
| Underlying CIR | **57%** | 59% | 60% |
| Underlying return on assets | **0.49%** | 0.61% | 0.51% |
| Underlying basic EPS[2] | **13.4p** | 16.1p | 13.7p |

| **As at:** | **31 Mar 2019** | 30 Sep 2018 |
|---|---|---|
| **Asset Quality:** | | |
| Impairment charge to average customer loans (cost of risk) | **0.21%** | 0.15% |
| Total provision to customer loans | **0.52%** | 0.51% |
| Indexed LTV of mortgage portfolio[3] | **58.2%** | 57.3% |
| **Regulatory Capital:** | | |
| CET1 ratio[4] | **14.5%** | 15.1% |
| Tier 1 ratio | **18.6%** | 18.3% |
| Total capital ratio | **21.9%** | 20.6% |
| CRD IV leverage ratio | **4.7%** | 4.6% |
| UK leverage ratio | **5.3%** | 5.1% |
| TNAV per share[5] | **260.1p** | 260.0p |
| **Funding and Liquidity:** | | |
| LDR | **118%** | 116% |
| LCR | **158%** | 161% |
| NSFR | **125%** | 126% |

(1) For a definition of each of the KPIs, refer to 'Measuring financial performance – glossary' on pages 246 to 247 of the Group Annual Report and Accounts for the year ended 30 September 2018 and in the Glossary on pages 81 to 82. The KPIs include statutory, regulatory and alternative performance measures. Where applicable certain KPIs are calculated on an annualised basis for the periods to 31 March.
(2) For pro forma purposes, the weighted average number of ordinary shares in issue assumes that the 540,856,644 share issuance arising on the acquisition of Virgin Money was completed on 1 October 2017, and excludes own shares held.
(3) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance. The Clydesdale Bank PLC portfolio is indexed using the MIAC Acadametrics indices at a given date, while the Virgin Money portfolio is indexed using the Markit indices.
(4) The pro forma CET 1 ratio at 30 September 2018 reflects the impact of the acquisition of Virgin Money and IRB accreditation.
(5) The pro forma total number of ordinary shares in issue used in the TNAV per share calculation for the comparative periods is the number of ordinary shares in issue on 15 October 2018 following the acquisition of Virgin Money (excluding own shares held). This has been applied across all periods for comparability purposes.

# Financial performance review - Pro forma basis

## 1. Sustainable growth in customer lending and deposit balances

| | As at | |
|---|---|---|
| | **31 Mar 2019 £m** | 30 Sep 2018 £m |
| Mortgages | **60,543** | 59,074 |
| SME lending | **7,619** | 7,538 |
| Unsecured personal lending | **4,508** | 4,327 |
| **Gross loans and advances to customers** | **72,670** | 70,939 |
| Current accounts | **(14,728)** | (14,665) |
| Variable rate savings accounts | **(24,536)** | (22,447) |
| Fixed rate term deposits | **(22,424)** | (23,851) |
| **Total customer deposits** | **(61,688)** | (60,963) |

**Mortgages**
Our continued focus on our differentiated mortgage propositions has resulted in annualised growth of 5.0% in the period, above system growth[(1)] of 2.6%. On a pro forma basis our market share has increased from 4.2% to 4.3%.

The mortgage market has remained highly competitive during the period. A large number of active lenders, combined with the surplus liquidity deployment from the large incumbent banks' ring-fenced entities, has resulted in an over-supply of lending and a dilution in mortgage margins. The uncertain economic backdrop and the maturity profile of business means that the gross lending market continues to be driven by remortgaging activity, up 10% on the prior period.

We continued to see a growing number of customers favour longer term fixed rate mortgage products, as customers seek to further capitalise on the prevailing low interest rate environment. Conversely, UK variable rate and Standard Variable Rate (SVR) balances have reduced. The buy-to-let (BTL) property market has been more subdued following last year's changes in tax relief for landlords, an increase in stamp duty and enhanced affordability assessments.

The average LTV of new lending increased slightly to 69.5% from 68.8% and the average LTV of the mortgage book also increased to 58.2% from 57.3.%. Our proportion of residential mortgages 90 days in arrears was stable at 0.30%.

We expect the pace of lending growth in our mortgage book to slow in the second half as we look to optimise the mix of lending in our portfolio and proactively reduce volume in selected segments in order to mitigate some of the margin pressures.

**SME lending**
Our targeted lending strategy, supported by lending proposition teams with sector specialisms (such as Healthcare, Hotels & Real Estate, Social Housing, Energy, and Growth Finance) has resulted in growth in our SME lending portfolio of £81m in the period (2.1% annualised), slightly lower than system growth[(2)] of 2.6%.

While we had a strong six months in terms of new business drawdowns (£1.1bn during the period), we are slightly behind market growth on a net basis due to higher redemptions following several customer driven business disposals during the period, as well as our decision to be more selective on refinancing activity. The Group remains on target to deliver on its pledge to lend SMEs £6bn over the three years to 2019.

Underlying asset quality in our SME book remains resilient and stable, reflective of the diversity within the portfolio as a result of controlled risk appetite and an economic environment which continues to support business performance.

SMEs are facing an extended period of uncertainty due to the continuation of Brexit negotiations. Despite this uncertainty, at a macro-economic level the market appears to have performed well and sectors which have previously struggled, such as construction and manufacturing, have shown improvement. We expect to see growth in our SME portfolio over the second half of the year as we look to attract new business banking customers and grow our SME franchise through participating in the RBS switching scheme.

(1) System growth sourced from the BoE 'Mortgages outstanding by type of lender, UK (BOE)' report (MM4).
(2) System growth sourced from the BoE 'Industrial analysis of monetary financial institutions' lending to UK residents' report (C1,2), excluding individuals and individual trusts, activities auxiliary to financial intermediation, insurance companies and pension funds, and financial intermediation results.

# Financial performance review - Pro forma basis

**Unsecured personal lending**
Credit card balances have increased by £104m to £3,609m. We have benefitted from the continued diversification of the portfolio through the VAA proposition, which was launched in April 2018. Performance of the VAA credit cards is strong and has driven the recruitment of new high quality customers, reflecting the more affluent nature of the customer base, with increased levels of retail spend, and over 110,000 new VAA cards issued by March 2019.

Unsecured personal loans have grown by £76m to £843m in the period driven by competitive pricing on our fixed rate personal loans which grew by 10% annualised over the period from £743m to £780m. In addition, in February 2019 we announced that we had entered into a joint venture agreement with Salary Finance Limited which adds a differentiated digital channel to our personal lending business. As at March 2019, customers had drawn £42m through Salary Finance which has helped contribute to the growth in our personal loan book.

**Customer lending asset quality**

| | 6 months ended 31 March 2019 | | | | 6 months ended 31 March 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Retail - secured bps | Retail - unsecured bps | SME bps | Total bps | Retail - secured bps | Retail - unsecured bps | SME bps | Total bps |
| **Gross cost of risk(1)** | 1 | 317 | 55 | 26 | 1 | 226 | 37 | 19 |
| Specific provision releases and recoveries | | | | (5) | | | | (5) |
| **Net cost of risk(1)** | | | | 21 | | | | 14 |

(1) Cost of risk is calculated on an annualised basis.

The Group's net cost of risk has increased from 14bps to 21bps on a pro forma basis inclusive of the move to IFRS 9. Mortgage impairment levels remain low, while the Retail unsecured cost of risk has increased due to a combination of growth and portfolio seasoning. In line with expectations, cost of risk for SME lending has returned to more normal levels following very low impairments in FY2018. Group impairment losses are expected to remain around current levels for the remainder of 2019, but with the continued risk from external economic uncertainty having the potential to impact on possible future impairment outcomes.

**Current accounts**
Current account deposits increased by £63m to £14,728m in the period. We continue to be successful in opening new business current accounts with further growth in the period of £169m taking total business current account balances to £6,561m. This has been partially offset by a reduction in retail current account balances as a result of a high level of competitor incentivisation activity during the period which has impacted both attrition and new business levels.

**Variable rate savings accounts**
Funding from variable rate savings accounts increased by £2,089m from £22,447m to £24,536m as we sought to optimise our deposit mix by refinancing more expensive term deposits with more efficient savings deposits.

**Fixed rate term deposits**
Our fixed rate term deposit book decreased by £1,427m from £23,851m to £22,424m as a result of deliberate management action to reduce maturity mismatch risk and optimise mix, primarily in the acquired Virgin Money book.

**Funding and liquidity**
The Group continues to maintain its strong funding and liquidity position. Our loan to deposit ratio was broadly stable over the period at 118% (30 September 2018: 116%), while the Group's liquidity surplus continues to comfortably exceed our regulatory minimum and internal risk appetite, with an LCR of 158% (30 September 2018: 161%) and NSFR of 125% (30 September 2018: 126%) at 31 March 2019.

In addition to Retail and SME deposits, we ensure appropriate diversification in our funding base through a number of wholesale funding programmes. We successfully completed further issuances of mortgage-backed securities through the Group's Lanark programme across USD and GBP tranches, raising $325m and £350m in February 2019. In addition, the inaugural issuance from the Virgin Money Covered Bond programme raised £500m in March 2019.

The Group recognises the consistency risks associated with its drawings from the Bank of England's Term Funding Scheme and plans gradual repayment, ahead of contractual maturity, to reduce this risk. The first such early repayment of £150m occurred in March 2019, reducing the outstanding amount to £8,487m at 31 March 2019.

# Financial performance review - Pro forma basis

**Net interest income**

| Average balance sheet | 6 months ended 31 March 2019 Average balance £m | Interest income/ (expense) £m | Average yield/ (rate)[1] % | 6 months ended 31 March 2018 Average balance £m | Interest income/ (expense) £m | Average yield/ (rate)[1] % |
|---|---|---|---|---|---|---|
| **Interest-earning assets:** | | | | | | |
| Mortgages | **59,991** | **783** | **2.62** | 57,449 | 782 | 2.73 |
| SME lending[2] | **7,500** | **156** | **4.17** | 7,276 | 141 | 3.88 |
| Unsecured personal lending | **4,506** | **172** | **7.65** | 4,246 | 151 | 7.12 |
| Liquid assets | **11,984** | **49** | **0.82** | 10,120 | 26 | 0.51 |
| Due from other banks | **1,647** | **6** | **0.74** | 1,313 | 2 | 0.25 |
| Swap income/other | **-** | **(6)** | **n/a** | - | (27) | n/a |
| **Total average interest-earning assets** | **85,628** | **1,160** | **2.72** | 80,404 | 1,075 | 2.68 |
| **Total average non-interest-earning assets** | **3,243** | | | 3,134 | | |
| **Total average assets** | **88,871** | | | 83,538 | | |
| **Interest-bearing liabilities:** | | | | | | |
| Current accounts | **11,581** | **(9)** | **(0.16)** | 11,520 | (6) | (0.09) |
| Savings accounts | **23,352** | **(99)** | **(0.85)** | 22,538 | (68) | (0.61) |
| Term deposits | **23,213** | **(185)** | **(1.60)** | 22,078 | (175) | (1.59) |
| Wholesale funding | **19,100** | **(139)** | **(1.46)** | 15,741 | (88) | (1.12) |
| **Total average interest-bearing liabilities** | **77,246** | **(432)** | **(1.12)** | 71,877 | (337) | (0.94) |
| **Total average non-interest-bearing liabilities** | **6,522** | | | 6,383 | | |
| **Total average liabilities** | **83,768** | | | 78,260 | | |
| **Total average equity** | **5,103** | | | 5,278 | | |
| **Total average liabilities and average equity** | **88,871** | | | 83,538 | | |
| | | | | | | |
| **Net interest income** | | **728** | | | 738 | |

(1) Average yield is calculated by annualising the interest income/expense for the period.
(2) Includes loans designated at fair value through profit or loss.

Group NIM of 1.71% has reduced from 1.84% since March 2018, but is stable compared to H2 2018 (1.72%).

The largest impact on Group NIM has been the continued dilution in mortgage margins due to sustained competition and more recent pressure in the higher margin segments of the market. Furthermore we continue to see mortgage customers favouring fixed rate deals and this customer preference, alongside proactive early retention programmes across the industry, continues to exert pressure on mortgage margins through competitive fixed rate pricing and lower SVR balances.

We saw improved yields in our SME book with a steady increase over the last 3 periods from 3.88% in the period to March 2018 to 4.17% in the period to March 2019, with an emphasis on pricing discipline and a higher interest rate environment helping to deliver this result. Pricing in the unsecured personal lending market remains very competitive, however the average gross yield has increased from 7.12% to 7.65% driven by the successful launch of the VAA cards towards the end of FY2018, and the seasoning effect in the Virgin Money credit card book with more balances now cash yielding.

Within our deposit portfolio the average cost of savings accounts increased from 0.61% to 0.85%. This increase was attributable to passing on the August 2018 base rate increase to our customers and we were able to manage market pricing pressure through product mix.

Wholesale funding costs have increased as a result of an increase in the issuance of senior debt as we position to meet MREL requirements and the issuance of £250m of subordinated debt in December 2018.

Given the ongoing margin pressures, we continue to expect our FY19 NIM to be within a guidance range of 165-170bps.

# Financial performance review - Pro forma basis

**Non-interest income**

Non-interest income increased by £11m (11%) compared with March 2018 from £104m to £115m. Excluding the impact of gains and losses on financial instruments held at fair value, non-interest income grew £9m from £109m to £118m, primarily due to the success of the VAA credit cards launched in April 2018 and growth in our SME banking fee income.

## 2. Delivering on our efficiency programme

| | 6 months to | | |
|---|---|---|---|
| **Operating and administrative expenses** | **31 Mar 2019 £m** | 31 Mar 2018 £m | 30 Sep 2018 £m |
| Personnel expenses | **203** | 207 | 216 |
| Depreciation and amortisation expenses | **54** | 59 | 62 |
| Other operating and administrative expenses | **223** | 227 | 227 |
| **Total underlying operating and administrative expenses** | **480** | 493 | 505 |
| Acquisition and integration costs | **228** | - | 39 |
| Legacy conduct | **33** | 220 | 176 |
| Restructuring and separation | **2** | 28 | 18 |
| Other[1] | **28** | 7 | 12 |
| **Total pro forma operating and administrative expenses** | **771** | 748 | 750 |

(1) Other includes a £17m charge in relation to SME transformation, including preparations to participate in the RBS Incentivised Switching remedy, and a charge of £11m for Guaranteed Minimum Pension (GMP) equalisation in the Group's defined benefit scheme.

Underlying operating expenses reduced from £493m to £480m, with the full impact of run-rate savings from the final year of our Sustain efficiency programme and delivery of initial cost savings from our integration programme.

We are progressing well with our integration programme, with £33m of annual run-rate cost synergies already realised through addressing senior management duplication and the initial harmonisation of some central cost activities. Six months into our three year integration process we have already increased our expected cost synergies to £150m, from the £120m announced at the time of the acquisition, and will give an update at our Capital Markets Day in June on the broader cost opportunity for the combined Group.

The acquisition of Virgin Money in October 2018 marked the next phase in our strategic transformation journey and inevitably led to the Group incurring a higher level of non-underlying costs, both one-off and recurring in nature, which overall caused a £23m increase in pro forma operating and administrative expenses, from £748m to £771m.

Acquisition and integration costs of £228m in the period included £55m of one-off transaction related costs and £45m of integration costs as it embarked upon a three year programme to fully integrate both banks. Incidental to the integration programme, a £127m charge was recognised in the period following a review of the Group's software estate, which identified a number of core assets (including £70m in relation to the Virgin Money Digital Bank asset) that are no longer of value to the Group's future strategy and therefore required to be written down. However this charge is capital neutral.

During the period, the Group also reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £30m was required, mainly due to the higher volume of speculative information requests received which is driven by the increased activity by claims management companies ahead of the August 2019 industry deadline. It also incorporates a reassessment of the costs of processing cases and the impact of experience adjustments. The Group has also recognised additional costs of £3m for other less significant conduct related matters.

Our strong track record in delivering cost efficiencies will help to underpin the Group's future profits and capital generation. We continue to expect the Group's underlying operating expenses to be less than £950m in FY2019, down from a pro forma combined cost base of £998m in FY2018.

# Financial performance review - Pro forma basis

## 3. Capital optimisation

| | As at | |
|---|---|---|
| | **31 Mar 2019 £m** | 30 Sep 2018 £m |
| Common equity tier 1 capital | **3,460** | 3,459 |
| Additional Tier 1 capital | **977** | 729 |
| Tier 2 capital | **783** | 536 |
| **Total capital** | **5,220** | 4,724 |
| **Risk weighted assets** | **23,864** | 22,943 |

| | **6 months to 31 Mar 2019 %/bps** |
|---|---|
| **Opening CET1 ratio** | **10.5%** |
| IRB accreditation impact | **3.5%** |
| **IRB pro forma CET1 ratio** | **14.0%** |
| Virgin Money acquisition impact | **1.1%** |
| **Opening Combined Group pro forma CET1 ratio (pre IFRS 9 impact)** | **15.1%** |
| IFRS 9 transitional impact | **(0.02)%** |
| **Opening Combined Group pro forma CET1 ratio as at 1 October 2018 (post IFRS 9 impact)** | **15.1%** |
| Generated | **114** |
| RWA growth | **(56)** |
| Investment spend | **(20)** |
| AT1 distributions | **(12)** |
| Underlying capital generated | **26** |
| Acquisition and integration costs | **(41)** |
| Legacy conduct | **(12)** |
| Ordinary dividends paid | **(19)** |
| Other | **(11)** |
| Net capital absorbed | **(57)** |
| **Closing CET1 ratio** | **14.5%** |

The Group delivered a CET1 ratio of 14.5% and total capital ratio of 21.9% at March 2019. In October 2018, the Group received accreditation to move onto IRB methodology for calculating risk-weighted assets on mortgages and corporate exposures, which increased the CET1 ratio by 3.5%. Also in October, the acquisition of the Virgin Money group increased the CET1 ratio by a further 1.1%, which when coupled with the impact of the introduction of IFRS 9, increased the September 2018 pro forma CET1 ratio to 15.1%.

Underlying capital generation in the period was 26bps, largely driven by strong underlying profits, offset by growth in lending with risk weighted assets increasing by £921m. Investment spend absorbed 20bps and AT1 distributions a further 12bps. After non-underlying items, principally acquisition and integration costs, as well as a further legacy conduct charge, the Group's CET1 ratio was 57bps lower at 14.5%.

The Group continues to maintain a significant buffer to its regulatory capital requirements and remains confident in its ability to deliver net capital generation going forward.

# Reconciliation of pro forma to underlying results

The underlying results presented within this section reflect the Group's results prepared on an underlying basis and as presented to the CEO and the Executive Leadership Team and the Board. These exclude certain items that are included in the pro forma results, as management believes that these items are not reflective of the underlying business and do not aid meaningful period on period comparison. The tables below reconcile the pro forma results to the underlying basis, and full details on the adjusted items are included on page 80:

| **6 months to 31 Mar 2019** | **Statutory results £m** | **Include Virgin Money pre-acquisition results £m** | **Pro forma results £m** | **Acquisition and integration costs £m** | **Legacy conduct £m** | **Restructuring and separation £m** | **Other £m** | **Underlying basis £m** |
|---|---|---|---|---|---|---|---|---|
| Net interest income | **820** | **22** | **842** | **(114)** | **-** | **-** | **-** | **728** |
| Non-interest income | **106** | **9** | **115** | **-** | **-** | **-** | **-** | **115** |
| **Total operating income** | **926** | **31** | **957** | **(114)** | **-** | **-** | **-** | **843** |
| Total operating and administrative expenses before impairment losses | **(711)** | **(60)** | **(771)** | **228** | **33** | **2** | **28** | **(480)** |
| **Operating profit/(loss) before impairment losses** | **215** | **(29)** | **186** | **114** | **33** | **2** | **28** | **363** |
| Impairment losses on credit exposures | **(173)** | **(4)** | **(177)** | **100** | **-** | **-** | **-** | **(77)** |
| **Profit/(loss) on ordinary activities before tax** | **42** | **(33)** | **9** | **214** | **33** | **2** | **28** | **286** |
| **Financial performance measures** | | | | | | | | |
| RoTE | **0.1%** | **(1.5)%** | **(1.4)%** | **9.1%** | **1.4%** | **0.1%** | **1.2%** | **10.4%** |
| CIR | **77%** | **4%** | **81%** | **(15)%** | **(5)%** | **-%** | **(4)%** | **57%** |
| Return on assets | **0.06%** | **(0.06)%** | **-%** | **0.38%** | **0.06%** | **-%** | **0.05%** | **0.49%** |
| Basic EPS | **0.2p** | **(2.0)p** | **(1.8)p** | **11.8p** | **1.8p** | **0.1p** | **1.5p** | **13.4p** |

| **6 months to 30 Sep 2018** | Statutory results £m | Include Virgin Money pre-acquisition results £m | Pro forma results £m | Virgin Money acquisition costs £m | Legacy conduct £m | Restructuring and separation £m | Other £m | Underlying basis £m |
|---|---|---|---|---|---|---|---|---|
| Net interest income | 425 | 294 | 719 | - | - | - | - | 719 |
| Non-interest income | 79 | 48 | 127 | - | - | - | (3) | 124 |
| **Total operating income** | 504 | 342 | 846 | - | - | - | (3) | 843 |
| Total operating and administrative expenses before impairment losses | (554) | (196) | (750) | 39 | 176 | 18 | 12 | (505) |
| **Operating (loss)/profit before impairment losses** | (50) | 146 | 96 | 39 | 176 | 18 | 9 | 338 |
| Impairment losses on credit exposures | (19) | (39) | (58) | - | - | - | - | (58) |
| **(Loss)/profit on ordinary activities before tax** | (69) | 107 | 38 | 39 | 176 | 18 | 9 | 280 |

| **6 months to 31 Mar 2018** | Statutory results £m | Include Virgin Money pre-acquisition results £m | Pro forma results £m | Legacy conduct £m | Restructuring and separation £m | Other £m | Underlying basis £m |
|---|---|---|---|---|---|---|---|
| Net interest income | 426 | 312 | 738 | - | - | - | 738 |
| Non-interest income | 77 | 27 | 104 | - | - | - | 104 |
| **Total operating income** | 503 | 339 | 842 | - | - | - | 842 |
| Total operating and administrative expenses before impairment losses | (576) | (172) | (748) | 220 | 28 | 7 | (493) |
| **Operating (loss)/ profit before impairment losses** | (73) | 167 | 94 | 220 | 28 | 7 | 349 |
| Impairment losses on credit exposures | (22) | (26) | (48) | - | - | - | (48) |
| **(Loss)/profit on ordinary activities before tax** | (95) | 141 | 46 | 220 | 28 | 7 | 301 |
| **Financial performance measures** | | | | | | | |
| RoTE | (7.0)% | 7.0% | -% | 10.2% | 1.3% | 0.3% | 11.8% |
| CIR | 115% | (26)% | 89% | (26)% | (3)% | (1)% | 59% |
| Return on assets | (0.36)% | 0.43% | 0.07% | 0.47% | 0.06% | 0.01% | 0.61% |
| Basic EPS | (10.2)p | 10.3p | 0.1p | 13.8p | 1.8p | 0.4p | 16.1p |

# Reconciliation of pro forma to underlying results (continued)

| 12 months to 30 Sep 2018 | Statutory results £m | Include Virgin Money pre-acquisition results £m | Pro forma results £m | Virgin Money acquisition costs £m | Legacy conduct £m | Restructuring and separation £m | Other £m | Underlying basis £m |
|---|---|---|---|---|---|---|---|---|
| Net interest income | 851 | 606 | 1,457 | - | - | - | - | 1,457 |
| Non-interest income | 156 | 75 | 231 | - | - | - | (3) | 228 |
| **Total operating income** | 1,007 | 681 | 1,688 | - | - | - | (3) | 1,685 |
| Total operating and administrative expenses before impairment losses | (1,130) | (368) | (1,498) | 39 | 396 | 46 | 19 | (998) |
| **Operating (loss)/profit before impairment losses** | (123) | 313 | 190 | 39 | 396 | 46 | 16 | 687 |
| Impairment losses on credit exposures | (41) | (65) | (106) | - | - | - | - | (106) |
| **(Loss)/profit on ordinary activities before tax** | (164) | 248 | 84 | 39 | 396 | 46 | 16 | 581 |
| **Financial performance measures** | | | | | | | | |
| RoTE | (6.9)% | 6.4% | (0.5)% | 0.9% | 9.1% | 1.1% | 0.4% | 11.0% |
| CIR | 112% | (23)% | 89% | (2)% | (24)% | (3)% | (1)% | 59% |
| Return on assets | (0.34)% | 0.38% | 0.04% | 0.04% | 0.41% | 0.05% | 0.02% | 0.56% |
| Basic EPS | (19.7)p | 18.4p | (1.3)p | 2.4p | 24.8p | 2.9p | 1.0p | 29.8p |

# Reconciliation of statutory to pro forma results

The statutory basis presented within this section reflects the Group's results as reported in the financial statements. These exclude items that are included in Virgin Money's pre-acquisition results, as these items are not reflective of the reported results. The underlying results reflect the Group's results prepared on an underlying basis and as presented to the CEO and the Executive Leadership Team and the Board. These exclude certain items that are included in the statutory results, as management believes that these items are not reflective of the underlying business and do not aid meaningful period on period comparison. The table below reconciles the statutory results to the pro forma results, and full details on the adjusted items to the underlying results are included on page 80:

| | Statutory basis | | | Include Virgin Money pre-acquisition results | | | Pro forma basis | | |
|---|---|---|---|---|---|---|---|---|---|
| | **6 months to 31 Mar 2019** | 6 months to 31 Mar 2018 | 6 months to 30 Sep 2018 | **1 Oct to 15 Oct 2018** | 6 months to 31 Mar 2018 | 6 months to 30 Sep 2018 | **6 months to 31 Mar 2019** | 6 months to 31 Mar 2018 | 6 months to 30 Sep 2018 |
| | **£m** | £m | £m | **£m** | £m | £m | **£m** | £m | £m |
| Net interest income | **820** | 426 | 425 | **22** | 312 | 294 | **842** | 738 | 719 |
| Non-interest income[(1)] | **106** | 77 | 79 | **9** | 27 | 48 | **115** | 104 | 127 |
| **Total operating income** | **926** | 503 | 504 | **31** | 339 | 342 | **957** | 842 | 846 |
| Operating and administrative expenses | **(711)** | (576) | (554) | **(60)** | (172) | (196) | **(771)** | (748) | (750) |
| **Operating profit/(loss) before impairment losses** | **215** | (73) | (50) | **(29)** | 167 | 146 | **186** | 94 | 96 |
| Impairment losses on credit exposures | **(173)** | (22) | (19) | **(4)** | (26) | (39) | **(177)** | (48) | (58) |
| **Profit/(loss) on ordinary activities before tax** | **42** | (95) | (69) | **(33)** | 141 | 107 | **9** | 46 | 38 |
| Acquisition and integration costs | | | | | | | **214** | - | 39 |
| Legacy conduct | | | | | | | **33** | 220 | 176 |
| Restructuring and separation | | | | | | | **2** | 28 | 18 |
| Other items | | | | | | | **28** | 7 | 9 |
| **Underlying profit on ordinary activities before tax** | | | | | | | **286** | 301 | 280 |

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

# Risk overview

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

Mapped to the principal risk categories, the Group maintains a risk landscape, capturing the highest priority risks with potential to impact the Group's current and medium term outlook. These risks are appropriately categorised with owners, required actions and mitigation plans in place. The risks currently being monitored include but are not limited to: geopolitical uncertainty including Brexit risk; technology risk and financial crime risk; regulatory change; integration risk; the continued risk of customer detriment; service interruption and third party supplier risk. These risks and the overall risk landscape are monitored by both Executive and Board Risk Committees.

Further detail on risks and how they are managed is available in the 2018 Annual Report and Accounts.

# Credit risk

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

In the period to 31 March 2019, the following changes have had a material impact on the Group's credit risk methodology and calculation, and how this is presented within this report:

1. The adoption of IFRS 9 'Financial Instruments' with effect from 1 October 2018; and
2. The acquisition of Virgin Money on 15 October 2018.

*The adoption of IFRS 9 'Financial Instruments' with effect from 1 October 2018*

The Group has elected not to restate comparative figures on an IFRS 9 basis as permitted by the standard. Where a comparative has been presented in the credit risk report, the basis of preparation is either:

- As at 30 September 2018: representing the position under IAS 39 as originally disclosed in the 2018 Annual Report and Accounts; or
- As at 1 October 2018: representing the position as at 30 September 2018 (excluding Virgin Money) as amended for the adoption of IFRS 9.

For those 30 September 2018 IAS 39 comparatives not included within this report, these can be found in the 2018 Annual Report and Accounts which is available on the Group's website.

*The acquisition of Virgin Money on 15 October 2018*

In addition to the adoption of IFRS 9 from 1 October 2018, the Group results for the six month period to 31 March 2019 have also been impacted by the Group's acquisition of Virgin Money on 15 October 2018.

Virgin Money adopted IFRS 9 with effect from 1 January 2018 and therefore had the required policies, methodologies, judgements and models in place to produce an expected credit loss (ECL) calculation in accordance with the standard before the acquisition on 15 October 2018.

While the overall policies and methodologies developed by the Group in preparing for its adoption of IFRS 9 on 1 October 2018 have many similarities to those used by Virgin Money, there are differences in the detail relating to the inputs and process supporting the ECL calculation. The complexity of the underlying data, model related methodology and inputs used means that a single methodology in providing a combined Group ECL view, while being developed, is not possible at this point in time, with each subsidiary retaining its own distinct set of IFRS 9 compliant models, macroeconomic inputs, scenarios and weightings.

Therefore, the detailed judgement and methodology commentary contained in the credit risk report relate to their application in the CYBG subsidiary models, pre-acquisition of Virgin Money (see Supplementary Information – IFRS 9, starting on page 37).

Further detail on the Virgin Money ECL methodology is contained in Note 5.4 to the 2018 Virgin Money Annual Report and Accounts which can be found at: https://uk.virginmoney.com/virgin/investor-relations/results/virgin-money-group-annual-report-and-accounts-2018.pdf. The policies and methodology adopted have not materially changed in the period from those audited and disclosed at December 2018.

The Group's statutory impairment charge for the period is £173m, which includes the effect of the acquired Virgin Money assets that are required to be assessed under the staging criteria introduced by IFRS 9, irrespective of the fact that the fair value of the acquired assets incorporated an adjustment for credit risk.

A number of the Group's key credit metrics are no longer applicable as a result of the change to an IFRS 9 basis of calculating ECLs and have been replaced with metrics appropriate to the revised basis. These have been highlighted in the table below.

**Key credit metrics**

| As at: | **31 Mar 2019 (unaudited) £m** | 1 Oct 2018[1] (unaudited) £m | 30 Sept 2018[1] (audited) £m | 31 Mar 2018[1] (unaudited) £m |
|---|---|---|---|---|
| **Impairment provisions held on credit exposures** | | | | |
| SME lending | **163** | 150 | 136 | 153 |
| Retail lending | **187** | 74 | 59 | 58 |
| | **350** | 224 | 195 | 211 |
| **Of which:** | | | | |
| Individually assessed | **50** | 43 | 43 | 54 |
| Modelled/calculated | **300** | 181 | 152 | 157 |
| | **350** | 224 | 195 | 211 |

| For the period ended: | **6 months to 31 Mar 2019 (unaudited) £m** | 1 Oct 2018[1] (unaudited) £m | 12 months to 30 Sept 2018[1] (audited) £m | 6 months to 31 Mar 2018[1] (unaudited) £m |
|---|---|---|---|---|
| **Underlying impairment charge on credit exposures** | | | | |
| SME lending | **18** | N/a | 15 | 8 |
| Retail lending | **55** | N/a | 26 | 14 |
| | **73** | N/a | 41 | 22 |
| **Asset quality measures:** | | | | |
| Underlying impairment charge [2] to average customer loans (cost of risk) | **0.21%** | N/a[3] | 0.12% | 0.13% |
| 90+ days past due (DPD) plus impaired assets to customer loans | **N/a** | N/a | 0.91% | 1.02% |
| Stage 3 assets to customer loans | **1.08%** | 1.77% | N/a | N/a |
| Total provision to customer loans | **0.49%** | 0.68% | 0.61% | 0.67% |
| Specific provision to impaired assets | **N/a** | N/a | 35.50% | 33.60% |
| Stage 3 provision to Stage 3 loans | **15.00%** | 14.55% | N/a | N/a |

(1) These exclude the impact of the acquisition of Virgin Money with March 2018 and September 2018 ratios presented on an IAS 39 basis

(2) Inclusive of gains/losses on assets held at fair value and excludes the acquisition accounting impact on impairment losses shown on page 18.

(3) An opening IFRS 9 impairment charge was not calculated as at 1 October 2018 and therefore this metric cannot be calculated for that date.

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

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

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

*Removal of IAS 39 collective provision*

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

*Introduction of a 12 month ECL calculation*

IFRS 9 requires a 12 month ECL calculation on all assets which have not undergone a significant increase in credit risk since origination. These are classed as Stage 1 under IFRS 9, with the calculation on loans and advances allocating the ECL at an individual account level.

*Introduction of a lifetime ECL calculation*

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

*Add: undrawn balances*

IFRS 9 requires that impairment allowances be held on an expected loss basis rather than the incurred loss basis under IAS 39. This change has brought into scope products (such as pipeline exposure) where no drawdown had occurred at the IFRS 9 adoption date, and for which no impairment allowance was held previously.

*Add: multiple economic scenarios*

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

# Credit risk

The distribution of the Group's gross loans and advances is analysed below.

**As at 31 March 2019 (unaudited)**

| | Stage 1 £m | Stage 2 <30 DPD £m | Stage 2 >30 DPD £m | Stage 2 Total £m | Stage 3 £m | Stage 3 POCI £m | Total £m |
|---|---|---|---|---|---|---|---|
| Mortgages | 58,850 | 1,417 | 126 | 1,543 | 316 | 121 | 60,830 |
| Retail unsecured of which: | 4,307 | 315 | 30 | 345 | 53 | 13 | 4,718 |
| - credit cards | 3,469 | 276 | 24 | 300 | 37 | 13 | 3,819 |
| - retail overdrafts | 51 | - | 1 | 1 | 4 | - | 56 |
| - other retail lending | 787 | 39 | 5 | 44 | 12 | - | 843 |
| SME | 4,582 | 2,397 | 11 | 2,408 | 285 | - | 7,275 |
| **Closing balance** | 67,739 | 4,129 | 167 | 4,296 | 654 | 134 | 72,823 |

As at 1 October 2018 (unaudited, excluding Virgin Money)

| | Stage 1 £m | Stage 2 <30 DPD £m | Stage 2 >30 DPD £m | Stage 2 Total £m | Stage 3 £m | Stage 3 POCI £m | Total £m |
|---|---|---|---|---|---|---|---|
| Mortgages | 23,572 | 605 | 84 | 689 | 279 | - | 24,540 |
| Retail unsecured of which: | 1,143 | 28 | 10 | 38 | 22 | - | 1,203 |
| - credit cards | 370 | 1 | 3 | 4 | 7 | - | 381 |
| - retail overdrafts | 50 | - | 1 | 1 | 4 | - | 55 |
| - other retail lending | 723 | 27 | 6 | 33 | 11 | - | 767 |
| SME | 4,741 | 2,161 | 9 | 2,170 | 263 | - | 7,174 |
| **Closing balance** | 29,456 | 2,794 | 103 | 2,897 | 564 | - | 32,917 |

Overall, the lending portfolio increased by £39.9bn between 1 October 2018 and 31 March 2019. In addition to underlying growth, the increase reflects the acquisition of Virgin Money on 15 October 2018, with the acquired portfolio totalling £39.0bn as at 31 March 2019. Of this, £134m is Stage 3 POCI, representing the Virgin Money assets that were classed as credit impaired at date of acquisition.

**Mortgages** – With total gross loans and advances of £60.8bn as at 31 March 2019, there has been continued underlying growth in the portfolio, although the increase in lending balance results mainly from the Virgin Money acquisition. The majority reside in Stage 1 and with the weighting further towards a secured Mortgage portfolio, this has resulted in the overall proportion of loans within Stages 2 and 3 reducing to 3.3% (1 October 2018: 3.9%). Stage 3 POCI for Mortgages, has reduced from £137m on acquisition to £121m as at 31 March 2019 as a result of customer redemptions and balance paydowns.

**Retail Unsecured** – Of the £4.7bn total Retail Unsecured portfolio, the majority is credit cards, at £3.8bn. The level of growth has been most prevalent from the successful take up of the Virgin Atlantic credit cards. The unsecured portfolio evidences stable performance with 91% of balances classed as stage 1. Stage 3 POCI for unsecured Retail has reduced from £34m on acquisition to £13m as at 31 March 2019 due to customer balance paydowns.

**SME** – At £7.3bn, SME lending continues to evidence core underlying growth. The proportions in Stages 2 have marginally increased from 30% to 33% in the period to 31 March 2019 reflecting the controlled and cautious approach to identifying customers experiencing financial difficulty.

# Credit risk

The following tables disclose the impairment allowance by portfolio:

**As at 31 March 2019 (unaudited)**

| | Stage 1 £m | Stage 2 <30 DPD £m | Stage 2 >30 DPD £m | Stage 2 Total £m | Stage 3 £m | Stage 3 POCI £m | Total £m |
|---|---|---|---|---|---|---|---|
| Mortgages | 6 | 4 | 3 | 7 | 23 | - | 36 |
| Retail unsecured of which: | 52 | 49 | 15 | 64 | 35 | - | 151 |
| - credit cards | 41 | 43 | 10 | 53 | 24 | - | 118 |
| - retail overdrafts | 2 | - | 1 | 1 | 3 | - | 6 |
| - other retail lending | 9 | 6 | 4 | 10 | 8 | - | 27 |
| SME | 29 | 73 | 1 | 74 | 60 | - | 163 |
| **Closing balance** | 87 | 126 | 19 | 145 | 118 | - | 350 |

As at 1 October 2018 (unaudited, excluding Virgin Money)

| | Stage 1 £m | Stage 2 <30 DPD £m | Stage 2 >30 DPD £m | Stage 2 Total £m | Stage 3 £m | Stage 3 POCI £m | Total £m |
|---|---|---|---|---|---|---|---|
| Mortgages | 3 | 2 | 1 | 3 | 23 | - | 29 |
| Retail unsecured of which: | 15 | 5 | 7 | 12 | 18 | - | 45 |
| - credit cards | 6 | - | 1 | 1 | 7 | - | 14 |
| - retail overdrafts | 2 | - | 1 | 1 | 3 | - | 6 |
| - other retail lending | 7 | 5 | 5 | 10 | 8 | - | 25 |
| SME | 35 | 71 | - | 71 | 44 | - | 150 |
| **Closing balance** | 53 | 78 | 8 | 86 | 85 | - | 224 |

The Group's impairment allowance has increased by £126m in the period from 1 October 2018 to 31 March 2019. The increase is a combination of the impact of the acquisition of Virgin Money, amounting to £110m, together with underlying movements in portfolio values and an adverse impact on credit outlook from the continued economic uncertainty.

Acquisition accounting requires that the Virgin Money loans and advances balance be fair valued on acquisition, resulting in a £Nil ECL allowance immediately following acquisition. The loans and advances balance is then subject to the IFRS 9 ECL methodology with a full ECL allowance calculated. Further detail on the ECL allowance of the Virgin Money acquired loans and advances can be found in the Supplementary Information – IFRS 9 section of the risk report starting on page 37.

**Mortgages** – The Mortgage impairment allowance of £36m is reflective of the level of collateral held and the low ECL for this portfolio.

**Retail Unsecured** – The total impairment allowance for the unsecured portfolio of £151m has increased by £106m in the period, primarily due to the £101m impairment allowance relative to the £3.5bn acquired Virgin Money credit card portfolio. The underlying impairment allowance for these portfolios marginally increased resulting from the combined effect of portfolio growth, higher default rates due to seasoning of the portfolio and a lower level of recoveries.

**SME** – The impairment allowance for SME increased by £13m to £163m; consistent with the stage allocations, this reflects a controlled and cautious approach to the impairment assessment of customers experiencing financial difficulty.

Risk management

# Credit risk

**Coverage ratios**

**As at 31 March 2019 (unaudited)**

| | Stage 1 | Stage 2 <30 DPD | Stage 2 >30 DPD | Stage 2 Total | Stage 3 | Stage 3 POCI | Total |
|---|---|---|---|---|---|---|---|
| | % | % | % | % | % | % | % |
| Mortgages | 0.01% | 0.30% | 2.62% | 0.48% | 7.24% | - | 0.06% |
| Retail unsecured of which: | 1.21% | 15.59% | 50.38% | 18.66% | 70.08% | - | 3.24% |
| - credit cards | 1.17% | 15.35% | 44.40% | 17.69% | 67.48% | - | 3.08% |
| - retail overdrafts | 4.13% | 12.27% | 61.94% | 52.56% | 84.87% | - | 10.48% |
| - other retail lending | 1.21% | 17.49% | 77.37% | 24.86% | 73.58% | - | 3.46% |
| SME | 0.62% | 2.99% | 7.89% | 3.01% | 20.60% | - | 2.19% |
| **Closing balance** | 0.13% | 3.02% | 11.67% | 3.36% | 18.08% | - | 0.48% |

As at 1 October 2018 (unaudited, excluding Virgin Money)

| | Stage 1 | Stage 2 <30 DPD | Stage 2 >30 DPD | Stage 2 Total | Stage 3 | Stage 3 POCI | Total |
|---|---|---|---|---|---|---|---|
| | % | % | % | % | % | % | % |
| Mortgages | 0.01% | 0.32% | 1.61% | 0.48% | 8.19% | - | 0.12% |
| Retail unsecured of which: | 1.38% | 18.17% | 65.20% | 30.04% | 80.36% | - | 3.78% |
| - credit cards | 1.78% | 9.52% | 53.16% | 39.89% | 94.32% | - | 3.94% |
| - retail overdrafts | 3.66% | 10.02% | 59.21% | 51.07% | 78.12% | - | 10.06% |
| - other retail lending | 1.03% | 18.61% | 71.71% | 28.05% | 72.56% | - | 3.24% |
| SME | 0.73% | 3.25% | 5.13% | 3.26% | 16.79% | - | 2.08% |
| **Closing balance** | 0.18% | 2.77% | 7.86% | 2.95% | 15.05% | - | 0.68% |

The impact of the Virgin Money acquisition results in a proportionately higher volume of the total portfolio being mortgage lending which requires a lower proportionate impairment allowance, consequently the total portfolio coverage has reduced by 24bps in line with the revised portfolio profile. Offsetting the reduction has been a modest 4bps underlying increase across the portfolios.

**Mortgages** – The coverage rate reduced by 6bps in the period as a result of the quality and value of the acquired Virgin Money mortgage portfolio.

**Retail Unsecured** – The total rate of coverage reduced by 54bps, primarily in the credit card portfolio where the quality of the growing Virgin Atlantic credit cards portfolio is stronger than the pre-existing portfolios.

**SME** – Coverage for SME lending increased by 11bps, reflective of migrations into Stages 2 and 3 which attract a lifetime loss impairment allowance.

**Credit quality of loans and advances as at 31 March 2019 (unaudited)**

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

**Retail Secured and Unsecured**

- Strong: broadly consistent with an internal probability of default (PD) rating of <=0.5%
- Good: broadly consistent with an internal PD rating of >0.5% to 2.0%
- Satisfactory: broadly consistent with an internal PD rating of >2.0% to 99.9%
- Default: where the Group's internal definition of default has been breached

| | Gross carrying amount | | | | |
|---|---|---|---|---|---|
| Retail Secured | Stage 1 12 month ECLs £m | Stage 2 (not credit impaired) Lifetime ECLs £m | Stage 3 (credit impaired) Lifetime ECLs £m | Stage 3 (POCI) Lifetime ECLs £m | Total £m |
| Strong | 51,728 | 569 | - | - | 52,297 |
| Good | 6,363 | 477 | - | - | 6,840 |
| Satisfactory | 759 | 497 | - | - | 1,256 |
| Default | - | - | 316 | 121 | 437 |
| **Total** | 58,850 | 1,543 | 316 | 121 | 60,830 |

| | Gross carrying amount | | | | |
|---|---|---|---|---|---|
| Retail Unsecured | Stage 1 12 month ECLs £m | Stage 2 (not credit impaired) Lifetime ECLs £m | Stage 3 (credit impaired) Lifetime ECLs £m | Stage 3 (POCI) Lifetime ECLs £m | Total £m |
| Strong | 1,563 | 14 | - | - | 1,577 |
| Good | 2,059 | 49 | - | - | 2,108 |
| Satisfactory | 685 | 282 | - | - | 967 |
| Default | - | - | 53 | 13 | 66 |
| **Total** | 4,307 | 345 | 53 | 13 | 4,718 |

**SME**

- Strong: broadly consistent with Standard & Poor's ratings of AAA to BBB- (internal rating 1 to 11);
- Good: broadly consistent with Standard & Poor's ratings of BBB- to BB- (internal rating 12 to 17);
- Satisfactory: broadly consistent with Standard & Poor's rating of BB- to CCC+ (internal rating 18 to 23);
- Default: broadly consistent with Standard & Poor's rating of CCC- (internal rating 98 and 99).

| | | Gross carrying amount | | | |
|---|---|---|---|---|---|
| | PD range % | Stage 1 12 month ECLs £m | Stage 2 (not credit impaired) Lifetime ECLs £m | Stage 3 (credit impaired) Lifetime ECLs £m | Total £m |
| Strong | 0 - 0.5 | 1,522 | 54 | - | 1,576 |
| Good | >0.5 - 2.0 | 2,305 | 1,052 | - | 3,357 |
| Satisfactory | >2.0 - 99.99 | 755 | 1,302 | - | 2,057 |
| Default | 100 | - | - | 285 | 285 |
| **Total** | | 4,582 | 2,408 | 285 | 7,275 |

**Retail mortgage lending**

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

| LTV[2] | **31 Mar 2019 (unaudited) %** | 30 Sep 2018[1] (audited) % |
|---|---|---|
| Less than 50% | **33** | 31 |
| 50% to 75% | **48** | 51 |
| 76% to 80% | **7** | 6 |
| 81% to 85% | **5** | 5 |
| 86% to 90% | **5** | 4 |
| 91% to 95% | **2** | 2 |
| 96% to 100% | **-** | - |
| Greater than 100% | **-** | - |
| Unknown | **-** | 1 |
| | **100** | 100 |

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

**Forbearance**

**Retail forbearance**

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

| **As at 31 March 2019 (unaudited)** | **Total Retail secured loans and advances subject to forbearance measures** | | | **Impairment allowance on Retail secured loans and advances subject to forbearance measures** | |
|---|---|---|---|---|---|
| | **Number of loans** | **Gross carrying amount** | **% of total portfolio** | **Impairment allowance** | **Coverage** |
| | | **£m** | | **£m** | **%** |
| Formal arrangements | **1,353** | **147** | **0.24** | **4.4** | **3.02** |
| Temporary arrangements | **916** | **115** | **0.19** | **3.0** | **2.57** |
| Payment arrangement | **323** | **38** | **0.06** | **0.6** | **1.52** |
| Payment holiday | **544** | **76** | **0.13** | **0.4** | **0.46** |
| Interest only conversion | **320** | **51** | **0.08** | **0.3** | **0.50** |
| Term extension | **184** | **18** | **0.03** | **0.1** | **0.44** |
| Other | **43** | **4** | **0.01** | **-** | **0.54** |
| Legal | **133** | **13** | **0.02** | **0.3** | **2.52** |
| **Total secured loans** | **3,816** | **462** | **0.76** | **9.1** | **1.95** |

| As at 30 September 2018[1] (audited) | Total Retail secured loans and advances subject to forbearance measures | | | Impairment allowance on Retail secured loans and advances subject to forbearance measures | |
|---|---|---|---|---|---|
| | Number of loans | Gross carrying amount | % of total portfolio | Impairment allowance | Coverage |
| | | £m | | £m | % |
| Formal arrangements | 1,497 | 168 | 0.68 | 3.3 | 2.00 |
| Temporary arrangements | 1,275 | 161 | 0.66 | 2.3 | 1.45 |
| Interest only conversion | 231 | 32 | 0.13 | 0.1 | 0.18 |
| Term extension | 150 | 12 | 0.05 | 0.1 | 0.48 |
| Other | 41 | 4 | 0.02 | - | 0.36 |
| Legal | 148 | 15 | 0.06 | 0.5 | 3.34 |
| Total secured loans | 3,342 | 392 | 1.60 | 6.3 | 1.61 |

(1) 30 September 2018 shown as Reported, excluding Virgin Money.

When all other avenues of resolution including forbearance have been explored, the Group will take steps to repossess and sell underlying collateral. In the period to 31 March 2019, there were 38 repossessions of which 9 were voluntary (12 months to 30 September 2018: 38 including 16 voluntary).

**Retail forbearance - unsecured consumer credit**

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including current accounts, unsecured loans and credit cards. The Group has assessed the total loan balances subject to forbearance on other types of consumer credit to be £34m as at 31 March 2019 (30 September 2018: £12m), representing 0.66% of the unsecured retail portfolio (30 September 2018: 1.02%).

Impairment provisions on forborne balances totalled £12.7m as at 31 March 2019 (30 September 2018: £4.2m) providing overall coverage of 37.53% (30 September 2018: 34.36%).

**SME forbearance**

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

**As at 31 March 2019 (unaudited)**

| | **Total SME loans and advances subject to forbearance measures** | | | **Impairment allowance on SME loans and advances subject to forbearance measures** | |
|---|---|---|---|---|---|
| | **Number of loans** | **Gross carrying amount £m** | **% of total portfolio** | **Impairment allowance £m** | **Coverage %** |
| Term extension | 205 | 186 | 2.40 | 16.6 | 8.93 |
| Deferral of contracted capital repayments | 104 | 141 | 1.83 | 24.3 | 17.25 |
| Reduction in contracted interest rate | 2 | 1 | 0.01 | - | 3.94 |
| Alternative forms of payment | 3 | 24 | 0.31 | 7.2 | 30.01 |
| Debt forgiveness | 3 | 7 | 0.09 | 0.2 | 2.18 |
| Refinancing | 16 | 9 | 0.11 | 1.3 | 14.79 |
| Covenant breach/reset/waiver | 58 | 185 | 2.41 | 9.8 | 5.25 |
| | 391 | 553 | 7.16 | 59.4 | 10.74 |

As at 30 September 2018 (audited)

| | Total SME loans and advances subject to forbearance measures | | | Impairment allowance on SME loans and advances subject to forbearance measures | |
|---|---|---|---|---|---|
| | Number of loans | Gross carrying amount £m | % of total portfolio | Impairment allowance £m | Coverage % |
| Term extension | 179 | 162 | 2.15 | 10.5 | 6.48 |
| Deferral of contracted capital repayments | 103 | 129 | 1.73 | 15.6 | 12.02 |
| Reduction in contracted interest rate | 2 | 1 | 0.01 | - | 4.05 |
| Alternative forms of payment | 4 | 25 | 0.33 | 7.5 | 30.46 |
| Debt forgiveness | 4 | 11 | 0.14 | 0.6 | 5.64 |
| Refinancing | 17 | 10 | 0.13 | 1.0 | 9.87 |
| Covenant breach/reset/waiver | 61 | 207 | 2.75 | 9.2 | 4.43 |
| | 370 | 545 | 7.24 | 44.4 | 8.14 |

Included in other financial assets at fair value is a portfolio of loans that is included in the above table. The value of fair value loans subject to forbearance as at 31 March 2019 is £10m (30 September 2018: £15m), representing 0.12% of the total SME portfolio (30 September 2018: 0.19%). Impairment allowances on these amounts totalled £0.4m (30 September 2018: £2m), a coverage of 4.21% (30 September 2018: 11.66%).

# Financial risk

The financial services industry is highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. The key risks include capital, liquidity and funding risks, market risk which in the case of the Group is non-traded market risk (incorporating interest rate and foreign exchange risks), pension risk and non-traded equity risk.

## Capital

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

Included in this section are certain Pillar 3 disclosures which the Group has assessed as requiring semi-annual disclosure.

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

| CET1 capital | 31 Mar 2019 £m | 30 Sep 2018 £m |
|---|---|---|
| Capital instruments and share premium | **146** | 89 |
| Retained earnings and other reserves | **4,074** | 2,637 |
| **CET1 capital before regulatory adjustments** | **4,220** | 2,726 |
| **CET1 capital: regulatory adjustments[2]** | | |
| Defined benefit pension fund assets | **(142)** | (138) |
| Prudent valuation adjustment | **(5)** | (3) |
| Intangible assets | **(485)** | (412) |
| Goodwill | **(10)** | - |
| Deferred tax asset relying on future profitability | **(102)** | (99) |
| Cash flow hedge reserve | **24** | 39 |
| IRB shortfall of credit risk adjustments to expected losses | **(80)** | - |
| IFRS 9 transitional relief | **40** | - |
| **Total regulatory adjustments to CET1** | **(760)** | (613) |
| **CET1 capital** | **3,460** | 2,113 |
| **AT1 capital instruments** | | |
| Capital instruments and related share premium | **697** | 450 |
| Instruments issued by subsidiaries that are given recognition in AT1 capital[3] | **242** | - |
| **AT1 capital before regulatory adjustments** | **939** | 450 |
| **AT1 capital: regulatory adjustments** | | |
| Fair value adjustment on acquisition of Virgin Money AT1 instruments | **38** | - |
| **Total regulatory adjustments to AT1 capital** | **38** | - |
| **AT1 capital** | **977** | 450 |
| **Total Tier 1 capital** | **4,437** | 2,563 |
| **Tier 2 capital: instruments and provisions** | | |
| Subordinated debt | **723** | 474 |
| Credit risk adjustments[4] | **-** | 152 |
| Instruments issued by subsidiaries that are given recognition in Tier 2 capital[5] | **60** | - |
| **Tier 2 capital before regulatory adjustments** | **783** | 626 |
| **Total Tier 2 capital** | **783** | 626 |
| **Total capital** | **5,220** | 3,189 |

(1) The table shows the capital position on a CRD IV `fully loaded` basis and transitional IFRS 9 basis
(2) A number of regulatory adjustments to CET1 capital are required under CRD IV regulatory capital rules.
(3) Qualifying Tier 1 capital of subsidiaries is restricted per CRR articles 85-87, subject to threshold calculations.
(4) The current period does not include Tier 2 credit risk adjustments due to the transition to IFRS 9 reporting.
(5) Under CRD IV, an element of disallowed Tier 1 capital of subsidiaries is added back to Tier 2, subject to threshold calculations (CRR article 88).

# Financial risk

**Capital (continued)**

| **Reconciliation of statutory total equity to regulatory capital (unaudited)** | **31 Mar 2019** | 30 Sep 2018 |
|---|---|---|
| | **£m** | £m |
| Statutory total equity | **5,358** | 3,186 |
| Deductions from capital | **(760)** | (613) |
| Foreseeable AT1 dividends and charges | **(19)** | (10) |
| Non-controlling interests deduction | **(142)** | - |
| **Regulatory Tier 1 capital** | **4,437** | 2,563 |

| **Regulatory capital flow of funds (unaudited)**[1] | **31 Mar 2019** | 30 Sep 2018 |
|---|---|---|
| | **£m** | £m |
| **CET1 capital**[2] | | |
| CET1 capital at 1 October | **2,113** | 2,437 |
| Share capital and share premium | **3** | 1 |
| Retained earnings and other reserves (including structured entities) | **(76)** | (217) |
| Acquisition of Virgin Money | **1,567** | - |
| Prudent valuation adjustment | **(2)** | 1 |
| Intangible assets | **(73)** | (73) |
| Goodwill | **(10)** | - |
| Deferred tax asset relying on future profitability | **(3)** | (71) |
| Defined benefit pension fund assets | **(4)** | (3) |
| Cash flow hedge reserve | **(15)** | 38 |
| IRB shortfall of credit risk adjustments to expected losses | **(80)** | - |
| IFRS 9 transitional relief | **40** | - |
| **Total CET1 capital** | **3,460** | 2,113 |
| | | |
| **Tier 1 capital** | | |
| Tier 1 capital at 1 October | **450** | 450 |
| Share capital issued: Additional Tier 1 Capital | **247** | - |
| Instruments issued by subsidiaries that are given recognition in AT1 capital | **242** | - |
| Fair value adjustment on acquisition of Virgin Money AT1 instruments | **38** | - |
| | **977** | 450 |
| **Total Tier 1 capital** | **4,437** | 2,563 |
| | | |
| **Tier 2 capital** | | |
| Tier 2 capital at 1 October | **626** | 627 |
| Credit risk adjustments[3] | **(152)** | (2) |
| Other movements | **2** | 1 |
| Capital instruments issued: subordinated debt | **247** | - |
| Instruments issued by subsidiaries that are given recognition in Tier 2 capital | **60** | - |
| **Total Tier 2 capital** | **783** | 626 |
| **Total capital** | **5,220** | 3,189 |

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

**Capital (continued)**

| Minimum Pillar 1 capital requirements (unaudited) | 31 Mar 2019 £m | 30 Sep 2018 £m |
|---|---|---|
| Credit risk | **1,671** | 1,449 |
| Operational risk | **208** | 132 |
| Counterparty risk | **16** | 10 |
| Credit valuation adjustment | **13** | 17 |
| **Tier 1 regulatory capital requirements** | **1,908** | 1,608 |

| IFRS 9 Transitional arrangements[1] (unaudited) | 31 Mar 2019 (£m) | |
|---|---|---|
| | **As reported** | **Excluding impact of IFRS 9** |
| **Available Capital (amounts)** | | |
| CET1 capital | **3,460** | **3,420** |
| Tier 1 capital | **4,437** | **4,397** |
| Total capital | **5,220** | **5,180** |
| **Risk-weighted assets (amounts)** | | |
| Total Risk-weighted assets | **23,864** | **23,809** |
| **Capital ratios** | | |
| CET1 (as a percentage of risk exposure amount) | **14.5%** | **14.4%** |
| Tier 1 (as a percentage of risk exposure amount) | **18.6%** | **18.5%** |
| Total capital (as a percentage of risk exposure amount) | **21.9%** | **21.8%** |
| **Leverage ratio** | | |
| Leverage ratio total exposure measure | **93,916** | **93,876** |
| Leverage ratio | **4.7%** | **4.7%** |

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

**RWA movements**

| RWA flow statement (unaudited)[1] | 6 months to 31 Mar 2019 IRB RWA £m | STD RWA £m | Other RWA[2] £m | Total £m | Capital required £m | 6 months to 31 Mar 2018 IRB RWA £m | STD RWA £m | Other RWA[2] £m | Total £m | Capital required £m |
|---|---|---|---|---|---|---|---|---|---|---|
| RWAs at 1 October | **-** | **18,104** | **1,998** | **20,102** | **1,608** | - | 17,753 | 1,925 | 19,678 | 1,574 |
| Asset size | **344** | **269** | **-** | **613** | **49** | - | 302 | - | 302 | 24 |
| Asset quality | **39** | **(10)** | **-** | **29** | **2** | - | 3 | - | 3 | - |
| Model updates[3] | **115** | **-** | **-** | **115** | **9** | - | - | - | - | - |
| Methodology and policy | **243** | **-** | **-** | **243** | **19** | - | 6 | - | 6 | - |
| Acquisitions and disposals | **4,330** | **2,870** | **966** | **8,166** | **653** | - | - | - | - | - |
| IRB accreditation | **10,247** | **(15,592)** | **-** | **(5,345)** | **(428)** | - | - | - | - | - |
| Other | **-** | **(64)** | **5** | **(59)** | **(5)** | - | - | (40) | (40) | (2) |
| **RWAs at 31 March** | **15,318** | **5,577** | **2,969** | **23,864** | **1,908** | - | 18,064 | 1,885 | 19,949 | 1,596 |

(1) While the Bank has obtained IRB accreditation, the PRA has now released a final policy statement outlining its approach to implementing definition of default in line with EBA regulations. Further to this, there are recommended changes to both PD and LGD model components relating directly to the calculation of risk-weighted capital requirements for residential mortgage portfolios. These changes are required to be implemented by 31 December 2020, subject to PRA approval.
(2) Other RWA includes operational risk, CVA and counterparty credit risk.
(3) Formal FIRB accreditation for the SME portfolios was received in October 2018 for a suite of re-calibrated models which were implemented during November and which resulted in a £170m model impact, included within the 'Model updates' row above. The differential is predominantly in relation to the Retail Mortgage quarterly PD model recalibrations. Since this implementation, no additional model changes have occurred.

**Capital (continued)**

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

| | **At 31 March 2019** | | | At 30 September 2018 | | |
|---|---|---|---|---|---|---|
| **Capital requirements for calculating RWAs** | **Capital required £m** | **RWA £m** | **Exposure £m** | Capital required £m | RWA £m | Exposure £m |
| Corporates | **484** | **6,049** | **8,234** | - | - | - |
| Of which: specialised lending | **-** | **-** | **-** | - | - | - |
| Of which: SMEs | **373** | **4,661** | **6,802** | - | - | - |
| Retail | **742** | **9,269** | **64,838** | - | - | - |
| Secured by real estate property | **742** | **9,269** | **64,838** | - | - | - |
| Of which: SMEs | **-** | **-** | **-** | - | - | - |
| Of which: non-SMEs | **742** | **9,269** | **64,838** | - | - | - |
| **Total IRB approach** | **1,226** | **15,318** | **73,072** | - | - | - |
| Central governments or central banks | **-** | **-** | **16,512** | - | 1 | 11,361 |
| Regional governments or local authorities | **1** | **12** | **158** | 1 | 12 | 143 |
| Public sector entities | **-** | **5** | **275** | - | 2 | 155 |
| Multilateral development banks | **-** | **-** | **973** | - | - | 155 |
| Institutions | **17** | **210** | **1,501** | 11 | 136 | 630 |
| Corporates | **26** | **323** | **356** | 316 | 3,956 | 4,311 |
| Of which: SMEs | **12** | **154** | **175** | - | - | - |
| Retail | **286** | **3,580** | **4,774** | 90 | 1,124 | 1,499 |
| Of which: SMEs | **-** | **-** | **-** | - | - | - |
| Secured by mortgages on immovable property | **37** | **462** | **821** | 938 | 11,708 | 28,423 |
| Of which: SMEs | **31** | **383** | **628** | - | - | - |
| Exposures in default | **5** | **57** | **48** | 45 | 562 | 465 |
| Of which: SMEs | **1** | **11** | **8** | - | - | - |
| Collective investments undertakings | **-** | **1** | **1** | - | 1 | 1 |
| Equity exposures | **1** | **12** | **9** | - | 5 | 4 |
| Items associated with particularly high risk | **5** | **60** | **40** | 4 | 49 | 33 |
| Of which: SMEs | **5** | **60** | **40** | - | - | - |
| Covered bonds | **10** | **131** | **1,309** | 5 | 61 | 615 |
| Other items | **57** | **718** | **936** | 39 | 487 | 715 |
| **Total standardised approach** | **445** | **5,571** | **27,713** | 1,449 | 18,104 | 48,510 |
| **Total credit risk** | **1,671** | **20,889** | **100,785** | 1,449 | 18,104 | 48,510 |
| Operational risk | **208** | **2,606** | | 132 | 1,655 | |
| Counterparty risk | **16** | **202** | | 10 | 125 | |
| Credit valuation adjustment | **13** | **167** | | 17 | 218 | |
| | **1,908** | **23,864** | | 1,608 | 20,102 | |

The exposure amounts disclosed above are post credit conversion factors (CCF) and pre credit mitigation.

Additional breakdown analysis of the IRB portfolios can be seen within the 'EU CR6 -IRB Approach – Credit risk by exposure class and PD range' table on pages 32 and 33.

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

**Capital (continued)**

| Capital position and CET1 (unaudited) | 31 Mar 2019 £m | Pro forma 30 Sep 2018 £m | Reported 30 Sep 2018 £m |
|---|---|---|---|
| **RWAs[(1)]** | | | |
| Retail mortgages | **9,269** | 8,794 | 9,002 |
| Business lending | **6,901** | 6,604 | 7,407 |
| Other retail lending | **3,625** | 3,463 | 981 |
| Other lending | **145** | 109 | 109 |
| Other[(2)] | **949** | 1,013 | 605 |
| Credit risk | **20,889** | 19,983 | 18,104 |
| Credit valuation adjustment | **167** | 243 | 218 |
| Operational risk | **2,606** | 2,523 | 1,655 |
| Counterparty risk | **202** | 194 | 125 |
| **Total RWAs** | **23,864** | 22,943 | 20,102 |
| **Capital ratios** | | | |
| CET1 ratio | **14.5%** | 15.1% | 10.5% |
| Tier 1 ratio | **18.6%** | 18.3% | 12.7% |
| **Total capital ratio** | **21.9%** | 20.6% | 15.9% |

(1) RWAs are calculated under the IRB approach for both the Retail Secured and FIRB Business SME portfolios with all other portfolios being calculated under the standardised approach, via either Sequential IRB implementation or Permanent Partial Use (PPU).
(2) The items included in the other exposure class that attract a capital charge include items in the course of collection, cash in hand, fixed assets and deferred tax assets that are not deducted.

**EU CR6 – IRB approach - Credit risk by exposure class and PD range.**

Clydesdale Bank PLC and Virgin Money PLC have separate IRB models for Retail Mortgages, with different modelling methodologies and risk profiles. Combining these into a single table does not provide a valid representation of risk, therefore the position of each bank as at 31 March 2019 (unaudited) is presented separately below.

**Clydesdale Bank PLC Retail Mortgages**
**(AIRB) Retail Secured by Immovable Property non-SME**

| PD scale | Original on balance sheet gross exposures £m | Off-balance sheet exposures pre-CCF £m | Average CCF | EAD post CRM and post CCF £m | Average PD | Number of obligors | Average LGD | RWAs £m | RWA density | EL £m | Value adjustments and provisions £m |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 0.00 to <0.15 | 2,141 | 805 | 102.1% | 3,013 | 0.09% | 18,243 | 16.48% | 113 | 3.8% | - | - |
| 0.15 to <0.25 | 3,777 | 359 | 102.2% | 4,235 | 0.19% | 35,818 | 13.59% | 236 | 5.6% | 1 | - |
| 0.25 to <0.50 | 9,753 | 309 | 102.2% | 10,302 | 0.37% | 55,233 | 14.77% | 1,037 | 10.1% | 6 | - |
| 0.50 to <0.75 | 2,258 | 65 | 102.1% | 2,379 | 0.62% | 11,216 | 18.95% | 433 | 18.2% | 3 | - |
| 0.75 to <2.50 | 5,512 | 115 | 102.0% | 5,754 | 1.29% | 29,887 | 17.75% | 1,548 | 27.0% | 13 | - |
| 2.50 to <10.00 | 1,158 | 17 | 102.4% | 1,203 | 4.36% | 8,359 | 17.70% | 674 | 56.1% | 9 | - |
| 10.00 to <100.00 | 231 | 4 | 102.3% | 240 | 34.87% | 1,875 | 16.78% | 210 | 87.9% | 14 | - |
| 100.00 (Default) | 263 | 6 | 100.0% | 269 | 100.00% | 2,431 | 20.75% | 619 | 229.9% | 9 | - |
| Subtotal | 25,093 | 1,680 | 102.1% | 27,395 | 1.99% | 163,062 | 15.97% | 4,870 | 17.8% | 55 | 28 |

**Virgin Money Retail Mortgages**
**(AIRB) Retail Secured by Immovable Property non-SME**

| PD scale | Original on balance sheet gross exposures £m | Off-balance sheet exposures pre-CCF £m | Average CCF | EAD post CRM and post CCF £m | Average PD | Number of obligors | Average LGD | RWAs £m | RWA density | EL £m | Value adjustments and provisions £m |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 0.00 to <0.15 | 1,771 | 186 | 100.0% | 1,982 | 0.12% | 13,303 | 10.04% | 58 | 2.9% | - | - |
| 0.15 to <0.25 | 8,830 | 244 | 100.0% | 9,179 | 0.21% | 62,209 | 7.77% | 313 | 3.4% | 1 | - |
| 0.25 to <0.50 | 11,766 | 321 | 100.0% | 12,230 | 0.36% | 68,808 | 10.99% | 892 | 7.3% | 5 | - |
| 0.50 to <0.75 | 5,519 | 201 | 100.0% | 5,794 | 0.62% | 42,416 | 13.24% | 735 | 12.7% | 5 | - |
| 0.75 to <2.50 | 6,124 | 321 | 100.0% | 6,536 | 1.12% | 42,690 | 16.65% | 1,483 | 22.7% | 12 | - |
| 2.50 to <10.00 | 1,124 | 20 | 100.0% | 1,159 | 4.56% | 9,208 | 15.59% | 557 | 48.1% | 8 | - |
| 10.00 to <100.00 | 493 | 11 | 100.0% | 511 | 37.20% | 4,294 | 11.08% | 285 | 55.8% | 20 | - |
| 100.00 (Default) | 53 | 1 | 100.0% | 54 | 100.00% | 496 | 12.33% | 75 | 138.5% | 3 | - |
| Subtotal | 35,680 | 1,305 | 100.0% | 37,445 | 1.26% | 243,424 | 11.63% | 4,398 | 11.7% | 54 | 14 |

**Capital (continued)**

**Clydesdale Bank PLC Corporates - Other**
**(FIRB) Corporates - Other**

| PD scale | Original on balance sheet gross exposures £m | Off-balance sheet exposures pre-CCF £m | Average CCF | EAD post CRM and post CCF £m | Average PD | Number of obligors | Average LGD | Average maturity | RWAs £m | RWA density | EL £m | Value adjustments and provisions £m |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 0.00 to <0.15 | 2 | 71 | 70.9% | 65 | 0.09% | 28 | 36.21% | 488 | 11 | 16.9% | - | - |
| 0.15 to <0.25 | 54 | 29 | 72.7% | 82 | 0.20% | 22 | 41.56% | 848 | 34 | 42.1% | - | - |
| 0.25 to <0.50 | 167 | 187 | 52.2% | 267 | 0.38% | 65 | 44.13% | 944 | 172 | 64.2% | - | - |
| 0.50 to <0.75 | 20 | 17 | 50.0% | 29 | 0.62% | 23 | 43.14% | 1307 | 26 | 90.9% | - | - |
| 0.75 to <2.50 | 546 | 259 | 62.2% | 718 | 1.45% | 265 | 43.31% | 1089 | 799 | 111.2% | 5 | - |
| 2.50 to <10.00 | 167 | 66 | 73.2% | 220 | 4.61% | 95 | 41.64% | 1,171 | 333 | 151.4% | 4 | - |
| 10.00 to <100.00 | 4 | 3 | 72.2% | 6 | 17.46% | 8 | 40.70% | 925 | 12 | 216.6% | - | - |
| 100.00 (Default) | 38 | 12 | 50.2% | 44 | 100.00% | 18 | 44.47% | 508 | - | 0.0% | 20 | - |
| Subtotal | 998 | 644 | 61.4% | 1,431 | 4.69% | 524 | 42.81% | 1,020 | 1,387 | 96.9% | 29 | 26 |

**Clydesdale Bank PLC SME Lending**
**(FIRB) Corporates - SME**

| PD scale | Original on balance sheet gross exposures £m | Off-balance sheet exposures pre-CCF £m | Average CCF | EAD post CRM and post CCF £m | Average PD | Number of obligors | Average LGD | Average maturity | RWAs £m | RWA density | EL £m | Value adjustments and provisions £m |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 0.00 to <0.15 | 95 | 109 | 65.1% | 167 | 0.10% | 158 | 42.82% | 1,104 | 47 | 28.1% | - | - |
| 0.15 to <0.25 | 213 | 161 | 68.3% | 329 | 0.19% | 674 | 38.75% | 862 | 85 | 25.8% | - | - |
| 0.25 to <0.50 | 754 | 402 | 68.0% | 1,039 | 0.40% | 1,610 | 39.26% | 877 | 424 | 40.8% | 2 | - |
| 0.50 to <0.75 | 346 | 117 | 60.7% | 417 | 0.62% | 667 | 39.78% | 1,034 | 227 | 54.5% | 1 | - |
| 0.75 to <2.50 | 2,844 | 810 | 66.4% | 3,396 | 1.49% | 5,996 | 40.63% | 967 | 2,554 | 75.2% | 21 | - |
| 2.50 to <10.00 | 946 | 281 | 67.2% | 1,135 | 4.41% | 1,891 | 41.55% | 866 | 1,145 | 100.8% | 21 | - |
| 10.00 to <100.00 | 104 | 19 | 69.6% | 117 | 17.39% | 187 | 40.88% | 731 | 179 | 153.3% | 8 | - |
| 100.00 (Default) | 197 | 6 | 74.3% | 201 | 100.00% | 250 | 40.73% | 702 | - | 0.0% | 82 | - |
| Subtotal | 5,499 | 1,905 | 66.6% | 6,801 | 4.85% | 11,433 | 40.49% | 927 | 4,661 | 68.5% | 135 | 126 |

The Group measures the amount of capital it requires and holds by applying the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the PRA and supplemented through additional regulation under the PRA Rulebook. The table below summarises the amount of capital in relation to RWAs the Group is currently required to hold, excluding any PRA Buffer. These ratios apply at the consolidated Group level.

| | As at 31 Mar 2019 (unaudited) | |
|---|---|---|
| **Minimum requirements** | **CET1** | **Total Capital** |
| Pillar 1 [1] | 4.5% | 8.0% |
| Pillar 2A | 3.6% | 6.4% |
| **Total capital requirement** | **8.1%** | **14.4%** |
| Capital conservation buffer [2] | 2.5% | 2.5% |
| UK countercyclical capital buffer [3] | 1.0% | 1.0% |
| **Total (excluding PRA buffer) [4]** | **11.6%** | **17.9%** |

(1) The minimum amount of total capital under Pillar 1 of the regulatory framework is determined as 8% of RWAs, of which at least 4.5% of RWAs is required to be covered by CET1 capital.
(2) The capital conservation buffer (CCB) was phased in over the period from 1 January 2016 to 1 January 2019, with 2.5% of RWAs applicable for 2019.
(3) The UK countercyclical capital buffer (CCyB) may be set between 0% and 2.5%. On 28 November 2018 the UK CCyB increased from 0.5% to 1.0%. At its February 2019 meeting, the FPC maintained the UK CCyB rate at 1%, noting the underlying vulnerabilities in the domestic and global economies have not, on balance, changed since the November 2018 Financial Stability Report.
(4) The Group may be subject to a PRA buffer as set by the PRA but is not permitted to disclose the level of any buffer. A PRA buffer can consist of two components:
- A risk management and governance buffer that is set as a scalar of the Pillar 1 and Pillar 2A requirements.
- A buffer relating to the results of the BoE stress tests.

At 31 March 2019, the Company had accumulated distributable reserves of £1,012m (30 September 2018: £1,005m) [1].

(1) Distributable reserves are determined as required by the Companies Act 2006 by reference to a company's individual financial statements.

# Financial risk

**Capital (continued)**

The Basel Committee published its final Basel III framework in December 2017. A key objective of the revisions is to reduce excessive variability of RWAs and improve the comparability of banks' capital ratios. Implementation dates range from 2022 to 2027 and the Committee has introduced transitional arrangements to ensure an orderly and timely implementation. The Group's initial analysis suggests that the new requirements will not have a material impact on the total amount of capital it is required to hold.

The Bank of England has not yet advised the Group's Final MREL requirements. From 1 January 2020 until 31 December 2021 the Group expects that it will be required to hold 18% of risk-weighted assets in the form of MREL. From 1 January 2022, the Group continues to expect that it will be subject to an end state MREL of two times Pillar 1 and Pillar 2A capital.

**Leverage**

| Leverage ratio (unaudited) | 31 Mar 2019 £m | 30 Sep 2018 £m |
|---|---|---|
| **Total Tier 1 capital for the leverage ratio** | | |
| Total CET1 capital | **3,460** | 2,113 |
| AT1 capital | **977** | 450 |
| **Total Tier 1** | **4,437** | 2,563 |
| **Exposures for the leverage ratio** | | |
| Total assets as per published financial statements | **90,155** | 43,456 |
| Adjustment for off-balance sheet items | **2,630** | 1,763 |
| Adjustment for derivative financial instruments | **(125)** | (134) |
| Adjustment for securities financing transactions | **2,016** | 1,468 |
| Other adjustments | **(760)** | (613) |
| **Leverage ratio exposure** | **93,916** | 45,940 |
| **CRD IV leverage ratio**[(1)] | **4.7%** | 5.6% |
| **UK leverage ratio**[(2)] | **5.3%** | 6.5% |

(1) IFRS 9 transitional capital arrangements have been applied to the leverage ratio calculation as at 31 March 2019.
(2) The Group's leverage ratio on a UK basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017. The Group is currently excluded from the full reporting requirements of the UK leverage ratio framework.

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

**Funding and liquidity risk**

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

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

# Financial risk

### External credit ratings

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

| | Outlook as at 31 Mar 2019(1) | As at 31 Mar 2019 | 30 Sep 2018 |
|---|---|---|---|
| **CYBG PLC** | | | |
| Moody's | **Positive** | **Baa3** | Not Rated |
| Fitch | **Rating Watch Negative** | **BBB+** | BBB+ |
| Standard & Poor's | **Stable** | **BBB-** | BBB- |
| **Clydesdale Bank PLC** | | | |
| Moody's(2) | **Positive** | **Baa1** | Baa1 |
| Fitch | **Rating Watch Negative** | **BBB+** | BBB+ |
| Standard & Poor's | **Stable** | **BBB+** | BBB+ |
| **Virgin Money Holdings (UK) plc** | | | |
| Moody's | **Positive** | **Baa3** | Baa3 |
| Fitch | **Rating Watch Negative** | **BBB+** | BBB+ |
| **Virgin Money plc** | | | |
| Moody's | **Positive** | **Baa1** | Baa2 |
| Fitch | **Rating Watch Negative** | **BBB+** | BBB+ |

(1) For detailed background on the latest credit opinions please refer to the respective rating agency websites.
(2) Long term deposit rating

On 14 December 2018, Moody's confirmed Clydesdale Bank's adjusted BCA and long term deposit ratings at baa2 and Baa1, respectively, and assigned a Baa3 issuer rating to CYBG PLC. Concurrently, Moody's upgraded Virgin Money's long term issuer rating to Baa1 from Baa2 and confirmed its adjusted BCA at baa2. Finally, the rating agency confirmed Virgin Money Holdings' Baa3 long term issuer rating. The outlook on Clydesdale Bank's long term deposit ratings, Virgin Money's long term deposit rating and long term issuer ratings, and Virgin Money Holdings' long term issuer ratings was changed to positive from ratings under review and the outlook on CYBG's new long term issuer ratings is positive. This rating action concluded a review initiated in June 2018.

On 11 February 2019, Standard & Poor's affirmed its BBB-/A-3 long- and short term issuer credit ratings on CYBG PLC and the BBB+/A-2 issuer credit ratings on Clydesdale Bank PLC. The outlook is stable.

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

As at 14 May 2019, there have been no changes to the Group's long term credit ratings or outlooks.

### Liquid assets

The quantity and quality of the Group's liquid assets are calibrated to the Board's view of liquidity risk appetite and remain at a prudent level above regulatory requirement. The Group was compliant with all internal and regulatory liquidity metrics at 31 March 2019.

The liquid asset portfolio provides a buffer against sudden and potentially sharp outflows of funds. Liquid assets must therefore be of a high quality, so they can be realised for cash and cannot be encumbered for any other purpose (e.g. to provide collateral for payments systems). Details on encumbered assets are provided in the following section.

The liquid asset portfolio is primarily comprised of cash at the BoE, UK Government Securities (Gilts) and listed securities (e.g. bonds issued by supra-nationals and AAA rated covered bonds).

| Liquid asset portfolio | 31 Mar 2019 (unaudited) £m | 30 Sep 2018 (audited) £m |
|---|---|---|
| Cash and balances with central banks | **7,614** | 3,942 |
| UK government treasury bills and gilts | **896** | 513 |
| Other debt securities | **2,819** | 943 |
| **Total** | **11,329** | 5,398 |

### Encumbered assets by asset category

Examples of reasons for asset encumbrance include, among others, supporting the Group's secured funding programmes to provide stable term funding to the Group, the posting of assets in respect of drawings under the Term Funding Scheme, use of assets as collateral for payments systems in order to support customer's transactional activity, and providing security for the Group's issuance of Scottish bank notes. The Group monitors the level of asset encumbrance to ensure an appropriate balance is maintained.

| **31 March 2019 (unaudited)** | Assets encumbered with non-central bank counterparties | | | | Positioned at the central bank (including encumbered) £m | Assets not positioned at the central bank | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Covered bonds £m | Securitisations £m | Other £m | Total £m | | Readily available for encumbrance £m | Other assets capable of being encumbered £m | Cannot be encumbered £m | Total £m | **Total £m** |
| Cash and balances with central banks | - | - | - | - | 3,116 | 7,264 | - | - | 10,380 | **10,380** |
| Due from other banks | 301 | 391 | 184 | 876 | - | - | 105 | - | 105 | **981** |
| Financial instruments at fair value through other comprehensive income | 23 | 169 | 521 | 713 | 58 | 3,360 | - | 2 | 3,420 | **4,133** |
| Other financial assets | - | - | - | - | - | - | 304 | 1 | 305 | **305** |
| Derivatives | - | - | - | - | - | - | - | 290 | 290 | **290** |
| Loans and advances to customers | 1,785 | 10,070 | - | 11,855 | 19,809 | 19,971 | 17,446 | 3,524 | 60,750 | **72,605** |
| Other assets | - | - | 85 | 85 | - | - | 190 | 1,186 | 1,376 | **1,461** |
| Total assets | 2,109 | 10,630 | 790 | 13,529 | 22,983 | 30,595 | 18,045 | 5,003 | 76,626 | **90,155** |

| **30 September 2018 (audited)** | Assets encumbered with non-central bank counterparties | | | | Positioned at the central bank (including encumbered) £m | Assets not positioned at the central bank | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Covered bonds £m | Securitisations £m | Other £m | Total £m | | Readily available for encumbrance £m | Other assets capable of being encumbered £m | Cannot be encumbered £m | Total £m | Total £m |
| Cash and balances with central banks | - | - | - | - | 2,809 | 3,764 | - | - | 6,573 | 6,573 |
| Due from other banks | 161 | 299 | 163 | 623 | - | - | 70 | - | 70 | 693 |
| Investments – available for sale | - | - | 36 | 36 | 46 | 1,468 | 5 | 7 | 1,526 | 1,562 |
| Other financial assets | - | - | - | - | - | - | 362 | - | 362 | 362 |
| Derivatives | - | - | - | - | - | - | - | 262 | 262 | 262 |
| Loans and advances to customers | 1,393 | 5,243 | - | 6,636 | 6,940 | 5,016 | 11,322 | 2,830 | 26,108 | 32,744 |
| Other assets | - | - | 143 | 143 | - | - | 95 | 1,022 | 1,117 | 1,260 |
| Total assets | 1,554 | 5,542 | 342 | 7,438 | 9,795 | 10,248 | 11,854 | 4,121 | 36,018 | 43,456 |

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

| | **3 months or less £m** | **3 to 12 months £m** | **1 to 5 years £m** | **Over 5 years £m** | **Total at 31 Mar 2019** | Total at 30 Sep 2018 |
|---|---|---|---|---|---|---|
| Covered bonds | 26 | - | 499 | 754 | **1,279** | 742 |
| Securitisation | 414 | 1,241 | 3,518 | - | **5,173** | 2,956 |
| Medium term notes | 20 | - | 300 | 1,164 | **1,484** | 796 |
| Subordinated liabilities | 6 | 3 | 722 | - | **731** | 479 |
| **Total debt securities in issue** | 466 | 1,244 | 5,039 | 1,918 | **8,667** | 4,973 |
| Of which issued by CYBG PLC | 9 | 3 | 722 | 795 | **1,529** | 1,275 |

# Risk report - Supplementary Information - IFRS 9

IFRS 9 replaced IAS 39 as the accounting standard for financial instruments and was adopted (with the exception of the hedge accounting requirements) by the Group with effect from 1 October 2018. IFRS 9 requires the calculation of ECL as opposed to the incurred credit loss basis that existed under IAS 39.

Under IFRS 9, ECL impairment provisions are classified into three groups or 'stages' to signify their level of credit deterioration.

- Stage 1: consists of those financial assets that have been assessed as not experiencing a significant increase in credit risk (SICR) since origination. For these financial assets the impairment allowance is a 12 month ECL.
- Stage 2: consists of those financial assets that have been assessed as experiencing a SICR since origination. For these financial assets the calculation is the full lifetime ECL.
- Stage 3: consists of those financial assets that are in default or otherwise classed as being credit impaired and includes financial assets for which an individually assessed provision has been raised, as well as other financial assets collectively assessed as being in Stage 3. Irrespective of how a financial asset enters Stage 3, a lifetime ECL calculation is required.

The length of time a Stage 3 exposure would need to be classed as performing before returning to either Stage 1 or Stage 2 will depend on the reason for initially being classed as Stage 3. Where this is due to the exercise of forbearance, the EBA's FINREP principles are followed; meaning that a period of between 24 to 36 months would need to have passed before being considered 'cured'. Where the exposure enters Stage 3 for a reason other than forbearance, it is possible for this to 'cure' back to performing within a 12 month period.

In terms of the staging criteria for the financial assets purchased as a result of the Virgin Money acquisition, the origination date for Group consolidated purposes is the date of acquisition (15 October 2018). All financial assets acquired are classed as performing on acquisition (except those which are already credit impaired), initially placed in Stage 1 and subsequently tracked for a SICR in line with the post-acquisition staging criteria. Those financial assets classed as 'purchased or originated credit impaired' (POCI) on acquisition will remain in this category until derecognition, with only changes in the lifetime ECL recorded in the income statement.

Definition of a significant increase in credit risk (SICR)

This is a significant judgement area, with the Group developing a series of triggers that indicate where a SICR has occurred when assessing exposures for the risk of default occurring at each reporting date compared to the risk at origination. There is no single factor that influences this decision, rather a combination of different criteria that enable the Group to make the assessment based on the quantitative and qualitative information available. This includes the impact of forward looking macroeconomic factors but excludes the existence of any collateral implications.

| *Retail staging criteria* | | | |
|---|---|---|---|
| | **Stage 1 (12-month ECL)** | **Stage 2 (lifetime ECL)** | **Stage 3 (lifetime ECL)** |
| Criteria | No conditions for inclusion in Stage 2 or Stage 3 exist. | • The residual lifetime PD has undergone a significant deterioration compared to origination; or<br>• Is in receipt of non-default forbearance; or<br>• Is more than 30 days past due; or<br>• Does not satisfy any of the Stage 3 criteria | • Is 90+ days past due; or<br>• Is in default or otherwise classed as credit impaired; or<br>• Has an individually assessed provision in place; or<br>• Is a post-maturity interest only home loan; or<br>• Is POCI. |

# Risk report - Supplementary Information - IFRS 9

*SME staging criteria*

| | Stage 1 (12-month ECL) | Stage 2 (lifetime ECL) | Stage 3 (lifetime ECL) |
|---|---|---|---|
| Criteria | No conditions for inclusion in Stage 2 or Stage 3 exist. | • The lifetime PD has undergone a significant deterioration compared to origination; or<br>• The eCRS rating has deteriorated significantly since origination; or<br>• Identified as in financial difficulty or on a watch list status; or<br>• Is in receipt of non-default forbearance, or.<br>• Is more than 30 days past due; or<br>• Does not satisfy any of the Stage 3 criteria. | The financial asset:<br>• Is 90+ days past due; or<br>• Is in default or otherwise classed as credit impaired; or<br>• Has an individually assessed provision in place; or<br>• Is POCI. |

For both Retail and SME portfolios, there are no set or predefined values for absolute or relative movements in PD to trigger a move in stage. The Group utilises a PD threshold curve (distinct for each portfolio), which applies larger relative movements to accounts with a low credit risk at origination and smaller relative movements to accounts with a high credit risk at origination to assess for SICR.

The Group's internal customer rating system (eCRS) for SME lending is used to generate credit ratings and draws data from a number of sources to assess the probability of a customer going into default within 12 months of the rating date. SME customers are assessed primarily using a combination of expert judgement and statistical risk rating tools. eCRS gradings are based on historical default data and assigned on origination and change over time depending on the customer's circumstances. Depending on the origination eCRS and the eCRS at the reporting date, a one or two notch deterioration from origination could result in a move from Stage 1 to a Stage 2 lifetime ECL calculation.

These approaches, along with the other identified triggers, result in a significant population of financial assets being classified in Stage 2 and subject to a lifetime ECL calculation before the 30 days past due backstop is reached.

The Group defines a financial instrument as in default when either of the following two events has taken place:

- It is considered that the customer or obligor is unlikely to pay its credit obligations to the Group in full, without recourse to actions such as realisation of security (if held);
- The customer or obligor is more than 90 days past due on any material obligation to the Group.

Where a customer is subject to one of the Group's forbearance programmes, this will result in a lifetime ECL calculation for the exposure. Certain forbearance programmes are consistent with being considered credit impaired and therefore reported under Stage 3 impairment.

Assessment of financial instruments
IFRS 9 describes two ways of assessing a loss allowance for a financial instrument – collectively or individually. In all cases, whether collective or individual, the Group generates an impairment allowance at the individual financial instrument level.

*Collectively Assessed:* these are financial instruments that are assessed and provided for on a group or a pooled basis due to the existence of shared risk characteristics. Financial assets with shared risk characteristics are assessed in the sense that assets with similar characteristics at a given point in time will tend to display a similar PD profile but only for as long as they retain those similar characteristics. In particular, movement between stages will tend to occur when individual assets have deteriorated, rather than because a proportion of a pool is presumed to have deteriorated. The outcome of the collective assessment results in the calculation of either a 12 month or lifetime ECL depending on the circumstances.

# Risk report - Supplementary Information - IFRS 9

_Individually Assessed:_ these are financial instruments assessed and provided for at the financial asset level; with the assessment (which is governed by the Group's Credit Policy) taking into consideration a range of likely potential outcomes relating to each customer and their associated financial assets. These will require a lifetime ECL calculation which incorporates multiple scenarios and weightings where material. Individually assessed assets fall into two categories (i) SME lending; and (ii) Mortgages.

It is not possible for an asset to have both an individual (Stage 3 manually-assessed) ECL and a calculated (Stage 1, 2 or 3 collectively assessed) ECL provision.

Calculation of ECL impairment provision

IFRS 9 requires ECL impairment provisions to be calculated in a manner that reflects: (i) an unbiased and probability weighted amount; (ii) the time value of money; and (iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

| Term | Defined as: | IFRS 9 compliance requires: |
|---|---|---|
| PD | - an estimate of the probability that a customer will default over either the next 12 months or lifetime of the account | - a forward-looking 12 month and lifetime PD, which needs to be capable of reflecting changes in the economic environment; |
| EAD | - an estimate of the amount the customer will owe at the time of default | - to be forward looking and based on contractual limits with certain exceptions for revolving products (such as credit cards) that may contain both a drawn and undrawn element |
| LGD | - an estimate of the loss that the Group will suffer if the customer defaults (incorporating any collateral held) | - to be forward looking with no prescribed floors |

While PD, EAD and LGD are also important components of the regulatory expected loss calculation, their use and definitions for regulatory purposes are not fully aligned with IFRS 9. The inherent conservatism that is a feature of the framework for regulatory calculations creates a bias in the IFRS 9 ECL calculation which is removed for accounting purposes.

Other changes from the impairment provisions calculated under IAS 39 are the requirements for the ECL calculation to be based on a multiple forward-looking scenario approach which is probability weighted and incorporates forecasts of future macroeconomic conditions.

*Multiple forward-looking scenarios and weightings*

Using a single forward-looking economic scenario, for example a central economic scenario based on the most likely outcome (normally referred to as a 'base case'), would not meet the objectives of IFRS 9 when there is a non-linear relationship between the different forward-looking scenarios and the associated change in (i) the risk of a default occurring, and/or (ii) credit losses. As such, in addition to the base case, which represents the Group's view of the most likely economic outcome and is also used by the Group for planning and forecasting purposes, the Group also uses a third party to supply forward looking scenarios and a range of macroeconomic conditions over the forecast period. Taking these together, the Group considers a 'mild upside' and a 'severe downside' scenario, which are considered to provide a balance in reaching an ECL calculation that is free from bias and addresses concerns around the potential for non-linearity of the ECL calculation. The Group applied the following weightings to the chosen scenarios at 1 October 2018 and 31 March 2019:

| | |
|---|---|
| Mild upside | 25% |
| Base case | 60% |
| Severe downside | 15% |

The scenario weightings are considered and debated by an internal review panel and then recommended and approved for use in the IFRS 9 models by ALCO. The slight weightings skew towards the mild upside scenario reflecting the relative conservatism in the Group's base case, which is closer to the chosen downside scenario.

# Risk report - Supplementary Information - IFRS 9

*Future macroeconomic conditions*

A range of future macroeconomic conditions is used in the scenarios over a five year forecast period and reflects the best estimates of future conditions under each scenario. The Group has identified the following key macroeconomic conditions as the most significant inputs for IFRS 9 modelling purposes: UK GDP growth, CPI inflation, house prices, bank rates, unemployment rates and CRE capital values. These are assessed and reviewed by an internal panel on a six monthly basis to ensure appropriateness and relevance to the ECL calculation. Where model inputs are not reflective of the current market conditions at the date of the financial statements, the Group may reflect these through the use of temporary adjustments to the ECL calculation using expert credit judgement.

The simple forward looking 5-year averages for the key model inputs used in the ECL calculations at 1 October 2018 and 31 March 2019 are:

| | UK GDP growth | CPI inflation | House prices | Bank rate | ILO Unemployment |
|---|---|---|---|---|---|
| **1 October 2018** | % | % | % | % | % |
| Mild upside | 2.6 | 2.4 | 4.9 | 2.5 | 3.3 |
| Base | 2.1 | 1.9 | 4.3 | 1.1 | 4.2 |
| Severe downside | 0.6 | 0.8 | (1.7) | 0.1 | 6.2 |
| | | | | | |
| **31 March 2019** | | | | | |
| Mild upside | 2.8 | 2.3 | 5.1 | 2.3 | 3.2 |
| Base | 2.1 | 1.9 | 4.3 | 1.1 | 4.2 |
| Severe downside | 0.4 | 0.8 | (3.0) | 0.1 | 6.0 |

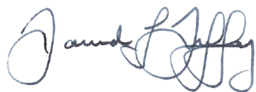
## Statement of Directors' responsibilities

The Directors confirm that to the best of their knowledge these interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting' (IAS 34) as adopted by the European Union and that the interim management report includes a fair review of the information required by DTR 4.2.7R and DTR 4.2.8R, namely:

a) an indication of important events that have occurred during the six months ended 31 March 2019 and their impact on the condensed consolidated interim financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year; and

b) material related party transactions in the six months ended 31 March 2019 and any material changes in the related party transactions described in the last Annual Report of CYBG PLC.

Signed by order of the Board



David Duffy
**Chief Executive Officer**
**14 May 2019**

## Independent review report to CYBG PLC

**Introduction**

We have been engaged by CYBG PLC to review the condensed set of financial statements in the interim financial report for the six months ended 31 March 2019 which comprises the interim condensed consolidated income statement, interim condensed consolidated statement of comprehensive income, interim condensed consolidated balance sheet, interim condensed consolidated statement of changes in equity, interim condensed consolidated statement of cash flows and the related explanatory notes 1.1 to 5.4. We have read the other information contained in the interim financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

**Directors' Responsibilities**

The interim financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the interim financial report in accordance with International Accounting Standard 34, "Interim Financial Reporting," as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in Section 1, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The condensed set of financial statements included in this interim financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

**Our Responsibility**

Our responsibility is to express to CYBG PLC a conclusion on the condensed set of financial statements in the interim financial report based on our review.

**Scope of Review**

We conducted our review in accordance with International Standard on Review Engagements 2410 (UK and Ireland), "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim financial report for the six months ended 31 March 2019 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Ernst & Young LLP
**Leeds**
**14 May 2019**

# Interim condensed consolidated income statement

| | Note | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|---|
| Interest income | | **1,266** | 559 | 1,127 |
| Other similar interest | | **(4)** | (7) | (13) |
| Interest expense and similar charges | | **(442)** | (126) | (263) |
| **Net interest income** | 2.2 | **820** | 426 | 851 |
| Gains less losses on financial instruments at fair value | | **(9)** | 1 | (3) |
| Other operating income | | **115** | 76 | 159 |
| **Non-interest income** | 2.3 | **106** | 77 | 156 |
| **Total operating income** | | **926** | 503 | 1,007 |
| Operating and administrative expenses before impairment losses | 2.4 | **(711)** | (576) | (1,130) |
| **Operating profit/(loss) before impairment losses** | | **215** | (73) | (123) |
| Impairment losses on credit exposures | | **(173)** | (22) | (41) |
| **Profit/(loss) on ordinary activities before tax** | | **42** | (95) | (164) |
| Tax (expense)/credit | 2.5 | **(13)** | 19 | 19 |
| **Profit/(loss) for the period** | | **29** | (76) | (145) |
| | | | | |
| **Attributable to:** | | | | |
| Ordinary shareholders | | **(5)** | (94) | (181) |
| Other equity holders | | **18** | 18 | 36 |
| Non-controlling interests | | **16** | - | - |
| **Profit/(loss) for the period** | | **29** | (76) | (145) |
| | | | | |
| Basic earnings/(loss) per share (pence) | 2.6 | **0.2** | (10.2) | (19.7) |
| Diluted earnings/(loss) per share (pence) | 2.6 | **0.2** | (10.2) | (19.7) |

All material items dealt with in arriving at the profit/(loss) before tax for the periods relate to continuing activities.

The notes on pages 48 to 79 form an integral part of these interim condensed consolidated financial statements.

# Interim condensed consolidated statement of comprehensive income

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| **Profit/(loss) for the period** | **29** | (76) | (145) |
| | | | |
| **Items that may be reclassified to the income statement** | | | |
| *Change in cash flow hedge reserve* | | | |
| Gains/(losses) during the period | **13** | (56) | (58) |
| Transfers to the income statement | **6** | 1 | 9 |
| Taxation thereon - deferred tax (charge)/credit | **(9)** | 13 | 11 |
| Taxation thereon - current tax credit | **5** | - | - |
| | **15** | (42) | (38) |
| *Change in available for sale reserve* | | | |
| Gains during the period | **-** | 2 | - |
| Taxation thereon - deferred tax charge | **-** | (1) | - |
| | **-** | 1 | - |
| *Change in FVOCI reserve* | | | |
| Gains during the period | **2** | - | - |
| | **2** | - | - |
| | | | |
| **Total items that may be reclassified to the income statement** | **17** | (41) | (38) |
| | | | |
| **Items that will not be reclassified to the income statement** | | | |
| *Change in asset revaluation reserve* | | | |
| Taxation thereon - deferred tax credit | **-** | - | 1 |
| | | | |
| Remeasurement of defined benefit pension plans | **(37)** | 3 | (9) |
| Taxation thereon - deferred tax credit/(charge) | **13** | (1) | 3 |
| | **(24)** | 2 | (6) |
| | | | |
| **Total items that will not be reclassified to the income statement** | **(24)** | 2 | (5) |
| **Other comprehensive losses, net of tax** | **(7)** | (39) | (43) |
| **Total comprehensive income/(losses) for the period, net of tax** | **22** | (115) | (188) |
| | | | |
| **Attributable to:** | | | |
| Ordinary shareholders | **(12)** | (133) | (224) |
| Other equity holders | **18** | 18 | 36 |
| Non-controlling interests | **16** | - | - |
| **Total comprehensive income/(losses) attributable to equity holders** | **22** | (115) | (188) |

The notes on pages 48 to 79 form an integral part of these interim condensed consolidated financial statements.

# Interim condensed consolidated balance sheet

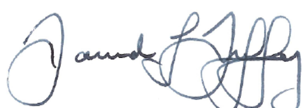
| | Note | 31 Mar 2019 (unaudited) £m | 30 Sep 2018[2] (audited) £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with central banks | | **10,380** | 6,573 |
| Due from other banks | | **981** | 693 |
| Financial instruments at fair value through other comprehensive income[1] | | **4,133** | - |
| Financial assets available for sale[1] | | **-** | 1,562 |
| Financial assets at fair value through profit or loss | 3.1 | **305** | 362 |
| Derivative financial instruments | 3.2 | **290** | 262 |
| Loans and advances to customers | 3.3 | **72,605** | 32,744 |
| Due from customers on acceptances | | **3** | 4 |
| Property, plant and equipment | | **150** | 88 |
| Investment properties | | **4** | 7 |
| Investments in joint ventures | | **1** | - |
| Intangible assets and goodwill | | **495** | 412 |
| Deferred tax assets | 3.4 | **286** | 206 |
| Defined benefit pension assets | 3.8 | **219** | 212 |
| Assets held for sale | | **14** | - |
| Other assets | | **289** | 331 |
| **Total assets** | | **90,155** | 43,456 |
| | | | |
| **Liabilities** | | | |
| Due to other banks | 3.5 | **11,087** | 3,088 |
| Financial liabilities at fair value through profit or loss | 3.1 | **8** | 15 |
| Derivative financial instruments | 3.2 | **290** | 361 |
| Due to customers | | **61,882** | 28,904 |
| Liabilities on acceptances | | **3** | 4 |
| Current tax liabilities | | **9** | - |
| Provisions for liabilities and charges | 3.6 | **199** | 331 |
| Debt securities in issue | 3.7 | **8,667** | 4,973 |
| Retirement benefit obligations | 3.8 | **3** | 3 |
| Deferred tax liabilities | 3.4 | **140** | 77 |
| Liabilities held for sale | | **3** | - |
| Other liabilities | | **2,506** | 2,514 |
| **Total liabilities** | | **84,797** | 40,270 |
| | | | |
| **Equity** | | | |
| Share capital and share premium | 4.1 | **146** | 89 |
| Other equity instruments | 4.1 | **697** | 450 |
| Capital reorganisation reserve | 4.1 | **(839)** | (839) |
| Merger reserve | 4.1 | **2,128** | 633 |
| Other reserves | 4.1 | **8** | (20) |
| Retained earnings | | **2,796** | 2,873 |
| Non-controlling interests | 4.1 | **422** | - |
| **Total equity** | | **5,358** | 3,186 |
| **Total liabilities and equity** | | **90,155** | 43,456 |

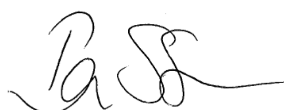
(1) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to Notes 1.2 and 5.3.

(2) The comparative period has been restated in line with the current period presentation. Derivative collateral in relation to clearing houses has been reclassified between other assets / liabilities and due from / to other banks

The notes on pages 48 to 79 form an integral part of these interim condensed consolidated financial statements.

These interim condensed consolidated financial statements were approved by the Board of Directors on 14 May 2019 and were signed on its behalf by:





David Duffy
**Chief Executive Officer**

Ian Smith
**Chief Financial Officer**

Company name: CYBG PLC, Company number: 09595911

# Interim condensed consolidated statement of changes in equity

| | Share capital and share premium | Capital reorg' reserve | Merger reserve | Other equity instruments | Other reserves | | | | | | | Cash flow hedge reserve | Retained earnings | Non controlling interest | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Own shares held | Deferred shares reserve | Equity based comp' reserve | Asset reval reserve | Available for sale reserve | FVOCI reserve | | | | | |
| Note | 4.1.1 | 4.1.3 | 4.1.4 | 4.1.2 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | 4.1.5 | | 4.1.5 | | 4.1.6 | |
| | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m | | £m | £m | £m | £m |
| **At 1 October 2017 (audited)[(1)]** | 88 | (839) | 633 | 450 | - | - | 8 | 1 | 7 | - | | (1) | 3,055 | - | 3,402 |
| Loss for the period | - | - | - | - | - | - | - | - | - | - | | - | (76) | - | (76) |
| Other comprehensive income/(losses) net of tax | - | - | - | - | - | - | - | - | 1 | - | | (42) | 2 | - | (39) |
| Total comprehensive income/(losses) for the period | - | - | - | - | - | - | - | - | 1 | - | | (42) | (74) | - | (115) |
| Dividends paid to ordinary shareholders | - | - | - | - | - | - | - | - | - | - | | - | (9) | - | (9) |
| AT1 distributions paid (net of tax) | - | - | - | - | - | - | - | - | - | - | | - | (15) | - | (15) |
| Transfer from equity-based compensation reserve | - | - | - | - | - | - | (5) | - | - | - | | - | 5 | - | - |
| Ordinary shares issued | 1 | - | - | - | - | - | - | - | - | - | | - | - | - | 1 |
| Equity-based compensation expensed | - | - | - | - | - | - | 6 | - | - | - | | - | - | - | 6 |
| **At 31 March 2018 (unaudited)** | 89 | (839) | 633 | 450 | - | - | 9 | 1 | 8 | - | | (43) | 2,962 | - | 3,270 |
| Loss for the period | - | - | - | - | - | - | - | - | - | - | | - | (69) | - | (69) |
| Other comprehensive income/(losses) net of tax | - | - | - | - | - | - | - | 1 | (1) | - | | 4 | (8) | - | (4) |
| Total comprehensive income/(losses) for the period | - | - | - | - | - | - | - | 1 | (1) | - | | 4 | (77) | - | (73) |
| AT1 distributions paid (net of tax) | - | - | - | - | - | - | - | - | - | - | | - | (14) | - | (14) |
| Transfer from equity-based compensation reserve | - | - | - | - | - | - | (2) | - | - | - | | - | 2 | - | - |
| Equity based compensation expensed | - | - | - | - | - | - | 3 | - | - | - | | - | - | - | 3 |
| **At 30 September 2018 (audited)[(1)]** | 89 | (839) | 633 | 450 | - | - | 10 | 2 | 7 | - | | (39) | 2,873 | - | 3,186 |
| Changes on adoption of IFRS 9 and IFRS 15 (note 5.3) | - | - | - | - | - | - | - | - | (7) | 4 | | - | (18) | - | (21) |
| **As at 1 October 2018** | 89 | (839) | 633 | 450 | - | - | 10 | 2 | - | 4 | | (39) | 2,855 | - | 3,165 |
| Profit for the period | - | - | - | - | - | - | - | - | - | - | | - | 29 | - | 29 |
| Other comprehensive income/(losses) net of tax | - | - | - | - | - | - | - | - | - | 2 | | 15 | (24) | - | (7) |
| Total comprehensive income for the period | - | - | - | - | - | - | - | - | - | 2 | | 15 | 5 | - | 22 |
| Acquisition of Virgin Money | 54 | - | 1,495 | - | (5) | 23 | - | - | - | - | | - | - | 422 | 1,989 |
| Dividends paid to ordinary shareholders | - | - | - | - | - | - | - | - | - | - | | - | (45) | - | (45) |
| AT1 distributions paid (net of tax) | - | - | - | - | - | - | - | - | - | - | | - | (13) | - | (13) |
| Distributions to non-controlling interests (net of tax) | - | - | - | - | - | - | - | - | - | - | | - | (13) | - | (13) |
| Transfer from equity based compensation reserve | - | - | - | - | - | - | (6) | - | - | - | | - | 6 | - | - |
| Equity based compensation expensed | - | - | - | - | - | - | 3 | - | - | - | | - | - | - | 3 |
| Settlement of Virgin Money share awards | 3 | - | - | - | 3 | (4) | - | - | - | - | | - | 1 | - | 3 |
| AT1 issuance | - | - | - | 247 | - | - | - | - | - | - | | - | - | - | 247 |
| **At 31 March 2019 (unaudited)** | **146** | **(839)** | **2,128** | **697** | **(2)** | **19** | **7** | **2** | **-** | **6** | | **(24)** | **2,796** | **422** | **5,358** |

(1) The balances as at 1 October 2017 and 30 September 2018 have been audited; the movements in the individual six months periods to 31 March 2018 and 31 March 2019, together with the impact of the adoption of IFRS 9 and IFRS 15, are unaudited.

The notes on pages 48 to 79 form an integral part of these interim condensed consolidated financial statements.

# Interim condensed consolidated statement of cash flows

| | Note | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Profit/(loss) on ordinary activities before tax | | **42** | (95) | (164) |
| *Adjustments for:* | | | | |
| Non-cash or non-operating items included in profit before tax | | **(458)** | (356) | (715) |
| Changes in operating assets | | **(1,720)** | (605) | (1,059) |
| Changes in operating liabilities | | **1,297** | (793) | (122) |
| Interest received | | **1,211** | 568 | 1,108 |
| Interest paid | | **(328)** | (84) | (173) |
| **Net cash provided by/(used in) operating activities** | | **44** | (1,365) | (1,125) |
| **Cash flows from investing activities** | | | | |
| Interest received | | **22** | 6 | 12 |
| Cash acquired on acquisition of Virgin Money | | **4,704** | - | - |
| Proceeds from maturity of financial instruments at FVOCI | | **287** | - | - |
| Proceeds from maturity of available for sale investments | | **-** | 50 | 245 |
| Proceeds from sale of financial instruments at FVOCI | | **134** | - | - |
| Proceeds from sale of available for sale investments | | **-** | 821 | 822 |
| Purchase of financial instruments at FVOCI | | **(833)** | - | - |
| Purchase of available for sale investments | | **-** | (178) | (593) |
| Proceeds from sale of tangible fixed assets[1] | | **3** | 6 | 9 |
| Purchase of tangible fixed assets[1] | | **(10)** | (10) | (22) |
| Purchase and development of intangible assets | | **(62)** | (67) | (144) |
| **Net cash provided by investing activities** | | **4,245** | 628 | 329 |
| **Cash flows from financing activities** | | | | |
| Interest received | | **-** | 1 | 1 |
| Interest paid | | **(79)** | (45) | (94) |
| Proceeds from issuance of other equity instruments | | **247** | - | - |
| Redemption and principal repayment on RMBS and covered bonds | 5.4 | **(1,288)** | (838) | (1,372) |
| Issuance of RMBS and covered bonds | 5.4 | **1,104** | 496 | 1,049 |
| Issuance of medium term notes/subordinated debt | 5.4 | **247** | - | 497 |
| Amounts drawn down under the TFS | 5.4 | **-** | 1,250 | 1,250 |
| Amounts repaid under the TFS | 5.4 | **(150)** | (900) | (900) |
| Ordinary dividends paid | | **(45)** | (9) | (9) |
| AT1 distributions | | **(18)** | (18) | (36) |
| Distributions to non controlling interests | | **(16)** | - | - |
| **Net cash provided by/(used in) financing activities** | | **2** | (63) | 386 |
| **Net increase/(decrease) in cash and cash equivalents** | | **4,291** | (800) | (410) |
| Cash and cash equivalents at the beginning of the period | | **6,542** | 6,952 | 6,952 |
| **Cash and cash equivalents at the end of the period[2]** | | **10,833** | 6,152 | 6,542 |

(1) Tangible fixed assets include property, plant and equipment, investment properties and property inventory.
(2) Cash and cash equivalents is cash and balances with central banks less mandatory deposits plus cash equivalents within other assets, less due to other banks, and other liabilities.

The notes on pages 48 to 79 form an integral part of these interim condensed consolidated financial statements.

# Notes to the interim condensed consolidated financial statements

## Section 1: Basis of preparation and accounting policies

**Overview**
These interim condensed consolidated financial statements for the six months ended 31 March 2019 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and IAS 34 'Interim Financial Reporting' as adopted by the European Union (EU). They do not include all the information required by International Financial Reporting Standards (IFRS) in full annual financial statements and should therefore be read in conjunction with the Annual Report and Accounts for the year ended 30 September 2018, which were prepared in accordance with IFRS as adopted by the EU. Copies of the 2018 Annual Report and Accounts are available from the Group's website - http://www.cybg.com/annual-results-2018/

The information in these interim condensed consolidated financial statements is unaudited and does not constitute annual accounts within the meaning of Section 434 of the Companies Act 2006 ('the Act'). Statutory accounts for the year ended 30 September 2018 have been delivered to the Registrar of Companies and contained an unqualified audit report under Section 495 of the Act, which did not draw attention to any matters by way of emphasis and they did not contain any statements under Section 498 of the Act.

### 1.1 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 business and financial review section of these interim condensed consolidated financial statements. This should be read in conjunction with the strategic report which can be found in the Annual Report and Accounts for the year ended 30 September 2018. In addition, the Risk report contained in the 2018 Annual Report includes the Group's risk management objectives. The Group's objectives, policies and processes for managing capital can be found in the risk management section of this report.

The Directors have a reasonable expectation that the Group has 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. Accordingly, they continue to adopt the going concern basis in preparing these interim condensed consolidated financial statements.

### 1.2 Accounting policies
The accounting policies adopted in the preparation of these interim condensed consolidated financial statements are consistent with those policies followed in the preparation of the CYBG PLC Annual Report and Accounts for the year ended 30 September 2018 except for those policies highlighted below. Comparatives are presented on a basis that conforms to the current presentation except where stated otherwise.

**Changes to accounting policies on adoption of both IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers' with effect from 1 October 2018**
The accounting policy for financial assets available for sale is no longer relevant as this financial asset category has been removed with the introduction of IFRS 9.

The accounting policies for financial assets at fair value through profit or loss (note 3.1), loans and advances to customers (note 3.3), and impairment provisions on credit exposures (note 3.3) have been revised, and an accounting policy for the new category of financial assets 'financial assets at fair value through other comprehensive income' introduced.

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

On transition and as permitted by IFRS 9, the Group has not restated comparative figures, with the impact of adopting IFRS 9 adjusted through retained earnings. Further detail on the transitional impact of IFRS 9 can be found in note 5.3.

## Section 1: Basis of preparation and accounting policies (continued)

*Classification and measurement*

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

*Financial assets at amortised cost*

Financial assets with contractual terms that give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding, and which are held within a business model whose objective is achieved by collecting contractual cash flows, are measured at amortised cost (unless designated at fair value through profit or loss to eliminate or significantly reduce a measurement mismatch).

Consideration for the time value of money and credit risk are typically the most significant elements of interest. However, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement.

The Group considers that loans and advances to customers, amounts due from other banks and cash and balances with central banks are the primary categories of financial assets that meet the amortised cost classification.

In certain limited circumstances the Group can elect to apply the fair value through profit or loss measurement option to some debt instruments that would otherwise be classified at amortised cost. This option can be applied to loans and advances where there is an accounting mismatch and the Group has entered into a derivative contract to offset the risk introduced by the debt instrument. Where this option is applied, the asset is classified as fair value through profit or loss.

*Financial assets at fair value through other comprehensive income (FVOCI)*

Debt instruments with contractual terms that give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding, and which are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, are measured at fair value through other comprehensive income (FVOCI) (unless the financial asset is designated at fair value through profit or loss to eliminate or significantly reduce a measurement mismatch). Financial assets at FVOCI are initially recognised at fair value including direct and incremental costs, and continue to be measured at fair value. The Group applies trade date accounting to purchases and sales of the financial assets at FVOCI.

The Group's listed securities classified as 'available for sale' under IAS 39 have been assessed as meeting the criteria to be classified as FVOCI.

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

Certain investments in equity instruments can be held at FVOCI (as opposed to being held at fair value through profit or loss) where an irrevocable election has been made to do so. The Group has not elected to designate any equity instruments at FVOCI at this time.

*Financial instruments at fair value through profit or loss (FVTPL)*

Financial instruments at fair value through profit or loss (FVTPL) comprise (i) instruments held for trading, (ii) items specifically designated as FVTPL on initial recognition, and (iii) financial assets where the business model is neither to hold to collect contractual cash flows nor to hold to collect contractual cash flows and sell. Financial instruments held at FVTPL are initially recognised at fair value, with transaction costs recognised in the income statement as incurred. Subsequently, they are measured at fair value and any gains and losses are recognised in the income statement as they arise. Where a financial asset is measured at fair value, a credit valuation adjustment is included to reflect the creditworthiness of the counterparty, representing the movement in fair value attributable to changes in credit risk.

A financial instrument 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.

## Section 1: Basis of preparation and accounting policies (continued)

A financial instrument can be designated as FVTPL in the following circumstances: (i) in respect of an entire contract if a host contract contains one or more embedded derivatives; (ii) if designating the instruments eliminates or significantly reduces measurement or recognition inconsistencies (e.g. eliminates an accounting mismatch) that would otherwise arise from measuring financial assets or liabilities on a different basis; or (iii) if financial assets and liabilities are both arranged and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

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

*Impairment of financial assets*

*Impairment of financial assets at amortised cost*

At each reporting date, the Group assesses financial assets measured at amortised cost, in addition to loan commitments and financial guarantees not measured at FVTPL, for impairment and calculates the resultant impairment loss allowance using an ECL methodology.

The ECL methodology and calculation is based upon the combination of PD, LGD and EAD estimates that consider a range of factors which have a direct bearing on credit risk and subsequently the required level of impairment loss provisioning.

This results in an impairment loss allowance calculation that reflects: (i) an unbiased and probability weighted amount; (ii) the time value of money which discounts the impairment loss; and (iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The impairment loss allowance is calculated as either a 12-month or lifetime ECL depending on whether the financial asset has exhibited a significant increase in credit risk since origination or otherwise becomes credit-impaired as at the reporting date. A low credit risk option is available which, when exercised, allows entities to not assess whether there has been a significant increase in credit risk since initial recognition where the financial asset is deemed as being of low credit risk at the reporting date.

The impairment loss allowance falls into the following three categories:

Stage 1
Where there are no indicators at the reporting date of a significant increase in credit risk since origination, a 12-month impairment loss allowance will be calculated. Where the low credit risk option has been exercised, the financial assets are regarded as high (investment grade) credit quality and are not subject to a significant increase in credit risk assessment. These financial assets will only have a 12-month impairment loss allowance calculated.

Stage 2
Where a significant increase in credit risk since origination has been identified at the reporting date (but the financial asset is not credit-impaired) a lifetime impairment loss allowance will be calculated. Indicators of a significant increase in credit risk include deterioration of the residual lifetime PD by set thresholds which are unique to each product portfolio, certain eCRS rating deterioration by set thresholds, non-default forbearance programmes, and watch list status. The Group adopts the backstop position that a significant increase in credit risk will have taken place when the financial asset reaches 30 days past due.

Stage 3
Where the financial asset is assessed as being credit-impaired at the reporting date, a lifetime impairment loss allowance will be calculated. This is the case where the customer has an individually assessed provision in place (specific provisions under IAS 39) or is included in a forbearance programme which is captured within the Group's definition of default. The Group adopts the backstop position that a financial asset becomes credit-impaired when it reaches 90 days past due.

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

POCI financial assets are those which are assessed as being credit-impaired upon initial recognition. Once a financial asset is classed as POCI, it remains there until de-recognition irrespective of its credit quality. POCI financial assets are disclosed separately from those financial assets in Stage 3. The Group regards the date of acquisition as the origination date for purchased portfolios.

## Section 1: Basis of preparation and accounting policies (continued)

The Group first assesses whether credit risk has increased significantly for individual financial assets. For some financial assets, where significant increase in credit risk is not evident on an individual instrument basis before the financial instrument becomes past due, the Group includes the asset in a group of financial assets on the basis of shared credit risk characteristics and assesses whether there has been a significant increase in credit risk on a collective basis. Assets that are individually assessed for a significant increase of credit risk since initial recognition (on the basis of reasonable and supportable information that is more forward-looking than past due information and for which 12-month or lifetime ECLs are or continue to be recognised) do not form part of those financial assets included in the collective assessment.

Financial assets are grouped together based on shared credit risk characteristics which consider factors such as instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry, geographical location of the borrower, collateral type and other relevant factors. These characteristics are relevant to the estimation of future cash flows 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 that are used for the measurement of the expected impairment losses are estimated on the basis of the contractual cash flows of the assets adjusted for the probability of the default occurring. The Group considers historical loss experience which has been adjusted based on current observable data reflecting 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 loss period that do not currently exist.

In addition, the Group uses reasonable and supportable forecasts of future economic conditions to estimate the amount of an expected impairment loss. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact reliability. The methodology and assumptions including forecasts of future economic conditions, the scenarios used, and the probability weightings applied in calculating ECLs are reviewed regularly and updated as necessary.

Interest income on financial assets in Stages 1 and 2 is recognised on the unwinding of the discount from the initial recognition of ECLs using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the ECL. Once a financial asset or group of similar financial assets has been categorised as credit-impaired (Stage 3), interest income is recognised on the net carrying value (after the ECL allowance) using the asset's original effective interest rate, being the rate of interest used to discount the future cash flows for the purpose of measuring the ECL. The interest income for POCI financial assets is calculated using the credit-adjusted effective interest rate applied to the amortised cost of the financial asset from initial recognition.

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

*Impairment of debt instruments at fair value through other comprehensive income (FVOCI)*

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

The Group exercises the low credit risk option for debt instruments classified as FVOCI.

*IFRS 15 'Revenues from Contracts with Customers'*

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

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

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

## Section 1: Basis of preparation and accounting policies (continued)

On transition and as permitted by IFRS 15, the Group has not restated comparative figures, with the impact of adopting IFRS 15 adjusted through retained earnings. Further detail on the transitional impact of IFRS 15 can be found in note 5.3.

*Interests in joint ventures*

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

***New accounting policies as a result of the acquisition of Virgin Money***

The following accounting policy has been adopted by the Group from 15 October 2018 as a result of the acquisition of Virgin Money:

*Client money*

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

### 1.3 Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amounts 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 best estimates can be reliably measured, actual amounts may differ from those estimated.

The following changes have been made to the critical accounting estimates and judgements as disclosed in note 1.8 of the 2018 Annual Report and have been reflected in determining the results reported in these interim condensed consolidated financial statements:

*Impairment provisions on credit exposures*

The change to an ECL methodology for financial assets under IFRS 9 requires a range of different critical accounting estimates and judgements to be applied than those required under IAS 39:

| Accounting estimates | Accounting judgements |
|---|---|
| *Economic scenarios:* in calculating the ECL, the Group relies on three scenarios, base case, mild upside and severe downside. These contain a number of key economic assumptions that ensure non-linear relationships between different forward-looking scenarios and their associated credit losses do not materially impact the ECL calculation. The base case used by the Group for IFRS 9 modelling is that also used for the Group's internal planning purposes. | *Significant increase in credit risk:* considerable management judgement is required in determining the point at which a significant increase in credit risk has occurred, which moves an account from a 12-month to a lifetime ECL calculation. The Group calculates a 12-month and a lifetime ECL for each financial asset and uses a PD threshold curve (distinct for each portfolio), which applies larger relative movements to accounts with a low risk at origination and smaller relative movements to the accounts with a high risk at origination to assess for a significant increase in credit risk. In addition to this, for SME lending, eCRS movements over a pre-determined threshold also constitute a significant increase in credit risk. The Group utilises the 30 days past due backstop in assessing for a significant increase in credit risk. |
| *Asset lifetimes:* in calculating the ECL, the Group takes the remaining contract term as the maximum period to consider credit losses wherever possible. For the Group's credit card and overdraft portfolios, a different approach is followed that takes into account behavioural factors such as observed retention rates and other portfolio level assumptions associated with the particular portfolio in determining the lifetime over which the ECL calculation is based. | *Definition of default:* the Group's interpretation of the definition of default for IFRS 9 purposes incorporates a number of the Group's forbearance programmes (the Group includes all other forms of non-default related forbearance as triggering the significant increase in credit risk assessment to Stage 2 and the calculation of a lifetime ECL). The Group also utilises the 90 days past due backstop for default purposes. |

## Section 1: Basis of preparation and accounting policies (continued)

*Effective interest rate (EIR)*
During the period, the Group has considered the application of EIR in relation to the Group's reported amounts of assets, liabilities, revenues and expenses as a result of the acquisition of Virgin Money. The Group has concluded that sufficient judgement is now exercised on EIR for it to be included in the Group's disclosures on critical accounting estimates and judgements.

The Group offers a range of mortgage and credit card products, interest income on which is recognised using the EIR method. This provides a level yield over the anticipated behavioural life of the product.

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

Mortgages - The main accounting judgement when assessing the cash flows within the Group's secured lending EIR model is the product lives and the early repayment charge income receivable. Prepayment profiles estimate the expected repayment each month over and above the contractual repayment. Prepayment profiles for each cohort are based on historic data, adjusted for management's prudent assumptions, as an indicator for expectations of future behaviour.

Credit cards - Management model expected future cash flows over the estimated customer life, supported by observed experience, with a restriction of five years on the maximum modelling period applied. Management uses estimates and assumptions of future customer behaviour including the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period.

*Financial assets and liabilities at fair value through profit or loss*

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

Further detail on the Group's critical accounting estimates and judgements, including sensitivities, will be provided in the Annual Report and Accounts for the year ending 30 September 2019.

### 1.4 Accounting developments
In addition to IFRS 9 and IFRS 15 as highlighted above, the Group has also adopted the following IASB pronouncements in the current financial period. These do not have a material impact on the interim condensed consolidated financial statements:

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

During the period, there has been no further pronouncements from the IASB which are relevant to the Group.

## Section 1: Basis of preparation and accounting policies (continued)

### 1.4 Accounting developments (continued)

*Update on the Group's implementation of IFRS 16 'Leases'*

IFRS 16 was issued in January 2016 and endorsed for use in the EU. It is effective for financial years beginning on or after 1 January 2019 and will be adopted by the Group with effect from 1 October 2019.

For lessees, operating leases will be brought onto the Group's balance sheet with an asset recognised for the contractual 'right of use' and a financial liability recognised for the contractual payments. This change will mainly impact the properties that the Group currently accounts for as operating leases. An implementation plan is in place and the Group is currently undertaking a review of its lease agreements. There are no substantial changes to the accounting for leases by lessors, nor for finance leases. A final update on the Group's IFRS 16 implementation plan, including a quantification of the financial effect on transition, will be provided in the Annual Report and Accounts for the year ending 30 September 2019.

### 1.5 Presentation of risk disclosures

Certain disclosures outlined in IFRS 7 'Financial Instruments: Disclosure' concerning the nature and extent of risks relating to financial instruments have been included within the risk management section of this report.

## Section 2: Results for the period

### 2.1 Segment information

In Note 2.1 to the financial statements section of the CYBG PLC 2018 Annual Report and Accounts, the Group's business was organised into two principal operating segments: SME banking and Retail banking. In addition, Central Functions consisted of the Group's back office support functions. At this time, the Group's operating segments were the operating units engaged in providing different products or services and whose operating results and overall performance were regularly reviewed by the Group's chief operating decision maker, the Executive Leadership Team.

Following the acquisition of Virgin Money, the business is currently being assessed and reported to the Group's chief operating decision maker as a single segment, with decisions being made on the performance of the Group on that basis. The Group has therefore determined that it currently has one reportable operating segment and is therefore not required to produce additional segmental disclosure.

The Group expects that its business will be aligned to three operating segments model: Retail, Mortgages and Business Banking. The reporting basis under the three segment model is currently being developed with the actual reporting of these segments expected to begin on 1 October 2019. The Group operates in a single geographic segment, being the UK and is not reliant on a single customer.

**Summary income statement**

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| Net interest income | **820** | 426 | 851 |
| Non-interest income | **106** | 77 | 156 |
| Total operating income | **926** | 503 | 1,007 |
| Operating and administrative expenses | **(711)** | (576) | (1,130) |
| Impairment losses on credit exposures | **(173)** | (22) | (41) |
| Segment profit/(loss) before tax | **42** | (95) | (164) |
| | | | |
| **Average interest earning assets** | **85,628** | 39,303 | 39,417 |

### 2.2 Net interest income

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| **Interest income** | | | |
| Loans and advances to customers | **1,204** | 526 | 1,057 |
| Loans and advances to other banks | **34** | 10 | 26 |
| Financial instruments at fair value through other comprehensive income | **15** | - | - |
| Financial assets available for sale | **-** | 6 | 12 |
| Financial assets at fair value through profit or loss | **12** | 15 | 29 |
| Other interest income | **1** | 2 | 3 |
| **Total interest income** | **1,266** | 559 | 1,127 |
| | | | |
| **Other similar interest** | | | |
| Derivatives economically hedging interest bearing assets | **(4)** | (7) | (13) |
| **Total other similar interest** | **(4)** | (7) | (13) |
| | | | |
| **Less: interest expense and similar charges** | | | |
| Due to customers | **(273)** | (71) | (148) |
| Debt securities in issue | **(90)** | (45) | (94) |
| Due to other banks | **(70)** | (9) | (18) |
| Financial liabilities at fair value through profit or loss | **-** | - | (1) |
| Other interest expense | **(9)** | (1) | (2) |
| **Total interest expense and similar charges** | **(442)** | (126) | (263) |
| **Net interest income** | **820** | 426 | 851 |

## Section 2: Results for the period (continued)

### 2.3 Non-interest income

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| **Gains less losses on financial instruments at fair value** | | | |
| Held for trading derivatives | **8** | 8 | 16 |
| Other assets and liabilities at fair value[1] | **(4)** | (6) | (13) |
| Ineffectiveness arising from fair value hedges | **(7)** | (1) | - |
| Ineffectiveness arising from cash flow hedges | **(6)** | - | (6) |
| | **(9)** | 1 | (3) |
| **Other operating income** | | | |
| Net fee and commission income | **103** | 72 | 141 |
| Margin on foreign exchange derivative brokerage | **11** | 8 | 18 |
| Other income | **1** | (4) | - |
| | **115** | 76 | 159 |
| **Total non-interest income** | **106** | 77 | 156 |

| | | | |
|---|---|---|---|
| Non-interest income includes the following fee and commission income disaggregated by income type: | | | |
| -Current account and debit card fees | **59** | 57 | 114 |
| -Credit cards | **20** | 6 | 13 |
| -Insurance, protection and investments | **23** | 8 | 13 |
| -Non banking and other fees[2] | **16** | 16 | 32 |
| Total fee and commission income | **118** | 87 | 172 |
| Total fee and commission expense | **(15)** | (15) | (31) |
| **Net fee and commission income** | **103** | 72 | 141 |

(1) A credit risk gain on other assets and liabilities at fair value of £1m, offset by a fair value loss of £5m, has been recognised in the current period (31 March 2018: £2m gain and £8m loss, 30 September 2018: £3m gain and £16m loss).
(2) Non banking and other fees include mortgages, invoice and asset finance, and ATM fees.

## Section 2: Results for the period (continued)

### 2.4 Operating and administrative expenses

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| Personnel expenses | **239** | 113 | 223 |
| Integration costs | **43** | - | - |
| Restructuring and related expense | **-** | 24 | 38 |
| Virgin Money transaction costs | **11** | - | 37 |
| SME transformation | **17** | 5 | 16 |
| Software rationalisation | **127** | - | - |
| Depreciation and amortisation expense | **51** | 43 | 89 |
| Other operating and administrative expenses | **223** | 391 | 727 |
| **Total operating and administrative expenses** | **711** | 576 | 1,130 |

Personnel expenses comprise the following items:

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| Salaries, wages and non-cash benefits and social security costs | **148** | 67 | 139 |
| Defined contribution pension expense | **23** | 19 | 33 |
| Defined benefit pension expense | **11** | 1 | 2 |
| Equity based compensation | **3** | 6 | 9 |
| Other personnel expenses | **54** | 20 | 40 |
| **Personnel expenses** | **239** | 113 | 223 |

On 26 October 2018, the High Court handed down a judgement concluding that defined benefit schemes should equalise pension benefits for men and women in relation to GMP, and concluded on the methods that were appropriate. The estimated increase in liabilities at the date of the judgement was £11m and is based on a number of assumptions and the actual impact may be different. This has been reflected as a past service cost within the defined benefit pension expense above, and in the closing net accounting surplus of the Scheme (note 3.8).

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

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| Operating lease charges | **17** | 14 | 26 |
| PPI redress expense (note 3.6) | **30** | 202 | 352 |
| Other conduct expenses (note 3.6) | **3** | 18 | 44 |
| Separation costs | **2** | 4 | 8 |

## Section 2: Results for the period (continued)

### 2.5 Taxation

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| **Current tax** | | | |
| Current period/year | **22** | 4 | 8 |
| Adjustment in respect of prior periods | **(3)** | 10 | 8 |
| | **19** | 14 | 16 |
| **Deferred tax** (note 3.4) | | | |
| Current period/year | **(8)** | 3 | (1) |
| Adjustment in respect of prior periods | **2** | (36) | (34) |
| | **(6)** | (33) | (35) |
| **Tax expense/(credit) for the period** | **13** | (19) | (19) |

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

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| Profit/(loss) on ordinary activities before tax | **42** | (95) | (164) |
| Tax expense/(credit) based on the standard rate of corporation tax in the UK of 19% (March and September 2018: 19%) | **8** | (18) | (31) |
| *Effects of:* | | | |
| Disallowable expenses | **3** | 24 | 42 |
| Conduct indemnity adjustment | **10** | - | (5) |
| Deferred tax assets recognised | **(16)** | (4) | (8) |
| Banking surcharge | **6** | - | - |
| Impact of rate change | **3** | 5 | 9 |
| Adjustments in respect of prior periods/years | **(1)** | (26) | (26) |
| **Tax expense/(credit) for the period/year** | **13** | (19) | (19) |

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

The increase in the conduct indemnity adjustment reflects a change in anticipated quantum and timing of the use of historic indemnified losses.

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

Banking Surcharge represents the tax incurred by the two banking entities within the Group at the Surcharge rate of 8%.

## Section 2: Results for the period (continued)

### 2.6 Earnings per share (EPS)

| | **6 months to 31 Mar 2019 (unaudited) £m** | 6 months to 31 Mar 2018 (unaudited) £m | 12 months to 30 Sep 2018 (audited) £m |
|---|---|---|---|
| Loss attributable to ordinary shareholders | **(5)** | (94) | (181) |
| Tax relief on AT1 distributions attributable to ordinary equity holders | **5** | 3 | 7 |
| Tax relief on non-controlling interests distributions attributable to ordinary equity holders | **3** | - | - |
| Profit/(loss) attributable to ordinary equity holders for the purposes of basic and diluted earnings/(loss) per share | **3** | (91) | (174) |

| | **31 Mar 2019 Number of shares** | 31 Mar 2018 Number of shares | 30 Sep 2018 Number of shares |
|---|---|---|---|
| Weighted-average number of ordinary shares in issue (millions) | | | |
| - Basic | **1,390** | 885 | 885 |
| - Diluted | **1,391** | 885 | 885 |
| Basic earnings/(loss) per share (pence) | **0.2** | (10.2) | (19.7) |
| Diluted earnings/(loss) per share (pence) | **0.2** | (10.2) | (19.7) |

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

## Section 3: Assets and liabilities

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

| | 31 Mar 2019 (unaudited) £m | 30 Sep 2018 (audited) £m |
|---|---|---|
| **Financial assets at fair value through profit or loss** | | |
| Loans and advances | **292** | 362 |
| Other financial assets at fair value through profit or loss | **13** | - |
| | **305** | 362 |
| **Financial liabilities at fair value through profit or loss** | | |
| Due to customers – term deposits | **8** | 15 |

**Loans and advances**

Included in financial assets at fair value through profit or loss is a historical portfolio of loans (sales ceased in 2012). Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £292m (30 September 2018: £362m) including accrued interest receivable of £1m (30 September 2018: £2m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £6m (30 September 2018: £8m); the change for the current period is a decrease of £2m (30 September 2018: decrease of £3m) of which £1m has been recognised in the income statement.

**Other financial assets at fair value through profit or loss**

Included in other financial assets at fair value through profit or loss are £7m of unlisted securities and £6m deferred consideration receivable which consists of the rights to future commission. These assets were reclassified as a result of the adoption of IFRS 9 (refer to Notes 1.2 and 5.3).

**Due to customers - term deposits**

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

The change in fair value attributable to changes in the Group's credit risk is £Nil (30 September 2018: £Nil). The Group is contractually obligated to pay £0.1m (30 September 2018: £0.3m) less than the carrying amount at maturity to the deposit holder.

### 3.2 Derivative financial instruments

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

| | 31 Mar 2019 (unaudited) £m | 30 Sep 2018 (audited) £m |
|---|---|---|
| **Fair value of derivative financial assets** | | |
| Designated as hedging instruments | **228** | 203 |
| Designated as held for trading | **62** | 59 |
| | **290** | 262 |
| **Fair value of derivative financial liabilities** | | |
| Designated as hedging instruments | **200** | 259 |
| Designated as held for trading | **90** | 102 |
| | **290** | 361 |

Cash collateral on derivatives placed with banks totalled £182m as at 31 March 2019 (30 September 2018: £306m). Cash collateral received on derivatives totalled £14m as at 31 March 2019 (30 September 2018: £37m). These amounts are included within due from and due to other banks respectively. Collateral placed with clearing houses, which did not meet offsetting criteria set out in IAS 32, totalled £111m as at 31 March 2019 (30 September 2018: £143m) and is included within other assets. Collateral received from clearing houses is included in other liabilities and totalled £Nil as at 31 March 2019 (30 September 2018: £34m).

## Section 3: Assets and liabilities (continued)

### 3.2 Derivative financial instruments (continued)

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

| Total derivative contracts | 31 March 2019 (unaudited) Notional contract amount £m | Fair value of assets £m | Fair value of liabilities £m | 30 September 2018 (audited) Notional contract amount £m | Fair value of assets £m | Fair value of liabilities £m |
|---|---|---|---|---|---|---|
| **Derivatives designated as hedging instruments** | | | | | | |
| *Cash flow hedges* | | | | | | |
| Interest rate swaps (gross) | **24,768** | **83** | **97** | 24,570 | 88 | 111 |
| Less: Net settled swaps | **(11,634)** | **(37)** | **(34)** | - | - | - |
| Interest rate swaps (net) | **13,134** | **46** | **63** | 24,570 | 88 | 111 |
| Cross currency swaps | **1,761** | **95** | **-** | 690 | 70 | - |
| | **14,895** | **141** | **63** | 25,260 | 158 | 111 |
| *Fair value hedges* | | | | | | |
| Interest rate swaps (gross) | **29,503** | **143** | **311** | 2,180 | 45 | 148 |
| Less: Net settled swaps | **(25,958)** | **(56)** | **(174)** | - | - | - |
| Interest rate swaps (net) | **3,545** | **87** | **137** | 2,180 | 45 | 148 |
| **Total derivatives designated as hedging instruments** | **18,440** | **228** | **200** | 27,440 | 203 | 259 |
| **Derivatives designated as held for trading** | | | | | | |
| *Foreign exchange rate related contracts* | | | | | | |
| Spot and forward foreign exchange | **2,354** | **34** | **25** | 1,788 | 26 | 23 |
| Cross currency swaps | **181** | **10** | **10** | 455 | 10 | 10 |
| Options | **7** | **-** | **-** | 11 | - | - |
| | **2,542** | **44** | **35** | 2,254 | 36 | 33 |
| *Interest rate related contracts* | | | | | | |
| Swaps (gross) | **5,203** | **28** | **57** | 811 | 15 | 59 |
| Less: Net settled swaps | **(3,294)** | **(14)** | **(8)** | - | - | - |
| Swaps (net) | **1,909** | **14** | **49** | 811 | 15 | 59 |
| Swaptions | **13** | **-** | **1** | 33 | - | - |
| Options | **555** | **1** | **2** | 501 | 1 | 3 |
| | **2,477** | **15** | **52** | 1,345 | 16 | 62 |
| *Commodity related contracts* | **63** | **3** | **3** | 53 | 7 | 7 |
| **Total derivatives designated as held for trading** | **5,082** | **62** | **90** | 3,652 | 59 | 102 |

Derivatives transacted to manage the Group's interest rate exposure on a net portfolio basis are accounted for as either cash flow hedges or fair value hedges as appropriate. Cash flow hedged derivatives include vanilla interest rate swaps and cross currency swaps. Derivatives traded to manage interest rate risk on certain fixed rate assets, such as UK Government Gilts, are accounted for as fair value hedges.

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

## Section 3: Assets and liabilities (continued)

### 3.3 Loans and advances to customers

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| Gross loans and advances to customers | **72,823** | 32,939 |
| Impairment provisions on credit exposures | **(350)** | (195) |
| Fair value hedge adjustment | **132** | - |
| | **72,605** | 32,744 |

Included within gross loans and advances is £672m (30 September 2018: £660m) relating to lease finance receivables.

The Group has a portfolio of fair valued business loans of £292m (30 September 2018: £362m) which are held separately as financial assets at fair value through profit or loss on the balance sheet (note 3.1). Combined with the above this is equivalent to total loans and advances of £72,897m (30 September 2018: £33,106m).

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

### 3.4 Deferred tax

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

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| **Deferred tax assets** | | |
| Tax losses carried forward | **102** | 99 |
| Capital allowances | **102** | 88 |
| Cash flow hedge reserve | **3** | 12 |
| Acquisition accounting adjustments | **45** | - |
| Transitional adjustment - IFRS 9 | **17** | - |
| Transitional adjustment - available for sale reserve | **1** | 1 |
| Employee equity based compensation | **6** | 3 |
| Pension spreading | **8** | - |
| Other | **2** | 3 |
| | **286** | 206 |
| **Deferred tax liabilities** | | |
| Defined benefit pension scheme surplus | **(77)** | (74) |
| Acquisition accounting adjustments | **(55)** | - |
| Gains on unlisted available for sale investments | **-** | (3) |
| Gains on financial instruments at fair value through other comprehensive income | **(1)** | - |
| Other | **(7)** | - |
| | **(140)** | (77) |
| **Net deferred tax balance** | **146** | 129 |

Since 1 April 2017, the statutory rate of UK corporation tax has been 19% and will fall to 17% from 1 April 2020. In accordance with the appropriate accounting standard, these enacted rates are used to measure the value at which assets are expected to be realised and liabilities settled.

The accounting adjustments relating to the acquisition of Virgin Money Holdings (UK) plc (Note 3.10) resulted in a net deferred tax liability of £22m on the date of acquisition, which has subsequently unwound in line with the related unwinding of the fair value adjustments to a net deferred tax liability of £10m at 31 March 2019. The constituent parts of the net liability have been shown as deferred tax assets of £45m and deferred tax liabilities of £55m as they are not expected to unwind at the same time.

In accordance with legislation, the tax relief on the IFRS 9 opening adjustment (Note 1.2) is spread evenly over 10 years and will unwind through entity corporation tax computations across the Group. The IFRS 9 deferred tax asset balance of £17m represents the combination of the Group's transitional position as presented in Note 5.3 and the IFRS 9 transitional element remaining of the Virgin Money Holdings (UK) plc adoption of IFRS 9 on 1 January 2018.

## Section 3: Assets and liabilities (continued)

### 3.4 Deferred tax (continued)

Payments to the pension scheme are expected to be greater than 210% of 2018 contributions and therefore in accordance with the legislation, tax relief is spread over 4 years.

At 31 March 2019, the Group had an unrecognised deferred tax asset of £143m (30 September 2018: £157m) representing trading losses with a gross value of £843m (30 September 2018: £926m). Although there is no prescribed period after which losses expire, a deferred tax asset has not been recognised in respect of these losses as the Directors have insufficient certainty over their recoverability in the foreseeable future.

### 3.5 Due to other banks

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018[1] (audited) £m |
|---|---|---|
| Secured loans | **8,420** | 2,254 |
| Securities sold under agreements to repurchase[2] | **2,590** | 802 |
| Transaction balances with other banks | **34** | 29 |
| Deposits from other banks | **43** | 3 |
| | **11,087** | 3,088 |

(1) The comparative period has been restated in line with the current year presentation. Derivative collateral in relation to clearing houses has been reclassified between other assets / liabilities and due from / to other banks
(2) The underlying securities sold under agreements to repurchase have a carrying value of £4,317m (30 September 2018: £1,172m).

Secured loans comprise amounts drawn under the Term Funding Scheme (including accrued interest).

### 3.6 Provisions for liabilities and charges

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| **PPI redress provision** | | |
| Opening balance | **275** | 422 |
| Charge to the income statement (note 2.4) | **30** | 352 |
| Charge reimbursed under Conduct Indemnity | **-** | 148 |
| Utilised | **(149)** | (647) |
| Closing balance | **156** | 275 |
| **Customer redress and other provisions** | | |
| Opening balance | **41** | 109 |
| Virgin Money provision on acquisition | **11** | - |
| Charge to the income statement | **3** | 44 |
| Utilised | **(30)** | (112) |
| Closing balance | **25** | 41 |
| **Restructuring provision[1]** | | |
| Opening balance | **15** | 23 |
| Virgin Money provision on acquisition | **2** | - |
| Charge to the income statement | **13** | 15 |
| Utilised | **(12)** | (23) |
| Closing balance | **18** | 15 |
| **Total provisions for liabilities and charges** | **199** | 331 |

(1) Restructuring provision includes surplus lease space provision.

## Section 3: Assets and liabilities (continued)

### 3.6 Provisions for liabilities and charges (continued)

**PPI redress**
In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. During the period, the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £30m was required mainly due to the higher volume of information requests received which is driven by the increased activity by claims management companies ahead of the August 2019 industry deadline. It also incorporates a reassessment of the costs of processing cases and the impact of experience adjustments. The total provision raised to date in respect of PPI is £2,670m (30 September 2018: £2,640m), with £156m of this remaining (30 September 2018: £275m) for customer-initiated complaints including costs of administration.

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 and resulted in an increase in operational and administrative costs. As reported previously, this involved the Group re-opening complaints and reviewing the original decision reached in light of the new PPI complaint handling processes. This process was concluded during the year to 30 September 2018 at a cost of £88m.

To 31 March 2019, the Group has received 533,000[(1)] complaints (30 September 2018: 483,000) and has allowed for 42,000 further walk in complaints (30 September 2018: 83,000). This reflects an expectation that the current level of complaints will remain at an elevated level as we approach the time bar in August 2019.

The overall provision is based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including: (i) the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies, the application of a time bar, Plevin, and FCA advertising); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; and (iv) the costs of administration.

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

The table below sets out the key assumptions and the effect on the provision at 31 March 2019 of future, potential, changes in key assumptions:

**Assumptions**

| | Change in assumption | Sensitivity [(2)] |
|---|---|---|
| Number of expected future customer initiated complaints (42,000 new complaints) | +/-10% | £12m |
| Uphold rates: | | |
| Future complaints | +/-1% | £1m |
| Average redress costs[(3)] | +/-1% | £1m |

(1) Of these cases, c13,000 were work in progress as at 31 March 2019 (30 September 2018: c12,000).
(2) 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.
(3) Sensitivity to a change in average redress across customer initiated complaints.

## Section 3: Assets and liabilities (continued)

### 3.6 Provisions for liabilities and charges (continued)

**Customer redress and other provisions**

Other provisions include amounts in respect of a number of non-PPI conduct related matters, legal proceedings, and claims arising in the ordinary course of the Group's business. Over the course of the period, the Group has raised further provisions of £3m in relation to non-PPI conduct matters (note 2.4). The ultimate cost to the Group of these customer redress matters is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. The matters are at varying stages of their life cycle and in certain circumstances, usually early in the life of a potential issue, elements of the potential exposure are contingent. These factors could result in the total cost of review and redress varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required. In addition to the other customer redress provisions, the net income statement impact arising from movements in other provisions was a charge of £3m.

**Conduct Indemnity Deed**

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

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

**Restructuring provision**

Restructuring of the business is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. During the period £13m (30 September 2018: £15m) was provided for in accordance with the requirements of IAS 37. £12m (30 September 2018: £23m) of the total provision was utilised in the period.

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

## Section 3: Assets and liabilities (continued)

### 3.7 Debt securities in issue

| **31 March 2019** | **Medium term notes £m** | **Subordinated debt £m** | **Securitisation £m** | **Covered bonds £m** | **Total (unaudited) £m** |
|---|---|---|---|---|---|
| Carrying value | **1,441** | **722** | **5,164** | **1,198** | **8,525** |
| Fair value hedge adjustments | **23** | **-** | **-** | **55** | **78** |
| Total debt securities | **1,464** | **722** | **5,164** | **1,253** | **8,603** |
| Accrued interest payable | **20** | **9** | **9** | **26** | **64** |
| | **1,484** | **731** | **5,173** | **1,279** | **8,667** |

| 30 September 2018 | Medium term notes £m | Subordinated debt £m | Securitisation £m | Covered bonds £m | Total (audited) £m |
|---|---|---|---|---|---|
| Carrying value | 794 | 476 | 2,949 | 698 | 4,917 |
| Fair value hedge adjustments | (1) | - | - | 34 | 33 |
| Total debt securities | 793 | 476 | 2,949 | 732 | 4,950 |
| Accrued interest payable | 3 | 3 | 7 | 10 | 23 |
| | 796 | 479 | 2,956 | 742 | 4,973 |

The acquisition of Virgin Money on 15 October 2018 resulted in recognition of the following debt securities (excluding accrued interest):

| | Medium term notes £m | Subordinated debt £m | Securitisation £m | Covered bonds £m | Total £m |
|---|---|---|---|---|---|
| Fair value of acquired balances | 647 | - | 2,909 | - | 3,556 |

The Group issued the following debt securities during the period:

| Issue date | Debt security | Initial proceeds |
|---|---|---|
| 14 December 2018 | CYBG PLC Tier 2 capital notes | £250m |
| 19 February 2019 | Lanark 2019-1 1A | $325m |
| 19 February 2019 | Lanark 2019-1 2A | £350m |
| 28 March 2019 | Virgin Money PLC Covered bond | £500m |

The following redemptions occurred during the period with the final redemption value in line with the scheduled programme terms:

| Redemption date | Debt security | Initial proceeds | Final redemption |
|---|---|---|---|
| 23 November 2018 | Lanark 2014-1 2A | £350m | £219m |
| 22 February 2019 | Lanark 2016-1 1A | £750m | £353m |
| 18 March 2019 | Gosforth 2015-1 Class A1 | £500m | £20m |

Any further reductions in the carrying value is as a result of scheduled principal repayments on outstanding securitisation notes.

### 3.8 Retirement benefit obligations

The Group operates a defined benefit scheme, which on 1 August 2017 was closed to future benefit accrual for the majority of current employees. The Group's trading subsidiary, Clydesdale Bank PLC, is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). The Scheme was established under trust on 30 September 2009 as a result of the merger of the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund. The assets of the Scheme are held in a trustee administered fund, with the Trustee responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

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

## Section 3: Assets and liabilities (continued)

### 3.8 Retirement benefit obligations (continued)

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependant relatives for which provision has been made on a basis consistent with the methodology applied to the defined benefit pension scheme. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members.

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

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| Active members' defined benefit obligation | **(26)** | (24) |
| Deferred members' defined benefit obligation | **(2,292)** | (2,131) |
| Pensioner and dependent members' defined benefit obligation | **(1,666)** | (1,591) |
| Total defined benefit obligation | **(3,984)** | (3,746) |
| Fair value of Scheme assets | **4,203** | 3,958 |
| Net defined benefit pension asset | **219** | 212 |
| Post-retirement medical benefits obligations | **(3)** | (3) |

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

### 3.9 Fair value of financial instruments

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

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

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

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

**(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.

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

## Section 3: Assets and liabilities (continued)

### 3.9 Fair value of financial instruments (continued)

| | 31 Mar 2019 (unaudited) | | 30 Sep 2018 (audited) | |
|---|---|---|---|---|
| | **Carrying value £m** | **Fair value £m** | Carrying value £m | Fair value £m |
| **Financial assets** | | | | |
| Loans and advances to customers[(1)] | **72,605** | **72,506** | 32,744 | 32,307 |
| **Financial liabilities** | | | | |
| Due to other banks[(2)] | **11,087** | **10,898** | 3,122 | 3,057 |
| Due to customers[(2)] | **61,882** | **61,951** | 28,904 | 28,968 |
| Debt securities in issue[(3)] | **8,667** | **8,756** | 4,973 | 5,052 |

(1) Loans and advances to customers are categorised as Level 3 in the fair value hierarchy with the exception of £1,119m (30 September 2018: £1,110m) of overdrafts which are categorised as Level 2.
(2) Categorised as Level 2 in the Fair Value Hierarchy.
(3) Categorised as Level 2 in the Fair Value Hierarchy with the exception of £2,220m of listed debt (30 September 2018: £1,279m) which is categorised as level 1.

**(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 at fair value, using the fair value hierarchy described above.

| | Fair value measurement as at 31 Mar 2019 (unaudited) | | | | Fair value measurement as at 30 Sep 2018 (audited) | | | |
|---|---|---|---|---|---|---|---|---|
| | **Level 1 £m** | **Level 2 £m** | **Level 3 £m** | **Total £m** | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **Financial assets** | | | | | | | | |
| Financial instruments at fair value through other comprehensive income | **4,133** | **-** | **-** | **4,133** | - | - | - | - |
| AFS investments | **-** | **-** | **-** | **-** | 1,551 | - | 11 | 1,562 |
| Financial assets at fair value through profit or loss | **-** | **292** | **13** | **305** | - | 362 | - | 362 |
| Derivative financial assets | **-** | **290** | **-** | **290** | - | 262 | - | 262 |
| **Total financial assets at fair value** | **4,133** | **582** | **13** | **4,728** | 1,551 | 624 | 11 | 2,186 |
| **Financial liabilities** | | | | | | | | |
| Financial liabilities at fair value | **-** | **8** | **-** | **8** | - | 15 | - | 15 |
| Derivative financial liabilities | **-** | **290** | **-** | **290** | - | 361 | - | 361 |
| **Total financial liabilities at fair value** | **-** | **298** | **-** | **298** | - | 376 | - | 376 |

(1) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to Notes 1.2 and 5.3.

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

Additional analysis on 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):

## Section 3: Assets and liabilities (continued)

### 3.9 Fair value of financial instruments (continued)

**Level 3 movement analysis:**

| | 6 months to 31 Mar 2019 | | | 12 months to 30 Sep 2018 | | |
|---|---|---|---|---|---|---|
| | **Financial assets available for sale £m** | **Financial assets at fair value through profit or loss £m** | **Financial liabilities at fair value £m** | Financial assets available for sale £m | Financial assets at fair value through profit or loss £m | Financial liabilities at fair value £m |
| Balance at the beginning of the period | **11** | **-** | **-** | 10 | 477 | (26) |
| Transfer to Level 2[1] | **-** | **-** | **-** | - | (477) | 26 |
| Reclassification on adoption of IFRS 9 | **(11)** | **11** | **-** | - | - | - |
| Fair value gains/(losses) recognised[2] | | | | | | |
| In profit or loss - unrealised | **-** | **1** | **-** | 1 | - | - |
| In profit or loss - realised | **-** | **-** | **-** | (1) | - | - |
| In available for sale - unrealised | **-** | **-** | **-** | 1 | - | - |
| Purchases | **-** | **2** | **-** | - | - | - |
| Settlements | **-** | **(1)** | **-** | - | - | - |
| Balance at the end of the period | **-** | **13** | **-** | 11 | - | - |

(1) Changes required as a result of the adoption of IFRS 9 from 1 October 2018. Refer to Notes 1.2 and 5.3.

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

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

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

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 31 March 2019.

| | **Fair value £m** | **Valuation technique** | **Unobservable inputs** | **Low range** | **High range** |
|---|---|---|---|---|---|
| **Financial assets at FVTPL** | | | | | |
| Equity investments | 7 | Discounted cash flow | Contingent litigation risk | 0% | 100% |
| Debt investments | 6 | Discounted cash flow | Funds under management attrition rate | 10% | 20% |

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

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

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

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.

## Section 3: Assets and liabilities (continued)

### 3.10 Acquisition of Virgin Money

On 15 October 2018, the Group acquired all the voting rights in Virgin Money Holdings (UK) plc by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1.5bn. This comprised the fair value of approximately 541m new CYBG PLC ordinary shares in exchange for all Virgin Money shares at a ratio of 1.2125 CYBG shares for each Virgin Money share. Immediately following completion, Virgin Money shareholders owned approximately 38% of the Combined Group (on a fully diluted basis).

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

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

The table below sets out the provisional fair values of the identifiable net assets and liabilities acquired. In accordance with IFRS 3 'Business Combinations', the acquisition accounting will be finalised within 12 months of the acquisition date.

## Section 3: Assets and liabilities (continued)

### 3.10 Acquisition of Virgin Money (continued)

| | Book value at 15 October 2018 £m | Fair value adjustments £m | Fair value at 15 October 2018 £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with central banks | 4,146 | - | 4,146 |
| Due from other banks | 598 | - | 598 |
| Financial instruments at fair value through other comprehensive income[1][2] | 2,028 | - | 2,028 |
| Other financial assets at fair value through profit or loss | 1 | - | 1 |
| Derivative financial instruments | 71 | - | 71 |
| Loans and advances to customers[3] | 37,840 | 34 | 37,874 |
| Property, plant and equipment | 73 | (7) | 66 |
| Intangible assets | 172 | 6 | 178 |
| Deferred tax assets | 23 | 22 | 45 |
| Other assets | 93 | - | 93 |
| **Total assets** | 45,045 | 55 | 45,100 |
| **Liabilities** | | | |
| Due to other banks[3] | 7,171 | (114) | 7,057 |
| Derivative financial instruments | 41 | - | 41 |
| Due to customers | 32,111 | 10 | 32,121 |
| Debt securities in issue | 3,548 | 8 | 3,556 |
| Deferred tax liabilities | - | 44 | 44 |
| Other liabilities | 337 | - | 337 |
| **Total liabilities** | 43,208 | (52) | 43,156 |
| **Net assets** | 1,837 | 107 | 1,944 |

| | |
|---|---|
| **Fair value of net assets acquired** | 1,944 |
| **Fair value of non-controlling interests[4]** | (422) |
| **Goodwill arising on acquisition** | 10 |
| **Total consideration[2][5]** | 1,532 |

(1) Under IFRS 9 'Financial Instruments', debt investments which would previously have been classified in the available for sale category are reclassified to the new fair value through other comprehensive income category.

(2) Adjusted to remove the CYBG debt securities held by Virgin Money.

(3) Included within Loans and advances to customers and Due to other banks is c£300m of fair value assets which will unwind through the income statement over the next 3 to 5 years.

(4) At the acquisition date, Virgin Money had in issue Fixed Rate Resettable AT1 securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these are classified as equity instruments. The Group has not acquired the AT1 securities which remain in issue to third parties, consequently these represent a non-controlling interest. As the AT1 instruments are actively traded, the fair value of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018.

(5) Includes 'shares to be issued' in the future relating to employee share plans in regard to the settlement of the outstanding Virgin Money share awards partially offset by the purchase of 'own shares' (Note 4.1.5).

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

The amounts of net interest income and profit before tax contributed to the Group's consolidated income statement for the period ended 31 March 2019 from the acquired Virgin Money business were £275m and £18m respectively. If the acquisition had occurred on 1 October 2018, the Group's total net interest income for the period would have increased by £22m to £842m and the profit before tax would have decreased by £33m to £9m.

Transaction costs of £40m were incurred by CYBG PLC in relation to the acquisition.

## Section 4: Capital

### 4.1 Equity

#### 4.1.1 Share capital and share premium

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| Share capital | **143** | 89 |
| Share premium | **3** | - |
| Share capital and share premium | **146** | 89 |

| | **31 Mar 2019 (unaudited) Number of shares** | 30 Sep 2018 (audited) Number of shares | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|---|---|
| **Ordinary shares of £0.10 each - allotted, called up, and fully paid** | | | | |
| Opening ordinary share capital | **886,079,959** | 883,606,066 | **89** | 88 |
| Share for share exchange | **540,856,644** | - | **54** | - |
| Issued under employee share schemes | **6,524,834** | 2,473,893 | **-** | 1 |
| Closing ordinary share capital | **1,433,461,437** | 886,079,959 | **143** | 89 |

**Acquisition of Virgin Money**

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

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Company. All shares in issue at 31 March 2019 rank equally with regard to the Company's residual assets.

During the period 6,524,834 (30 September 2018: 2,473,893) ordinary shares were issued under employee share schemes with a nominal value of £0.7m (30 September 2018: £0.2m).

A final dividend in respect of the year ended 30 September 2018 of 3.1p per ordinary share in the Company, amounting to £45m, was paid on 15 February 2019.

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

#### 4.1.2 Other equity instruments

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

- Perpetual securities (fixed 8% up to the first reset date) issued on 8 February 2016 with a nominal value of £450m and optional redemption on 8 December 2022.
- Perpetual securities (fixed 9.25% up to the first reset date) issued on 13 March 2019 with a nominal value of £250m and optional redemption on 8 June 2024.

The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £3m (30 September 2018: £Nil). AT1 distributions of £18m were made in the current period, £13m net of tax (30 September 2018: £36m paid, £29m net of tax, 31 March 2018: £18m paid, £15m net of tax).

#### 4.1.3 Capital reorganisation reserve

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

## Section 4: Capital (continued)

### 4.1.4 Merger reserve

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

### 4.1.5 Other reserves

*Own shares held*

Virgin Money established an Employee Benefit Trust (EBT) in 2011 in connection with the operation of its share plans. On the date of acquisition by CYBG PLC, the shares held in the EBT were converted to CYBG shares at a ratio of 1.2125 CYBG shares for each Virgin Money share. The investment in own shares as at 31 March 2019 is £2m (2018: £Nil). The market value of the shares held in the EBT at 31 March 2019 was £1m (2018: £Nil).

*Deferred shares reserve*

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

*Equity based compensation reserve*

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

*Asset revaluation reserve*

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

*Available for sale reserve*

The available for sale reserve recorded the gains and losses arising from changes in the fair value of available for sale financial assets prior to 1 October 2018. On adoption of IFRS 9 'Financial Instruments' on 1 October 2018 the balance on this reserve was transferred to the FVOCI reserve with £3m being released to retained earnings (Note 5.3).

*FVOCI reserve*

The FVOCI reserve records the unrealised gains and losses arising from changes in the fair value of financial instruments at fair value through other comprehensive income. The movements in this reserve are detailed in the consolidated statement of comprehensive income.

*Cash flow hedge reserve*

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

As at 31 March 2019, the cash flow hedge reserve reflected a cumulative loss of £24m (30 September 2018: £39m cumulative loss). The fair value of derivatives in cash flow hedges increased by £13m in the period (30 September 2018: £58m decrease), and a £0.2m gain (30 September 2018: £3m loss) was recycled to interest income in line with the hedged item affecting profit or loss. A £6m loss (30 September 2018: £6m loss) was transferred to non-interest income due to ineffectiveness arising from cash flow hedges. There was a current tax credit of £5m (30 September 2018: £Nil) and a deferred tax charge of £9m (30 September 2018: credit of £11m).

### 4.1.6 Non-controlling interests

At the acquisition date, Virgin Money had in issue Fixed Rate Resettable AT1 securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these are classified as equity instruments. The Group has not acquired the AT1 securities which remain in issue to third parties, consequently these represent a non-controlling interest. As the AT1 instruments are actively traded, the fair value on acquisition of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018.

Distributions to non-controlling interests of £16m were made in the current period, £13m net of tax (30 September 2018: £Nil, 31 March 2018: £Nil).

## Section 5: Other notes

### 5.1 Contingent liabilities and commitments

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

| | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| Guarantees and assets pledged as collateral security: | | |
| Due in less than 3 months | **23** | 26 |
| Due between 3 months and 1 year | **30** | 36 |
| Due between 1 year and 3 years | **10** | 10 |
| Due between 3 years and 5 years | **10** | 2 |
| Due after 5 years | **43** | 45 |
| | **116** | 119 |
| **Other credit commitments** | | |
| Undrawn formal standby facilities, credit lines and other commitments to lend at call | **14,583** | 7,016 |

**Other contingent liabilities**

*Conduct risk related matters*
There continues to be significant uncertainty and thus judgement is required in determining the quantum of conduct risk related liabilities, with note 3.6 reflecting the Group's current position in relation to redress provisions including those for PPI. The final amount required to settle the Group's potential liabilities for these, and other conduct related matters, is materially uncertain. Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated.

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

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

## Section 5: Other notes (continued)

### 5.2 Related party transactions

Following the acquisition of Virgin Money, the Group has a number of additional related entities. No comparative information is required where the entity only became a related party during the period.

| Assets with related entities | **31 Mar 2019 (unaudited) £m** | 30 Sep 2018 (audited) £m |
|---|---|---|
| **Other assets** | | |
| Commissions and charges due from Virgin Atlantic Airways Limited[1] | **1** | - |
| **Total assets with related entities** | **1** | - |
| | | |
| **Liabilities with related entities** | | |
| | | |
| **Customer deposits** | | |
| The Virgin Money Foundation | **1** | - |
| | | |
| **Other liabilities** | | |
| Group pension deposits | **13** | 36 |
| Commissions and charges due to Virgin Atlantic Airways Limited[1] | **4** | - |
| Trademark licence fees to Virgin Enterprises Limited | **4** | - |
| | **21** | 36 |
| | | |
| **Total liabilities with related entities** | **22** | 36 |
| | | |
| **Non-interest income** | | |
| Net fees and commissions to Virgin Atlantic Airways Limited | **(4)** | - |
| | | |
| **Operating and administrative expenses** | | |
| Trademark licence fees to Virgin Enterprises Limited[2] | **(5)** | - |
| Other costs to Virgin Atlantic Airways Limited | **(1)** | - |
| **Total income statement** | **(10)** | |

(1)The Group incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. £2.7m of cash costs payable to VAA have been deferred to the balance sheet as part of the EIR asset

(2)Licence Fees of £5m were payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark. This contract was previously held by Virgin Money Holdings (UK) plc. However, following the acquisition of Virgin Money Holdings (UK) plc. The contract was renewed directly between CYBG plc and Virgin Enterprises Ltd.

In addition to the above the Group has made donations to the Virgin Money Foundation to enable it to pursue its charitable objectives. The Group has also provided services to the Virgin Money Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the period was £0.3m.

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.2m (31 March 2018: £0.2m, 30 September 2018: £0.3m), were charged to the Group sponsored scheme.

Pension contributions of £55m (31 March 2018: £14m, 30 September 2018: £18m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group. Information on the pension schemes operated by the Group is provided in note 3.8.

During the period to 31 March 2019 the Group paid £0.2m of ordinary dividends to Virgin Group Holdings Ltd.

## Section 5: Other notes (continued)

### 5.3 Transition to IFRS 9 'Financial Instruments' from IAS 39 'Financial Instruments: Recognition and Measurement' and the adoption of IFRS 15 'Revenue from Contracts with Customers'

*IFRS 9*

IFRS 9 replaced IAS 39 as the accounting standard for financial instruments and was adopted (except for the hedge accounting requirements) by the Group with effect from 1 October 2018.

The requirements of IFRS 9 allow for the transitional adjustments to be reflected through the opening retained earnings line, without the need to produce comparative information on an IFRS 9 basis.

The following disclosures summarise the impact on the Group's financial position of adopting IFRS 9 on 1 October 2018[(1)] and set out the changes to the Group's financial asset classifications and impairment loss calculation. The amendments to the Group's accounting policies as a consequence of adopting IFRS 9 can be found in note 1.2 to these interim condensed consolidated financial statements; with further detail on the effect on the Group's critical accounting estimates and judgements in note 1.3. Further disclosures in relation to the adoption of IFRS 9 can be found in the Risk report on pages 37 to 40.

The carrying amount of the Group's financial assets (and financial liability at fair value through profit or loss) at 30 September 2018 under IAS 39 and at 1 October 2018 under IFRS 9 are as follows:

| Financial assets | Measurement under IAS 39 | Measurement under IFRS 9 | IAS 39 carrying amount £m | IFRS 9 carrying amount £m |
|---|---|---|---|---|
| Cash and balances with central banks | Amortised cost | Amortised cost | 6,573 | 6,573 |
| Due from other banks | Amortised cost | Amortised cost | 836 | 836 |
| Financial assets available for sale[(2)] | Available for sale | Fair value through profit or loss | 1,562 | 11 |
| | | Fair value through other comprehensive income | n/a | 1,551 |
| Other financial assets at fair value | Fair value through profit or loss | Fair value through profit or loss | 362 | 362 |
| Derivative financial instruments | Fair value through profit or loss | Fair value through profit or loss | 262 | 262 |
| Loans and advances to customers | Amortised cost | Amortised cost | 32,744 | 32,715 |
| Due from customers on acceptances | Amortised cost | Amortised cost | 4 | 4 |
| **Financial liabilities** | | | | |
| Other financial liabilities at fair value | Fair value through profit or loss | Fair value through profit or loss | 15 | 15 |

(1) The acquisition of Virgin Money on 15 October 2018 has no impact or effect on the Group's disclosures on the transition to IFRS 9, which is based on the Group balance sheet position as at 30 September 2018 which was prior to the acquisition.

(2) The Group's listed securities, comprising of UK Government Securities, and other listed securities (e.g. bonds issued by supra-nationals and AAA rated covered bonds), are held in a business model that is 'to hold to collect and sell' and classified at fair value through other comprehensive income. The Group's unlisted securities, and other financial assets held as available for sale have been classified at fair value through profit or loss.

The changes required (net of deferred tax) to the Group's financial assets and liabilities on adoption of IFRS 9 have been adjusted through the Group's retained earnings figure for 30 September 2018.

## Section 5: Other notes (continued)

### 5.3 Transition to IFRS 9 'Financial Instruments' from IAS 39 'Financial Instruments: Recognition and Measurement' and the adoption of IFRS 15 'Revenue from Contracts with Customers' (continued)

*IFRS 15*

The Group also adopted IFRS 15 'Revenue from Contracts with Customers' with effect from 1 October 2018.

The requirements of IFRS 15 allow for the transitional adjustments to be reflected through the opening retained earnings line, without the need to produce comparative information on an IFRS 15 basis.

The majority of the Group's income was either not in scope for IFRS 15 or was being recognised in a way that was consistent with the requirements of the new standard. The limited exception to this was income recognised in relation to the Group's rights to future commission on the deferred consideration receivable. This was held as an 'other' available for sale financial asset under IAS 39 and reclassified to FVTPL on transition to IFRS 9 as detailed in this note. As a result of this remeasurement, the impact has been the recognition of a further £1m of future commission income on transition to IFRS 15, which has been reflected in increases to both other assets and retained earnings on transition.

The change to the carrying amounts of the Group's assets, liabilities, reserves and retained earnings as at 30 September 2018 as a result of the IFRS 9 and IFRS 15 reclassifications and re-measurements required on 1 October 2018 are as follows:

| | Carrying amount as at 30 Sept 2018 £m | Reclassifications £m | Remeasurement £m | Carrying amount as at 1 Oct 2018 £m | Retained earnings impact as at 1 Oct 2018 £m |
|---|---|---|---|---|---|
| **Financial assets available for sale** | | | | | |
| Opening balance | 1,562 | - | - | 1,562 | - |
| Less: | | | | | |
| Reclassified to other financial assets at fair value | - | (11) | - | (11) | - |
| Reclassified to FVOCI | - | (1,551) | - | (1,551) | - |
| | **1,562** | **(1,562)** | **-** | **-** | **-** |
| **Other financial assets at fair value** | | | | | |
| Opening balance | 362 | - | - | 362 | - |
| Add: | | | | | |
| Reclassified from IAS 39 investments - available for sale | - | 11 | - | 11 | - |
| | **362** | **11** | **-** | **373** | **-** |
| **FVOCI financial assets** | | | | | |
| Opening balance | - | - | - | - | - |
| Add: | | | | | |
| Reclassified from IAS 39 investments - available for sale | - | 1,551 | - | 1,551 | - |
| | **-** | **1,551** | **-** | **1,551** | **-** |
| **Loans and advances to customers at amortised cost** | | | | | |
| Opening balance | 32,744 | - | - | 32,744 | - |
| Less: | | | | | |
| ECL remeasurement | - | - | (29) | (29) | (29) |
| | **32,744** | **-** | **(29)** | **32,715** | **(29)** |
| **Deferred tax assets** | | | | | |
| Opening balance | 206 | - | - | 206 | - |
| Add: | | | | | |
| Remeasurement in ECL | - | - | 7 | 7 | 7 |
| | **206** | **-** | **7** | **213** | **7** |

## Section 5: Other notes (continued)

### 5.3 Transition to IFRS 9 'Financial Instruments' from IAS 39 'Financial Instruments: Recognition and Measurement' and the adoption of IFRS 15 'Revenue from Contracts with Customers' (continued)

| | Carrying amount as at 30 Sept 2018 £m | Reclassifications £m | Remeasurement £m | Carrying amount as at 1 Oct 2018 £m | Retained earnings impact as at 1 Oct 2018 £m |
|---|---|---|---|---|---|
| **Other assets** | | | | | |
| Opening balance | 188 | - | - | 188 | - |
| Add: | | | | | |
| IFRS 15 remeasurement | - | - | 1 | 1 | 1 |
| | **188** | **-** | **1** | **189** | **1** |
| **Available for sale reserve** | | | | | |
| Opening balance | 7 | - | - | 7 | - |
| Less: | | | | | |
| AFS reserve release | - | - | (3) | (3) | (3) |
| Reclassification to FVOCI reserve | - | (4) | - | (4) | - |
| | **7** | **(4)** | **(3)** | **-** | **(3)** |
| **FVOCI reserve** | | | | | |
| Opening balance | - | - | - | - | - |
| Add: | | | | | |
| Reclassification from available for sale reserve | - | 4 | - | 4 | - |
| | **-** | **4** | **-** | **4** | **-** |
| **Retained earnings** | | | | | |
| Opening balance | 2,873 | - | - | 2,873 | |
| Less: | | | | | |
| ECL remeasurement (IFRS 9) | - | - | (29) | (29) | |
| Deferred tax remeasurement (IFRS 9) | - | - | 7 | 7 | |
| AFS reserve release (IFRS 9) | - | - | 3 | 3 | |
| IFRS 15 remeasurement | - | - | 1 | 1 | |
| | **2,873** | **-** | **(18)** | **2,855** | |

The move to IFRS 9 has resulted in a net £19m decrease in retained earnings at 1 October 2018 primarily due to the change in the measurement in impairment losses, which are now calculated on an ECL basis as opposed to the incurred loss methodology used in IAS 39. The calculation and gross impairment loss adjustment of £29m as at 1 October 2018 includes ECLs calculated on loan commitments and financial guarantee contracts, which are not separately disclosed as provisions due to materiality. In addition, while an ECL calculation is also performed on the Group's financial assets held at FVOCI, the resultant impairment provision is not material enough to be reported separately in the above tables.

## Section 5: Other notes (continued)

### 5.4 Notes to the statement of cash flows

| | Term Funding Scheme £m | Debt securities in issue £m | Total £m |
|---|---|---|---|
| At 1 October 2017 | 1,901 | 4,785 | 6,686 |
| **Cash flows:** | | | |
| Issuances | - | 1,546 | 1,546 |
| Redemptions | - | (1,372) | (1,372) |
| Draw downs | 1,250 | - | 1,250 |
| Repayment | (900) | - | (900) |
| **Non-cash flows** | | | - |
| Movement in accrued interest | 3 | 2 | 5 |
| Unrealised foreign exchange movements | - | 30 | 30 |
| Unamortised costs | - | (18) | (18) |
| At 30 September 2018 | 2,254 | 4,973 | 7,227 |
| **Cash flows:** | | | |
| Issuances | - | 1,351 | 1,351 |
| Redemptions | - | (1,288) | (1,288) |
| Draw downs | - | - | - |
| Repayment | (150) | - | (150) |
| **Non-cash flows** | | | |
| Acquisition of TFS and debt securities in issue | 6,389 | 3,548 | 9,937 |
| Fair value adjustments and associated unwind on acquired TFS and debt securities in issue | (80) | 7 | (73) |
| Movement in accrued interest | 7 | 43 | 50 |
| Unrealised foreign exchange movements | - | (12) | (12) |
| Unamortised costs | - | (2) | (2) |
| Other movements | - | 47 | 47 |
| **At 31 March 2019** | **8,420** | **8,667** | **17,087** |

# Measuring financial performance - glossary

**Underlying adjustments to the pro forma view of performance**

In arriving at an underlying basis, the effects of certain items that do not promote an understanding of historical or future trends of earnings or cash flows are removed, as management consider that this presents more comparable results period on period. These items are all significant, and are typically one-off in nature. Additional detail is provided below where considered necessary to further explain the rationale for their exclusion from underlying performance, in particular for new items in the current period or recurring non-underlying items:

| Item | **6 months to 31 Mar 2019 £m** | 6 months to 31 Mar 2018 £m | 6 months to 30 Sep 2018 £m | Reason for exclusion from the Group's current underlying performance |
|---|---|---|---|---|
| **Acquisition and integration costs:** | | | | All costs incurred as a direct result of the acquisition of Virgin Money, or in relation to the resultant integration of the two businesses, have been removed from underlying performance due to the scale and nature of the transaction. Further information on the items is provided below to aid understanding. |
| Integration costs | **(45)** | - | - | These are part of the Group's publicised three year integration plan following the acquisition of Virgin Money and comprise a number of one-off expenses that are required to realise the anticipated cost synergies. |
| Acquisition accounting | **(67)** | - | - | This consists of the unwind of the IFRS 3 fair value adjustments created on the acquisition of Virgin Money in October 2018 (£33m gain) and the IFRS 9 impairment impact on acquired assets (£100m charge). These represent either one-off adjustments or are the scheduled reversals of the accounting adjustments that arose following the fair value exercise required by IFRS 3 when CYBG acquired Virgin Money in October 2018. These will continue to be treated as non-underlying adjustments over the expected three to five-year period until they have been fully reversed. |
| Intangible asset write-off | **(127)** | - | - | The charge for the software write off is significant and has arisen in respect of software assets which are no longer considered to be of value relative to the Group's strategy following the acquisition of Virgin Money. |
| Mortgage EIR adjustments | **80** | - | - | The alignment of accounting practices is a one off exercise arising from the acquisition. |
| Virgin Money transaction costs | **(55)** | - | (39) | These costs related directly to the transaction and comprised legal, advisory and other associated costs required to complete the transaction. |
| **Total acquisition and integration costs** | **(214)** | **-** | **(39)** | |
| **Legacy conduct** | **(33)** | **(220)** | **(176)** | These costs are historical in nature and are not indicative of the Group's current practices. |
| **Restructuring and separation** | **(2)** | **(28)** | **(18)** | These costs were significant in prior periods and related to the Sustain programme, and demerger from NAB, both of which completed in the current period. |
| **Other:** | | | | |
| SME transform-ation | **(17)** | (5) | (11) | These costs are significant and considered to be one-off due to the unique growth opportunities currently available to the Group in respect of its SME business. |
| GMP equalisation cost | **(11)** | - | - | |
| Virgin Money digital bank | **-** | (2) | (1) | |
| Gain on disposal of Visa C shares | **-** | - | 3 | |
| **Total other** | **(28)** | **(7)** | **(9)** | |

# Glossary

For a glossary of terms and abbreviations used within this report refer to pages 245 to 254 of the Group Annual Report and Accounts for the year ended 30 September 2018.

For terms not previously included within the Glossary, or where terms have been redefined refer below:

| | |
|---|---|
| **12 month expected credit loss** | The expected credit loss calculation performed on financial assets where no significant increase in credit risk since origination has been identified. This is also referred to as a 'Stage 1' impairment loss. |
| **Coverage ratio** | Impairment allowance as at the period end shown as a percentage of gross loans and advances as at the period end. |
| **Credit conversion factor (CCF)** | Credit conversion factors are used in determining the exposure at default in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn and off-balance sheet commitments expected to be drawn down at the point of default. |
| **Credit impaired financial assets** | Financial assets that are in default or have an individually assessed provision. This is also referred to as a 'Stage 3' impairment loss and subject to a lifetime expected credit loss calculation. The Group considers 90 days past due as a backstop in determining whether a financial asset is credit impaired. |
| **Credit risk mitigation (CRM)** | Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set-off or netting. |
| **Exposure at default (EAD)** | The estimate of the amount that the customer will owe at the time of default. |
| **IFRS 9** | The new financial instrument accounting standard which was adopted by the Group with effect from 1 October 2018. |
| **IFRS 9 capital transitional arrangement** | As permitted by Article 473a of Regulation (EU) no 575/2013 (CRR) as amended, the accounting impact of adopting IFRS 9 can be spread over a five year transitional period for regulatory purposes. The add back to CET 1 capital is a decreasing percentage of the increase in the IFRS 9 expected credit loss ranging from 95% in the first year to 25% in the fifth year. |
| **Impairment allowances** | An expected credit loss provision held on the balance sheet for financial assets calculated in accordance with IFRS 9. The impairment allowance is calculated as either a 12 month or a lifetime expected credit loss. |
| **Impairment losses** | The expected credit losses calculated in accordance with IFRS 9 and recognised in the income statement with the carrying value of the financial asset reduced by creating an impairment allowance. Impairment losses are calculated as either a 12 month or lifetime expected credit loss. |
| **Lifetime expected credit loss** | The expected credit loss calculation performed on financial assets where a significant increase in credit risk since origination has been identified. This can be either a 'Stage 2' or 'Stage 3' impairment loss depending on whether the financial asset is credit impaired. |
| **Loss given default (LGD)** | The estimate of the loss that the Group will suffer if the customer defaults (incorporating the effect of any collateral held). |

# Glossary (continued)

| | |
|---|---|
| **Net interest margin (NIM)** | Underlying net interest income as a percentage of average interest earning assets for a given period. Underlying net interest income of £728m (30 September 2018: £1,457m) is divided by average interest earning assets for a given period of £85,628m (30 September 2018: £81,742m) (which is then adjusted to exclude short term repos used for liquidity management purposes, fair value adjustments, amounts received under the Conduct Indemnity and not yet utilised, and any associated income). As a result of the exclusions noted above, average interest earning assets used as the denominator have reduced by £173m (30 September 2018: £187m) and the net interest income numerator has reduced by £Nil (30 September 2018: £3m). |
| **Pro forma tangible net asset value per share** | Tangible equity (total equity less intangible assets, AT1 and non-controlling interests) as at the period end divided by the number of ordinary shares in issue at the period end. For comparative periods, the number of ordinary shares in issue used in the calculation is the number of ordinary shares in issue on 15 October 2018 following the acquisition (excluding own shares held). |
| **Pro forma underlying basic earnings per share** | Underlying profit after tax attributable to ordinary equity shareholders, including tax relief on any distributions made to other equity holders and non-controlling interests, divided by the weighted average number of ordinary shares in issue for a given period (excluding own shares held). The weighted average number of ordinary shares in issue assumes that the 540,856,644 shares issued on the acquisition of Virgin Money, was completed on 1 October 2017. |
| **Probability of default** | The probability that a customer will default over either the next 12 months or lifetime of the account. |
| **Significant increase in credit risk** | The assessment performed on financial assets at the reporting date to determine whether a 12-month or lifetime expected credit loss calculation is required. Qualitative and quantitative triggers are assessed in determining whether there has been a significant increase in credit risk since origination. The Group considers 30 days past due as a backstop in determining whether a significant increase in credit risk since origination has occurred. |
| **Statutory basic earnings per share** | Statutory profit/(loss) after tax attributable to ordinary equity shareholders, including tax relief on any distributions made to other equity holders and non-controlling interests, divided by the weighted average number of ordinary shares in issue for a given period (excluding own shares held). |
| **Statutory return on tangible equity** | Statutory profit/(loss) after tax attributable to ordinary equity holders as a percentage of average tangible equity (total equity less intangible assets, AT1 and non-controlling interests) for a given period. |
| **Tangible net asset value per share** | Tangible equity (total equity less intangible assets, AT1 and non-controlling interests) as at the period end divided by the number of ordinary shares in issue at the period end (excluding own shares held). |
| **Underlying profit after tax attributable to ordinary equity holders** | Underlying profit before tax of £286m (30 September 2018: £581m) less tax charge of £68m (30 September 2018: £101m), less AT1 distributions (net of tax relief) of £13m (30 September 2018: £29m), less distributions to non-controlling interests (net of tax relief) of £13m (30 September 2018: £25m) and was equal to £192m (30 September 2018: £426m). The underlying tax charge is calculated by applying the statutory tax rate for the relevant period to the taxable items adjusted on the underlying basis. |
| **Underlying return on tangible equity** | Underlying profit after tax attributable to ordinary equity shareholders, including tax relief on any distributions made to other equity holders and non-controlling interests, as a percentage of average tangible equity (total equity less intangible assets, AT1 and non-controlling interests) for a given period. |

# Abbreviations

| | |
|---|---|
| **AIRB** | Advanced internal ratings-based |
| **CCF** | Credit conversion factor |
| **CRM** | Credit risk mitigation |
| **EAD** | Exposure at default |
| **ECL** | Expected credit loss |
| **EIR** | Effective interest rate |
| **FIRB** | Foundation internal ratings-based |
| **FVOCI** | Fair value through other comprehensive income |
| **FVTPL** | Fair value through profit or loss |
| **GMP** | Guaranteed Minimum Pension |
| **ILO** | International Labour Organisation |
| **POCI** | Purchased or originated credit impaired |
| **SICR** | Significant increase in credit risk |
| **SVR** | Standard variable rate |
| **VAA** | Virgin Atlantic Airways |

Additional information

# Officers and professional advisers

| | |
|---|---|
| **Non-Executive Directors** | |
| **Chairman** | Jim Pettigrew [(1) (4)] |
| **Deputy Chairman and Senior Independent Non-Executive Director** | David Bennett [(1) (2) (3) (4)] |
| **Non-Executive Directors** | Clive Adamson [(2) (3)]<br>Paul Coby [(3)]<br>Geeta Gopalan [(3) (5)]<br>Adrian Grace [(1)]<br>Fiona MacLeod [(1) (3) (4)]<br>Darren Pope [(2) (5)]<br>Dr Teresa Robson-Capps [(2)]<br>Amy Stirling [(5)]<br>Tim Wade [(2) (3)] |
| **Executive Directors** | David Duffy<br>Ian Smith |
| **Company Secretary** | Lorna McMillan |
| **Group General Counsel** | James Peirson |
| **Independent auditors** | Ernst & Young LLP<br>1 Bridgewater Place<br>Water Lane<br>Leeds<br>LS11 5QR |

(1) Member of the Remuneration Committee
(2) Member of the Audit Committee
(3) Member of the Risk Committee
(4) Member of the Governance and Nomination Committee
(5) Appointed on 15 October 2018

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