Virgin Money Group
Annual Report and Accounts

2017

There's Money and There's Virgin Money

About us

With our powerful brand, strong balance sheet and customer-focused culture, we delivered a strong performance for all of our stakeholders in 2017.

What's in this report?

The 2017 Annual Report and Accounts incorporates the Strategic Report and the consolidated Financial Statements, both of which have been approved by the Board of Directors.

On behalf of the Board
Glen Moreno
Chair
26 February 2018

Cover image: Virgin Money Lounge, Manchester

Five year track record

		2017	2016	2015	2014	2013
Growth						
Mortgage balances	£bn	**33.7**	29.7	25.5	21.9	19.6
Credit card balances	£bn	**3.0**	2.4	1.6	1.1	0.8
Total assets	£bn	**41.1**	35.1	30.2	26.5	24.6
Deposit balances	£bn	**30.8**	28.1	25.1	22.4	21.1
Quality						
Cost of risk	%	**0.13**	0.13	0.12	0.07	0.15
Common Equity Tier 1 capital ratio	%	**13.8**	15.2	17.5	19.0	15.5
Total capital ratio	%	**18.1**	20.4	20.2	22.1	18.6
Leverage ratio	%	**3.9**	4.4	4.0	4.1	3.8
Returns						
Statutory total income	£m	**662.7**	581.4	521.9	438.3	383.0
Statutory profit before tax	£m	**262.6**	194.4	138.0	34.0	185.4
Underlying profit before tax	£m	**273.3**	213.3	160.7	104.7	43.6
Net interest margin	%	**1.57**	1.60	1.65	1.50	1.26
Cost:income ratio	%	**52.3**	57.2	63.5	72.5	80.1
Return on tangible equity	%	**14.0**	12.4	10.9	7.4	2.6
Statutory basic earnings per share	p	**37.8**	29.4	22.9	(0.4)	42.4
Underlying basic earnings per share	p	**39.8**	32.7	26.8	18.5	5.6

2017 highlights

Total customer loan balances grew by

+14%

Low cost of risk

0.13%

Return on tangible equity

14.0%

Statutory basic earnings per share

+29%

Alternative performance measures

These results have been prepared in accordance with International Financial Reporting Standards (IFRS). Aspects of the results are adjusted for IPO share based payments, strategic items and fair value (losses)/gains on financial instruments, to reflect underlying performance. Further information, including reconciliations of the Group's statutory and underlying results, is reported on page 48 and in note 2 to the consolidated financial statements.

The Group uses a number of alternative performance measures, including underlying profit, in the analysis and discussion of its business performance and financial position. Further information is provided on page 262.

Non-financial reporting

The Group has complied with the new EU non-financial reporting directive requirements within the strategic report. The non-financial information provided by the Group can be found at:

> Description of business model – page 18

> Principal risks – page 36

> Environmental – page 28

> Employees – pages 14 and 22

> Social matters – page 26

> Human Rights and Modern Slavery statement – page 25

> Anti-bribery statement – page 25

2017 Company highlights

In 2017 we delivered a strong performance for all of our stakeholders. Highlights included:

Company and shareholders

Growth of
37%
in statutory profit after tax

Growth of
28%
in underlying profit before tax

Growth of
9%
in tangible net asset value per share

Final dividend

Recommended final dividend of 4.1 pence per ordinary share. This will result in a total dividend for 2017 of 6.0 pence per share, an increase of 17.6% compared to 2016

Colleagues

More than
3,000
colleagues work for Virgin Money and our latest engagement score of 76% compares well against industry standards

Customers

Increased our overall customer Net Promoter Score (NPS) to
+40
from +29 in 2016, maintaining our position as one of the best-rated retail banks in the UK for customer advocacy

Communities

Virgin Money Giving helped to raise almost
£95 million
for good causes.
Our not-for-profit online donation service has raised more than £600 million for charities since launching in 2009

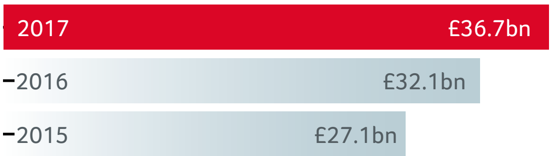
Corporate Partners

Increased our intermediary NPS to
+61
from +55 in 2016. We also won 'Best Lender for Partnership' from Legal & General for the third consecutive year and 'Best Innovative Lender' from Sesame Bankhall Group

Financial highlights

Total customer loan balances

14%
growth

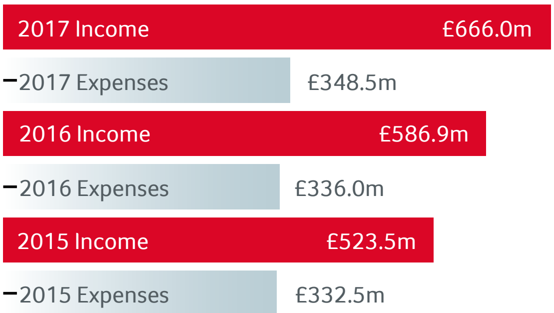


Deposit balances

10%
growth

Positive JAWS

9.8%
13.5% growth in underlying total income against 3.7% growth in expenses

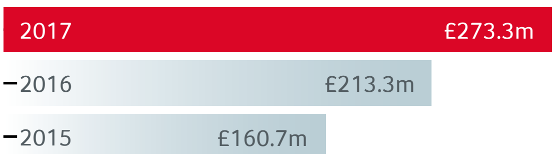


Cost:income ratio

52.3%
for 2017

Underlying profit before tax

28%
growth



Statutory profit after tax

37%
growth

NIM

1.57%
for 2017

2017	1.57%
2016	1.60%
2015	1.65%

Return on tangible equity

14.0%
for 2017

2017	14.0%
2016	12.4%
2015	10.9%

CET1 Ratio

13.8%
for 2017

2017	13.8%
2016	15.2%
2015	17.5%

Tangible net asset value per share

9%
growth

2017	£2.97
2016	£2.73
2015	£2.54

Underlying basic earnings per share

22%
growth

2017	39.8 pence
2016	32.7 pence
2015	26.8 pence

Statutory basic earnings per share

29%
growth

2017	37.8 pence
2016	29.4 pence
2015	22.9 pence

Business performance

Mortgages

We offer customers a range of residential and buy-to-let mortgages in the prime secured lending market. Mortgages are sold predominantly through our intermediary partners and supplemented by direct distribution.

Mortgage balances increased to

£33.7 billion

Growth of 13% was driven by our award-winning intermediary proposition.

Lending to first time buyers increased

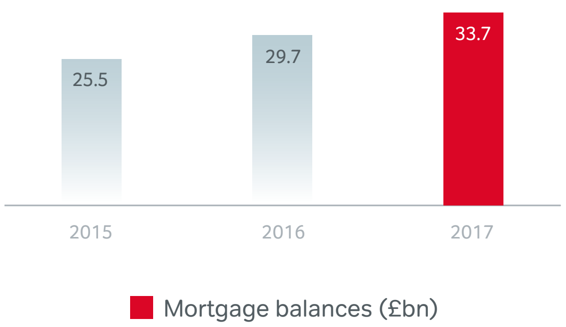
20% year-on-year. New build completions increased by almost 50% year-on-year.

Mortgage retention supported balance growth

72% of mortgage customers selected a new mortgage product with us at the end of their existing deal, up from 68% in 2016.

Mortgage completion spread

168 bps from 187 bps in 2016.



Savings

We offer customers a range of competitively-priced instant access and fixed term savings products, both also available as ISAs. Savings are sold primarily through our digital channels and supplemented by our Stores and contact centres.

Deposit balances increased to

£30.8 billion

Growth of 10% was underpinned by our award-winning ISA proposition.

Cash ISA balances increased to

£16.6 billion

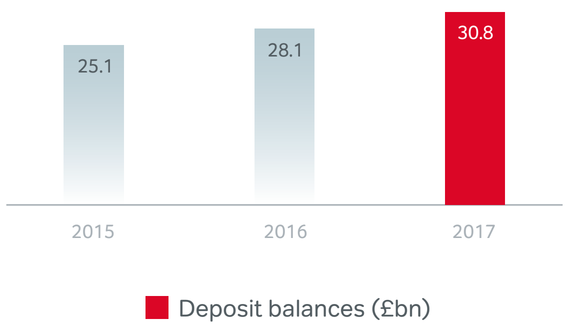
Growth of 27% year-on-year reflected the strong appeal of our ISA products.

Strong retention of savings customers

89% of fixed rate savings customers stayed with us at the end of their product term.

Total cost of funds reduced to

59 bps from 80 bps in 2016.



Credit cards

We offer prime credit quality customers a range of balance transfer and retail credit cards. Cards are sold primarily through our digital channels.

Credit card balances increased to

£3.0 billion

Growth of 24% was achieved while consistently targeting low risk customer segments.

Market share

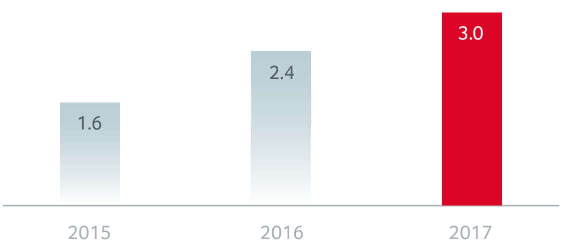
4.1% share of the £71 billion cards market.

Retail spend per active account

+8% retail spend per active account supported by increased customer engagement and 'Virgin Money Back', our new cashback initiative.

Cost of risk

1.51% compared to 1.70% in 2016. reflecting continued low arrears performance.



Credit card balances (£bn)

Financial services

We offer customers investment, insurance and currency services. We work with specialist partners to deliver these propositions, primarily through digital channels.

Funds under management

£3.7 billion

Growth of 10% including the performance of the FTSE All-Share Index.

Stocks & shares ISA sales

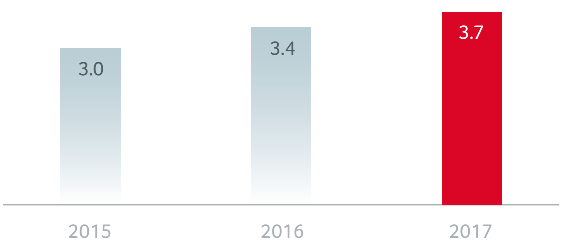
+40% benefitting from the increased £20,000 ISA savings allowance and strong partnership sales through Virgin Atlantic Airways.

Travel insurance NPS

+38 from +35 in 2016 demonstrating the benefit of improvements to the customer journey in our direct channel.

Life insurance

+4,000 policies. Our new life insurance proposition performed well in its first year since launch.



Funds under management (£bn)

Chair's statement

Glen Moreno Chair

I am pleased to report that Virgin Money once again delivered profitable growth despite a year of economic uncertainty and increased competition in the UK banking sector.

Overview and Strategy

2017 was a year of continued strong progress for Virgin Money. The overall performance of the business demonstrated delivery against all three elements of our strategy of growth, quality and returns. We generated market-beating growth across our core products, maintained a high-quality balance sheet and continued to improve operating leverage, resulting in increased profitability.

As a result of this strong financial performance, the Board has recommended a final dividend of 4.1 pence per ordinary share. This will result in a total dividend for the year of 6.0 pence per share, an increase of 17.6 per cent compared to 2016.

The UK banking sector continues to face a number of near-term challenges. The future performance of the UK economy is uncertain. The volume and pace of regulatory change remains high and competitive pressures in our product markets increased during the year.

Against the backdrop of regulatory change and heightened competition, the Board took time to review and refresh our strategy to underpin profitable growth in the long term. As a result of the significant technological and regulatory change impacting UK retail banking, the focus of our refreshed strategy is on broadening our retail customer proposition and launching a range of products and services for the Small and Medium Enterprises (SME) banking market in the UK.

A particular benefit of this strategy is that it will allow us to diversify our funding sources so that we remain competitively funded in an environment of lower asset pricing. We plan to target new sources of funding in the SME deposit market and through our new digital bank, which aims to increase our reach into current accounts and additional savings markets.

Broadening our customer proposition in this way represents a significant strategic step in support of the long-term success of the business and our ability to deliver sustainable value to shareholders.

Our purpose and corporate culture

Our corporate ambition is to make 'everyone better off' (EBO). This means delivering good value to our customers, treating colleagues well, making a positive contribution to society, building positive relationships with our corporate partners and delivering sustainable profits to our shareholders. Our culture is based on this ambition and sustains a virtuous circle which raises awareness of the Virgin Money brand and business as a force for good in the communities in which we work.

We believe that our culture is unique in the UK banking sector. It provides the foundation for our strategy and differentiated approach to banking.

We are dedicated to supporting the communities in which we work to help them flourish, both socially and economically.

Over 13,900 charities have now registered with Virgin Money Giving, our not-for-profit online donation platform, and more than £600 million has been donated to charities through the service since its launch in 2009, including £95 million in 2017.

The Virgin Money Foundation, which tackles social and economic disadvantage, awarded grants of nearly £3 million in 2017. You can read more about how we benefit our stakeholders on page 20.

Remuneration

The remuneration structure at Virgin Money is designed to link reward with the delivery of our strategy of growth, quality and returns. We believe in fair rewards for colleagues whose performance is aligned to delivering long-term and sustainable returns for shareholders.

During the year the business continued to grow strongly producing increased statutory profits, strong capital generation and an increased dividend. As a result, the annual bonus outcome for Executive Directors was set at the upper end of the range of potential outcomes.

More information on how we ensure our approach to remuneration supports the business strategy can be found in our remuneration report on page 95.

Directors

We are committed to ensuring that the Board has the right balance of skills and experience to meet the challenges and opportunities ahead. As a result we review the Board's composition regularly. A number of changes were announced during the year as part of the Board's succession planning to ensure that the Board is well placed for the next phase of the Group's development.

Darren Pope succeeded Norman McLuskie as Chair of the Audit Committee, with Norman assuming the Chair of the Remuneration Committee, succeeding Marilyn Spearing. Additionally, Geeta Gopalan has become Chair of the Risk Committee, succeeding Colin Keogh, who now chairs Virgin Money Unit Trust Managers Limited.

I would like to thank Non-Executive Director Gordon McCallum, who retired from the Board in October 2017, for his significant contribution to the development of Virgin Money over the past 20 years. Amy Stirling was nominated by the Virgin Group to replace Gordon and joined the Board in December 2017.

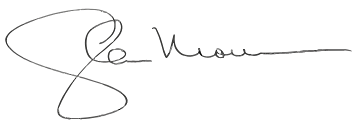
Chair succession

After three years as Chair, I confirmed my intention to retire in 2018 and to return home to the USA. Irene Dorner will join the Board as Chair Elect on 1 March 2018, becoming Chair on 1 April 2018, following my retirement. Irene brings a wealth of retail banking experience at an important time for the Group.

Outlook

We enter 2018 with customer advocacy at its highest ever level and a strongly performing business. Regulatory change and competitive pressures will bring both challenges and opportunities. We have refreshed our strategy to address these issues and to enable the business to continue to grow profitably in the long term. I am pleased that the strength of our core business allows us to fund capital investment and innovation from internal capital resources.

We have made significant progress in my three years as Chair and I would like to reiterate my thanks to the Board, the management team and all colleagues across the business for everything they have done to make Virgin Money succeed.



Glen Moreno
Chair
26 February 2018

Strategic Report
Financial Results
Governance
Risk Management Report
Financial Statements
Other Information

Chief Executive's review

Jayne-Anne Gadhia CBE Chief Executive

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

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

Overview

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

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

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

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

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

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

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

Customers and distribution

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

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

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

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

Business performance

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

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

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

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

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

Regulatory developments

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

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

Refreshed strategy

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

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

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

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

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

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

Colleagues

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

Outlook

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

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

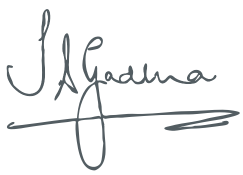
Our natural long term share of the UK mortgage market remains at 3 to 3.5 per cent. In 2018 we expect to grow our mortgage and cards lending at a single digit percentage rate with banking NIM towards the lower end of a 165 to 170 basis points range. Cost discipline will continue as we invest in our strategic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

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

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

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

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



Jayne-Anne Gadhia CBE
Chief Executive
26 February 2018


Lounge Hosts, Virgin Money Lounge, Manchester.

Women in Finance Charter

We are passionate about fairness, equality and inclusion. We are committed to achieving a 50:50 gender balance throughout the business by 2020.

Aim

As part of the UK government's drive to improve economic productivity, I was asked by HM Treasury to review why women make less progress in financial services than in other industries. The 'Empowering Productivity: Harnessing the Talents of Women in Financial Services' report was published in 2016. We found that there are significant barriers to the progress of women and breaking down these barriers will improve results both for the financial services sector and individual businesses, including Virgin Money.

As the Chief Executive, I have taken personal responsibility for addressing these issues at Virgin Money. During 2017 we continued to make good progress towards achieving our 2020 target of a 50:50 gender-balanced workforce.

Meeting the Charter Commitments

I am responsible and accountable for gender diversity and inclusion at Virgin Money. A gender-balanced workforce is good for business, customers, profitability and workplace culture. To meet our Charter commitments:

> we have committed to achieve 50:50 gender balance (within a 10% tolerance) throughout the business by the end of 2020;

> we publish progress against our 50:50 target annually; and

> we have linked annual performance related pay to commitments to promote gender diversity for all members of the Executive Committee.

The last commitment reflects the fact that gender balance should be addressed as a business issue and rewarded as such. As the CEO, one of my five personal objectives in 2017 was to lead the business towards fairness, equality and balance in relation to gender.

Progress in 2017

I am pleased to report that gender balance improved at all levels of the company in 2017:

> female representation within senior management grades increased to 29 per cent, an improvement of 32 per cent; and

> male representation in our entry level roles increased to 27 per cent, an improvement of 8 per cent.

Whilst progress has been made, these two areas will remain a focus given the under-representation of women in senior roles and under-representation of men in customer service positions.

I am pleased to report that we achieved gender balance in hiring and promotions into senior management in 2017. Whilst this represents good progress, the team that reports to the Executive Committee continues to be dominated by men. Men account for 68 per cent of the Executive Committee and their direct reports, and 71 per cent of the wider senior management team. To address this, all members of the Executive Committee have an annual objective to improve gender balance through recruitment, promotion and development. There is no intention to promote or hire women over men. Our aim is to create a genuinely level playing field where both men and women succeed on merit.

Our second area of focus remains gender balance into entry level roles. Whilst we increased male representation in 2017, only 27 per cent of colleagues in customer service positions are men. We are committed to ensuring our Stores and contact centres are equally attractive to men and women as places to work and develop careers.

Action in 2017

When researching and writing 'Empowering Productivity: Harnessing the Talents of Women in Financial Services', it became clear to me there are a number of key issues across the industry which must be addressed in order to develop a fully inclusive workforce at all levels. They include the need to create the right culture, develop supportive line managers and have the technology to support a flexible working environment. In 2017, Virgin Money made progress on these key areas:

Encouraging the right culture

> support to colleagues on maternity leave was enhanced, including the provision of maternity mentoring to encourage and enable continued career development;

> during 2017, 56 per cent of new fathers took extended parental leave at an average of 11 weeks each. Our Shared Parental Leave policy provides colleagues with the equivalent of maternity pay when their partner returns to work; and

> we launched a Returners Programme enabling experienced women and men who may have taken a career break, or are looking to update their skills and knowledge, to transition into new roles. The programme runs over a paid three month term with the possibility of a permanent role on completion.

Investing in supporting people managers

> we delivered 'unconscious bias' training to all our current and aspiring people managers to drive awareness of the issue and to support them in developing strategies to manage it;

- we required all recruitment agencies to provide us with diverse lists of candidates and anonymous profiles, ensuring managers decide who to interview on merit alone. Additionally, we use mixed gender interview panels which reduce the potential for gender bias; and
- we continued to use a gender analysis tool in our annual pay process to help managers understand the impact salary and bonus outcomes have on the gender pay gap as part of their decision making process.

Using technology to promote diversity

- we continued to upgrade our technology to make flexible and home working easier. We have migrated all Stores and offices to our new IT platform, with over half of our colleagues receiving laptops;
- we improved colleague access to learning materials via mobile technology, and enabled colleagues on parental leave to stay in touch through a new app; and
- we launched the Women in Finance Charter app, in conjunction with HM Treasury, to showcase best practice actions companies are taking to improve gender balance.

2017 gender balance

In 2017 we made progress against our target to have a 50:50 gender balanced workforce (within a 10 per cent tolerance) across all levels of the business by the end of 2020:

Level	Reward Group	Headcount %			
		Female 2017	Female 2016	Male 2017	Male 2016
Executive	Exec 1	**31%**	27%	**69%**	73%
	Exec 2	**26%**	21%	**74%**	79%
Management	Band A	**29%**	22%	**71%**	78%
	Band B	**44%**	43%	**56%**	57%
Non Management	Band C	**36%**	34%	**64%**	66%
	Band D	**53%**	52%	**47%**	48%
	Band E	**73%**	75%	**27%**	25%

Female representation in senior management (Executive and Band A) improved to 29 per cent at 31 December 2017, up from 22 per cent as at 31 December 2016.

As defined by the Hampton Alexander review, 31.8 per cent of our Executive Committee and their direct reports were female as of 31 December 2017.

Priorities for 2018

Looking ahead to 2018, we intend to make further progress by continuing to focus on management capability, a flexible working culture and identifying and removing barriers to fairness, equality and inclusion. In particular, we will:

Management capability

- continue to set bonus targets for all Executive Committee members to improve gender balance;
- continue with the formal requirement for gender balance in interview panels and candidate shortlists; and
- take specific action to attract and retain men in entry level and customer-facing roles.

Flexible working culture

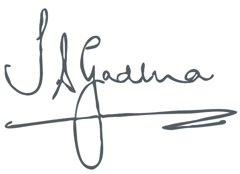
- reduce the formalities associated with requesting flexible working arrangements;
- continue to support parents by promoting shared parental leave and family friendly working practices; and
- pilot a programme to assess a technology solution for contact centre home working.

Removing barriers

- profile senior leaders – who have adopted flexible working arrangements – as role models to encourage wider take-up;
- enhance the skills of our future business leaders through gender balanced development programmes; and
- develop insight and build confidence through our 'Gender Agenda Network', including events to profile and discuss the key issues relating to fairness and inclusion.

I believe it is important to be held to account to deliver the Charter commitments, both at Virgin Money and across the financial services industry. We will continue to report on our progress in the years ahead, both within our annual report and on our website, and we will supplement this with disclosures on our gender pay gap.

I will continue to champion HM Treasury's Women in Finance Charter and I encourage all financial services companies to sign up to its recommendations, set challenging targets and report transparently on progress.



Jayne-Anne Gadhia CBE
Chief Executive
26 February 2018

Market overview

As a UK retail bank we are focused on serving domestic customers and continue to benefit from the resilience of the UK economy and housing market, although there is a degree of uncertainty in the outlook. Important regulatory reforms which will have an impact on our markets take effect in 2018, and we look forward to the longer term opportunities these will create, notably for our digital bank.

UK economy

Gross domestic product (GDP) growth has picked up in recent quarters, having slowed at the beginning of 2017. As a result, UK GDP is estimated to have increased by 1.7 per cent in 2017, slightly below the 1.9 per cent growth experienced in 2016. Consumption growth has been subdued reflecting the squeeze in real incomes following the depreciation of sterling in the aftermath of the EU referendum. Partially offsetting that, net trade has picked up supported by sterling's depreciation and the strength of global growth.

The level of unemployment in the UK fell to a 42-year low of 4.3 per cent and was one of the major economic success stories of 2017. Despite this, real wage growth has remained subdued, as inflation has increased to its highest level in five years. CPI inflation remained around 3 per cent for much of 2017, as imports became more expensive as a result of the lower value of sterling.

In light of the recovery in GDP growth and the reduction in spare capacity in the economy, the Bank of England increased interest rates for the first time in a decade in November 2017 in order to bring inflation back towards the 2 per cent target. Although interest rates are expected to rise gradually over the coming years, they are expected to remain low by historical standards.

The HM Treasury consensus for 2018 predicts that the UK economy will continue to grow, albeit at a somewhat subdued rate. The strength of the global economy is expected to be beneficial for the UK and unemployment is expected to remain at historically low levels. Inflation is likely to fall back gradually and wage growth is expected to pick up. Nonetheless, the macro and political environment, including the impact of the UK leaving the European Union, remains uncertain which adds a degree of caution to our outlook.

Housing and mortgages

The housing market was resilient in 2017 and is expected to see modest growth in 2018. Increasing employment and a gradual pickup in real wages should support the demand for mortgages. The mortgage market is expected to remain highly competitive in 2018. As a result of ring-fencing, high street banks may deploy excess ring-fenced deposits into UK mortgage lending. We also expect that smaller lenders will seek to protect their market share.

Overall, the mortgage market is expected to see modest growth, with UK Finance forecasting that gross lending will be £260 billion in 2018.

Within specific segments, lending to first time buyers looks set to increase further, supported by the tax changes to stamp duty and the £10 billion extension of the Help to Buy scheme. Re-mortgaging will continue to represent a significant volume of overall transactions, as customers look to take advantage of competitive pricing in anticipation of higher interest rates. In contrast, the buy-to-let market is expected to be flat on 2017 as the recent regulatory and taxation changes weigh on customer demand.

Savings

The total retail savings market grew by 3.5 per cent in 2017. This was despite a reduction in the savings ratio in the last three years from 9.3 per cent in 2015 to 4.8 per cent during Q3 2017. In part, this behaviour can be explained by the prevailing low interest rate environment, low wage growth and inflation. Looking forward, the savings ratio is expected to increase modestly in the coming years to exceed 5 per cent by 2022.

Recent personal tax changes have influenced customer behaviour with the introduction of the Personal Savings Allowance reducing the attractiveness of ISA products for certain customers. However, for those customers who continue to favour the ISA savings vehicle, typically higher rate tax payers and customers with historic portfolios, the higher ISA allowance has encouraged larger average balances.

The savings market is also expected to adjust to a rising interest rate environment following a decade of historically low rates. The market for retail savings balances is expected to grow in 2018 at a similar rate to that recorded in 2017. Set against that, there may be increased competition from smaller lenders who have used Bank of England funding schemes, as those schemes come to an end.

Credit cards

Credit card balances in the UK grew by 5.1 per cent in 2017. Although the Bank of England has highlighted risks from the rapid growth in consumer credit, a recent FCA study notes that this growth has been driven by borrowers with higher credit scores who may be less likely to suffer financial distress.

A combination of regulatory concern over the pace of growth in unsecured lending and concerns around consumer indebtedness in the UK is expected to see this rate of growth moderating.

The recent Bank of England credit conditions survey has also highlighted the potential for an increase in impairments across the sector.

Reflecting a more cautious outlook, we expect the market to continue to reduce the length of interest-free promotional periods on new credit cards being issued.

Total outstanding balances on credit cards are expected to continue growing at a rate below recent trends.

Open Banking, PSD2 and GDPR

There are three major components of current regulatory reform coming into force in 2018: Open Banking, PSD2 and GDPR. The common themes through each of these initiatives are innovation, competition and consumer protection.

Customers will be able to bring together all of their financial relationships and data in one place, seamlessly instruct payments and move funds from a single device. The regulations address concerns around security and put a strong authentication and permission framework around customer data.

When taken together, these changes could lead to a fundamental shift in how customers manage both their money and data over the longer term. As a consequence, these changes have the potential to change the nature of competition in UK retail banking.

Ring-fencing

Ring-fencing will require large UK banks to separate their core retail banking services from their investment and international banking activities. A side effect of ring-fencing may be an excess of liquidity for certain large UK ring-fenced banks, which could in turn, lead to heightened competition.

Key opportunities

Optimising returns in mortgage lending: The breadth of our customer proposition and our commercial agility positions us well to serve sections of the mortgage market which offer stronger than average risk adjusted returns, such as lending to first time buyers, without compromising our underwriting discipline.

Changes in technology and regulation: Our refreshed strategy will allow us to take advantage of the significant technological and regulatory changes which will shape UK retail banking in the coming years. PSD2 and Open Banking allow customers to choose to share data from their banking products with third parties. PSD2 and Open Banking represent an opportunity to attract new customers and take market share from the high street banks. Our entry into SME banking and the development of our digital bank will enable us to capitalise on these opportunities, and will diversify our sources of funding to support sustainable value creation for shareholders.

Developing our credit card offering: We will offer an increasingly differentiated range of credit card products for prime credit quality customers. Continued development of our cash back loyalty programme and the introduction of our Virgin Atlantic Airways affinity range of credit cards will continue to diversify our portfolio and support profitable growth.

Key challenges

Competition: The mortgage market remains highly competitive. We will continue to deliver outstanding service to our intermediary partners and target growth in value-accretive market segments. Competition in the savings market may increase with the closure of the TFS. We are diversifying our sources of funding through the development of SME and digital banking, and further developing our wholesale funding programmes.

Economic environment: Uncertainty remains over the future performance of the UK economy with the potential for risks to crystallise if inflation remains higher than wage growth, causing a reduction in households' real earnings. Our lending discipline will continue to support asset quality and the delivery of sustainable returns through the cycle.

Regulatory environment: The volume and pace of regulatory change, including Open Banking, PSD2, GDPR and ring-fencing, remains high. We will continue to invest in our business and ensure compliance with the changing regulatory landscape.

Our business model and strategy

External environment

Our business model is evolving to reflect the external environment in which we operate

- The economic outlook has been strengthened by global growth. Our central planning scenario assumes a continuation of relatively benign economic conditions in 2018 with modest economic growth, unemployment remaining low, a stable UK housing market and the potential for a modest rise in the bank base rate
- The introduction of ring-fencing next year is expected to increase competitive pressures in our main product markets, notably in mortgage pricing
- The volume and pace of regulatory change remains high including Open Banking, PSD2 and GDPR
- The opportunity exists to win customers from the high street banks through digital transformation

Competitive strengths

The core strengths of our business enable us to compete effectively in existing markets as well as to grasp opportunities in digital and SME banking

- We are recognised as one of Britain's most trusted banks and operate with one of the most admired brands in the UK
- We offer customers straightforward and transparent product design
- We acquire prime customers and deliver high-quality asset growth, primarily through secured lending
- Our stable funding base draws on our strong retail savings franchise supplemented by wholesale funding capability
- A low risk appetite is reflected in our low cost of risk
- Multi-channel distribution allows customers to interact with us at their convenience
- Efficiency and cost discipline result in operational leverage and enhanced financial returns

Developing the business

The development of our strategy will result in two new business areas, SME banking and digital banking. These will broaden our customer appeal and provide access to a wider pool of banking revenues and funding sources

- In SME banking we have launched a deposit product as we look to diversify our sources of funding. We plan to launch a Business Current Account by the end of 2018
- The Virgin Money digital bank will take advantage of changes in the regulatory environment and customer behaviour to extend our market reach within retail banking services
- We will explore value accretive opportunities to develop our investment business

Strategic priorities

We are focused on:

- Managing lending growth for value and constantly broadening our customer proposition
- Maintaining our high quality balance sheet at all times
- Accessing lower cost funding in addition to continued operational efficiency to underpin accretive returns in the long term
- EBO – we will ensure the sustainability of our strategy through our focus on providing value to all of our stakeholders

Existing business areas

Lending
Mortgages & credit cards

Deposit taking
Savings & Basic Bank Account

Investment
Investments & pensions

Insurance
Life & travel insurance

2017 key performance indicators

Growth

Number of customers
3.34 million

Customer loans
£36.7 billion

Deposit balances
£30.8 billion

TNAV per share
£2.97

Quality

Cost of risk
13 bps

CET1 ratio
13.8%

Leverage ratio
3.9%

Returns

Return on Tangible Equity
14.0%

Banking NIM
1.72%

Cost:income ratio
52.3% (exit ratio <50%)

Underlying profit before tax
£273.3 million

EBO

Customer NPS
+40

Colleague engagement score
76%

Virgin Money Giving donations
£95 million

Intermediary NPS
+61

Creating future value

Growth

> We will continue to prioritise returns and operate within a stable risk appetite as we continue to grow our mortgage and credit card businesses

> Developing our SME and digital bank proposition will significantly increase our accessible markets, grow customer numbers and drive new sources of funding and income

> The development of our funding franchise targets £10 billion of deposits from new sources within five years of launch

Quality

> Asset quality and balance sheet strength will remain at the heart of our business model and strategy

> Our focus on disciplined credit risk management will support impairment performance through the economic cycle

> The CET1 ratio will remain above 12 per cent at all times

Returns

> Digital bank operating costs will be approximately 40 per cent lower per account than our existing business areas

> Diversification of customer deposit base will drive superior cost of funds

> A broader proposition, lower cost to serve and new sources of funding will drive enhanced returns

EBO

By delivering to our other stakeholders, we reinforce our ability to deliver sustainable value for shareholders.

> We will continue to deliver excellent customer service across a broader proposition

> We will invest further in colleagues to develop and attract the talent we need

> We will roll-out the Virgin Money Foundation to operate nationally

> We will develop deeper relationships with our corporate partners

Delivering for stakeholders

Customers

We delivered further significant improvements in customer advocacy in 2017. More customers than ever before would recommend Virgin Money to their friends and family, with our overall Net Promoter Score (NPS) increasing to +40, up from +29 at 2016.

Aim

We provide our customers with good value products, supported by outstanding service, with the aim of driving stronger customer relationships, deeper product engagement and increased cross-product holdings.

Customer achievements 2017

> We delivered 8.2 per cent growth in mortgage customer numbers during the year, to more than 350,000. Supported by investment in our digital capability, we improved retention at maturity to 72 per cent, from 68 per cent in 2016.

> We now have 1.2 million customers in our credit card business following another year of strong growth. Customer engagement increased as we improved our online service for mobile usage and we now regularly have more than one million visits per month to our online servicing platform. Virgin Money Back, our customer cashback platform, supported an 8 per cent increase in average retail spend per active account;

> We continue to offer our 1.3 million savings customers both good value and sustainable savings rates in the context of the market. This approach continues to deliver improvements to our average cost of retail funds whilst supporting strong retention levels. Average savings accounts per customer increased to 1.3, average balances per customer rose to around £24,000, and retention levels on fixed rate maturities remained strong at 89 per cent;

> Our investment and pensions customers continued to demonstrate brand loyalty and engagement. While customer numbers were stable year-on-year, we achieved a 13 per cent increase in the number of active investment customers;

> The number of customers in our insurance lines was lower than in 2016 as we focused on offering higher quality products at lower volumes and the brand continued to support retention of loyal customers at renewal;

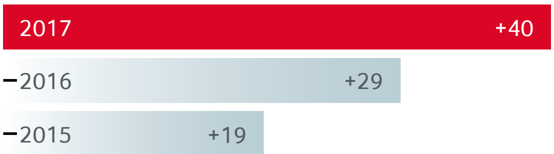
> The proportion of new product sales made to existing customers increased to 12.2 per cent, from 10.7 per cent in 2016; and

> As a result of improving the Virgin Money Giving (VMG) customer journey we now have 1.4 million registered users of our not-for-profit online donation service.

Net Promoter Score (NPS)

Overall customer NPS improved to

+40 in 2017



Increased our customer base to

3.34 million

Increased total registered VMG users to

1.4 million

Virgin Money Lounge, Edinburgh

Customer priorities for 2018

We will:

> Build on our high levels of mortgage retention and continue to focus on prime segments of the mortgage market. This will include support for first time buyers and custom build mortgages. We also expect to enter the specialist buy-to-let portfolio landlord market during 2018;

> Launch our Virgin Atlantic Airways retail financial services partnership. The partnership will offer propositions to a significant number of customers who are already heavily engaged with the Virgin brand;

> Strengthen the relationship with our savers through good value products and pricing that rewards customer loyalty;

> Leverage the strength of the Virgin brand as we broaden our SME savings range in 2018;

> Build significant potential for growth and value through developing our investment and pensions business;

> Build deeper relationships with our VMG customer base by looking to meet their financial needs beyond charitable donations;

> Launch an initial beta model of our digital bank this year, in advance of full launch in 2019; and

> Continue to recognise issues relating to accessibility, financial inclusion and responsible lending.

Supported by our national Store footprint and contact centres, our digital channels continued to be a significant factor in growing the business cost effectively.

Digital engagement in core products

Our digital channels continued to be a significant factor in growing the business cost efficiently in 2017. Our website remains the most popular channel, with over 28 million website visits, up from 22 million in 2016. 78 per cent of sales were delivered digitally during the year and the use of mobile devices to access products and services increased to 52 per cent of all our digital interactions, up from 50 per cent in 2016.

Our aim is to offer our customers access to our products and services using the device of their choice. We will continue to improve our digital capability and customer journeys across current platforms and we are focused on meeting the needs of our customers in a rapidly evolving digital landscape.

We continue to attract a younger, more affluent and digitally active customer base and our new digital bank will make it simpler, faster and more convenient to meet their financial needs.

28 million
website visits

78%
of our sales are through digital channels

52%
use their mobile to access products and services

Stores and Lounges

We continue to value face-to-face interactions with our customers. Alongside our network of 74 Stores, we aim to offer our customers a differentiated banking experience with access to our exclusive customer Lounges. Our seven Lounges continue to deliver strong customer satisfaction with an NPS of +87 and Stores co-located with a Lounge broadly outperform the overall network based on sales performance. As a result of this success we plan to open our eighth Lounge in Cardiff in 2018.

Delivering for stakeholders

Colleagues

Virgin Money's success is built firmly on the commitment, skill and attitudes of all our people and our shared purpose of being a better bank which makes 'everyone better off'.

Aim

Our colleagues are integral to our success; it is through their engagement and advocacy that we are able to deliver strong and sustainable business performance. We aim to provide an environment which nurtures a high performing, diverse and committed workforce where colleagues can reach their full potential.

Colleague achievements 2017

Investing in colleague development

> We launched a digital degree-level apprenticeship as part of a wider programme to extend our use of apprenticeships;

> We gave colleagues access to our online learning materials through their mobile devices; and

> We launched two new development programmes targeting colleagues at different stages of their careers, complementing our award-winning Future Business Leaders programme.

Building colleague engagement

> Colleague engagement remains strong at 76 per cent;

> We launched our new internal mentoring programme, including maternity and diversity related mentoring; and

> We launched an Aspiring Managers programme, to prepare future people managers ahead of promotion.

Creating a diverse workforce

> We signed the Time to Change pledge, aimed at making Virgin Money a better place to work for colleagues who have a mental health disability and we achieved the highest (3rd tier) Disability Confident accreditation;

> We signed the Business in the Community pledge to increase by 12 per cent the number of older people (defined as over 50 years) we employ by 2022;

> We were ranked 95th in Stonewall's Top 100 companies workplace index for LGBT+ inclusivity, advancing 244 places within a year, reflecting our commitment to being an LGBT+ friendly employer; and

> We were accredited as a Best Employer for Race by Business in the Community.

Colleague diversity data

We believe a diverse workforce will drive better business outcomes and create a workplace that is engaging, inclusive and accessible. We saw increased minority representation across all groups in 2017. The table below details our colleague diversity and the progress made in 2017.

		2017	2016
Gender			
Board members	Female	4 (40%)	3 (37%)
	Male	6 (60)%	5 (63%)
Senior managers (excluding CEO)	Female	42 (29%)	31 (21%)
	Male	105 (71%)	114 (79%)
Colleagues	Female	1,854 (56%)	1,758 (56%)
	Male	1,436 (44%)	1,381 (44%)
Percentage of colleagues who identify as LGBT+			
LGBT+		3.5%	3.2%
Percentage of colleagues from an ethnic minority			
Ethnicity		4.9%	4.4%
Percentage of colleagues who disclose they have a disability			
Disability		4.1%	3.0%
Colleagues aged 50 or more			
Multigenerational		568	546

Note: The LGBT+, ethnicity and disability data is derived from the annual colleague survey, for which the 2017 response rate was 89 per cent of permanent colleagues.

The appointment of Irene Dorner as Chair from April will result in a 50:50 gender balanced Board in 2018.

Gender Pay Gap

Virgin Money welcomes the UK government initiative to improve equality through collecting and reporting gender pay data. Our mean gender pay gap reduced by 10 per cent, to 32.5 per cent during 2017.

At Virgin Money men and women are paid equally for doing the same or similar jobs. The Virgin Money gender pay gap is caused by under-representation of women in senior roles and under-representation of men in customer service positions. The under-representation of women in senior roles accounts for approximately one-third of the gender pay gap.

The under-representation of men in customer service positions accounts for approximately 50 per cent of our gender pay gap.

It remains a priority to achieve gender balance throughout the company, achieving 50:50 balance by the end of 2020 (within 10 per cent) at all levels. As we make further progress towards a 50:50 balance, our gender pay gap will continue to reduce.

Details of our gender pay gap can be found on our website.

Colleague priorities for 2018

Investing in colleague development

We will continue our investment in colleague development through:

> expanding our new coaching skills programme to provide tailored development for colleagues;

> launching an online tool kit to enable personalised career planning; and

> expanding our development programme for maternity returners following a successful pilot scheme in 2017.

Building colleague commitment

We will continue to seek increasing levels of engagement from all colleagues through:

> promoting our enhanced pay approach to shared parental leave;

> enabling colleagues to make a difference through the roll out of our work experience programme; and

> obtaining interim feedback more regularly to enable us to action new priorities quickly.

Creating a diverse workforce

Business decision making and colleague engagement will be enhanced by providing an inclusive environment. Our diversity and inclusion activity will continue to be overseen by the People Director, with executive sponsors for each minority group.

In 2017 we improved representation across all minority groups (see table on page 22). To maintain this progress in 2018, we will:

> continue to promote Virgin Money as an inclusive employer, setting targets and deploying recruitment strategies to drive a greater diversity of candidate interest in roles;

> extend our support to enabling flexible working, including the use of technology to improve working from home; and

> drive greater diversity and inclusion with our corporate partners, including launching 'The Accelerator' with the British Black Business Awards to enable greater progression of ethnic minority managers.

Initiatives relating to gender equality are covered in the Women in Finance update on page 14.

Virgin Money Red Hot Awards 2017

Corporate Partners

We work with a number of corporate partners to provide mortgages, investments, insurance and currency services to our customers.

Intermediary partnerships remain a key part of our strategy. Improvements to our award-winning intermediary proposition in 2017 led to new highs in our intermediary NPS, which increased to +61 from +55 in 2016. We also operate strategic partnerships with established providers to provide a broader range of financial services products.

Corporate Partner achievements 2017

> Won the ‘Best Lender for Partnership with Mortgage Club’ at the L&G Mortgage Club annual awards for the third year running;

> Awarded ‘Five Stars’ in the Mortgage category at the Financial Adviser Service Awards;

> Recognised as the ‘Best Mortgage Lender’ at the Mortgage Strategy awards; and

> Partnered with BGL Group to relaunch our Life Insurance proposition.

Mortgage balance growth to

£33.7 billion up 13% in 2017

	2017	2016	2015
Intermediary Net Promoter Score	**+61**	+55	+40
Mortgages Balances (£bn)	**33.7**	29.7	25.5

Corporate Partner priorities 2018

> Maintain outstanding levels of service to our network of professional mortgage intermediary partners in an increasingly competitive mortgage market;

> Launch our new strategic partnership with Virgin Atlantic Airways. The first products will be launched in the first half of 2018; and

> Build on the strength and success of our partnership with Manchester United Football Club.

“Working with Virgin Money to launch their new life insurance product is a natural partnering of two innovative brands which both put the customer at the very heart of the proposition.”

Peter Thompson, Group Director, BGL

“We're pleased to be partnering with Virgin Money on their Custom Build proposition. Together with our intermediary partners we'll give customers real choice and put them in control of designing and building their dream home.”

Rachel Pyne, Operations Director, BuildLoan

Human Rights and Modern Slavery statement

Virgin Money has zero tolerance of slavery, servitude, forced labour and human trafficking (Modern Slavery). We are committed to conducting business with honesty and integrity and treating everyone with dignity and respect. Aimed at further reducing the risk of slavery within our supply chain, we have focused on deepening our understanding of the risks involved and delivered training to key areas of the business. This has driven further review and improvements to our sourcing and procurement processes. We will continue to measure the effectiveness of our approach and improve the mapping of our supply chain to identify areas of risk.

The policy applies to both Virgin Money colleagues and the employees of our partners and suppliers. New suppliers are required to sign a Code of Conduct stating our minimum expectations of human rights standards and labour conditions with which providers are expected to treat employees. To read our Modern Slavery statement in full please visit virginmoney.com.

Anti-Bribery statement

We have a comprehensive Anti-Bribery policy in place which complies with laws and regulations wherever we operate, and applies to all directors, colleagues, and anyone else acting on our behalf. All colleagues, including contractors, complete annual anti-bribery training and are encouraged to report confidentially any instances of suspected bribery.

When we engage in business relationships with third parties, we make sure they have the necessary skills and experience to provide the services we pay them for. All our business partners have to be reputable, reliable and charge a fair market price for their services.

We expect all our existing and potential business partners to have the same ethical standards as Virgin Money. They must comply with the UK Bribery Act and be able to meet our due diligence requirements. To read our Anti-Bribery statement in full please visit virginmoney.com.

Community

We are committed to supporting the communities in which we work to help them flourish, both socially and economically.

Our work covers four key areas – fundraising; investing in education; employability and enterprise; and supporting colleague engagement in their local communities.

Community achievements 2017

> £95 million was donated to charities through Virgin Money Giving, our not-for-profit online donation service;

> Runners in the 2017 Virgin Money London Marathon raised £62 million for charity, setting a new world record for an annual, single day charity fundraising event for the eleventh successive year;

> Our Charity of the Year for 2016/2017 and the official charity of the 2017 Virgin Money London Marathon was Heads Together. As well as changing the conversation on mental health, they raised £1.94 million through the partnership with Virgin Money, including £250,000 raised by colleagues;

> The Virgin Money Foundation awarded grants of nearly £3 million in 2017 to organisations working in areas including housing, employability, youth social action and financial inclusion;

> Our support for the 'LifeSavers' financial education programme has helped over 14,000 young people learn more about money, and our Make £5 Grow programme gave over 24,000 young people the experience of starting a small business;

> Our 'Strive to Thrive' programme has helped 600 young people aged 14 to 19 increase their chances of finding employment through improving their confidence and self-awareness and giving them employability and life skills; and

> Colleagues volunteered 1,555 days to support community activities.

Community priorities 2018

> Continue to invest in Virgin Money Giving to help charities and fundraisers raise more for good causes in the UK;

> Support our Charity of the Year for 2017/2018 and the official charity of the 2018 Virgin Money London Marathon, Teenage Cancer Trust;

> Extend the reach of The Virgin Money Foundation beyond the North East of England, and launch the Heart of the Community Fund through Virgin Money Lounges;

> Continue to invest in a range of programmes which support young people in developing financial, entrepreneurial and employability skills; and

> Support colleagues engaging in national and local community projects and use their business skills to help young people and young businesses flourish.

More than £600 million
raised through Virgin Money Giving, since launch in October 2009

Jazmin Sawyers, GBR Olympic Athlete, congratulates the medalists of the Mini Marathon.
Photo: Virgin Money London Marathon

Managing and reducing environmental impacts

We are committed to taking positive action to eliminate the impact our activities have on the broader environment and continue to target Net Zero Greenhouse Gas (GHG) Emissions by 2030.

Environment achievements 2017

> Secured 100% renewable energy for electricity contracts within our control;

> Increased awareness of environmental initiatives across the Company, including the provision of new tools such as 'Skype for business' which reduces the need for corporate travel;

> Completed our first Carbon Disclosure Project (CDP) submission and worked with industry experts to identify how environmental issues relate to our business; and

> Incorporated environmental assessments into our procurement process to ensure suppliers understand the part they can play in reducing their impact on the environment.

Environment priorities 2018

> Improve our property efficiency by investing in ways to reduce our energy and water usage and the way we dispose of waste;

> Build colleague awareness and engagement on the measures that they can take to support and contribute to our sustainability agenda;

> Build upon the insight we gained from the CDP submission by analysing and interpreting our emissions data to ensure we optimise energy usage; and

> Further review our policies and procedures with a focus on reducing the environmental impact of our corporate travel and the goods and services we buy.

Managing our emissions

The Group is required to report on GHG emissions under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the Regulations). The Group follows the principles of the GHG Protocol Corporate Standard and the Department for Environment, Food and Rural Affairs (DEFRA) Voluntary Reporting 2012 Guidelines (the Guidelines) to calculate its emissions in Scope 1, 2 and 3. We have reported comprehensive data on GHG emissions within Scope 1 and 2, and business travel within Scope 3, since 2014.

Scope for disclosure

> Reported Scope 1 emissions: cover emissions generated from the gas and oil used in all buildings from which the Group operates; emissions generated from Group-owned vehicles used for business travel; and fugitive emissions arising from the use of air-conditioning and chiller/refrigerant equipment to service the Group's property portfolio;

> Reported Scope 2 emissions: cover emissions generated from the use of electricity in all buildings from which the Group operates; and

> Reported Scope 3 emissions: relate to business travel undertaken by all colleagues using rail, private vehicles, hired vehicles, contracted taxi services and air travel.

Emissions

The data gathering process for figures within our Scope 1 and 2 reporting is continuous and calculated using the most accurate information available at the time. If more accurate data becomes available or updated CO_2e emission factors are applied, this may lead to a restatement of data.

GHG emissions CO_2e tonnes

Scope	2017	2016
Scope 1	**1,741.2***	1,753.8
Scope 2	**4,619.2***	4,933.0
Scope 3	**1,027.2**	998.8
Total	**7,387.6**	7,685.6

Intensity ratio

We have chosen to use an intensity ratio of GHG per Full Time Equivalent (FTE). FTE is straightforward to calculate and verify and also normalises consumption in a growing business. We are encouraged by the reduction in this ratio in 2017.

Scope	2017	2016
GHG emissions per average FTE	**2.50 tCO_2e**	2.66 tCO_2e

Independent assurance

Although not required by the Regulations, we appointed PricewaterhouseCoopers LLP (PwC) in 2017 to undertake a limited assurance engagement using the ISAE 3410 assurance standard over the Scope 1 and 2 GHG data highlighted in this report with a (*). Their assurance report is available on virginmoney.com[1].

Use of resources

The table below shows actual consumption in 2017 compared with 2016.

		2017	2016
Energy	Stated in Gwh % from renewable sources	**21.8** **58%**	19.6 56%
Travel	Total miles travelled	**5.8m**	5.7m
Waste	Tonnes produced % sent to landfill	**508.2** **2%**	567.6 2%
Water	Cubic metres per FTE	**10.8**	12.7

Energy – % renewable energy use stated for office, Store and Lounge locations.

Travel – includes all air, rail, taxi and public transport processed through either our corporate travel provider or claimed through personal expenses.

Waste – includes trade and secure waste for offices, Stores and Lounges.

Water – consumption is for metered sites only.

1 The level of assurance provided for a limited assurance engagement is substantially lower than a reasonable assurance agreement. A summary of the work PwC performed is included within their assurance opinion. Non-financial performance information, GHG quantification in particular, is subject to more inherent limitations than financial information. It is important to read the data in the context of PwC's full statement and Virgin Money's reporting guidelines available at virginmoney.com

Risk overview

Risk management

Effective risk management is a core part of our strategy.

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

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

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

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

Achievements in 2017

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

Credit

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

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

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

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

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

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

Capital and funding

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

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

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

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

Risk overview

Risk management

Regulatory initiatives

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

> During 2017, the FCA published its approach to implementing the revised Payment Services Directive (PSD2), which came into force on 13 January 2018. As well as promoting innovation, PSD2 aims to improve consumer protection, increase the security of payments, and reduce the cost of payment services;

> The General Data Protection Regulation (GDPR) provides an updated EU data protection framework to replace the existing 1995 Data Protection Directive (the Directive). GDPR will come into force in May 2018;

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

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

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

Cyber-crime and financial crime risk

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

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

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

Outlook

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

Macro-economic environment

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

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


Virgin Money Lounge, Sheffield

Risk overview

Risk management

Maintaining strong credit quality

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

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

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

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

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

Capital and funding

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

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

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

Macro-structural changes

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

- A capital conservation buffer of 0.625 per cent was introduced on 1 January 2016, and increased to 1.25 per cent on 1 January 2017. This will increase each year to a maximum of 2.5 per cent in 2019. During 2017, the Bank of England increased the countercyclical buffer from 0 per cent to 0.5 per cent of risk-weighted assets. This will come into force in June 2018. A further increase of 0.5 per cent, to 1.0 per cent, will come into force in November 2018, subject to review in the first half of 2018. These changes are fully reflected in our capital and funding plans;

- Minimum Requirements for Own Funds and Eligible Liabilities (MREL) will be fully phased in by 1 January 2022. The Bank of England provided MREL guidance, including transitional arrangements, in late 2016. Prior to 31 December 2019 our MREL requirement will be equal to our minimum regulatory capital requirements. From 1 January 2020 until 31 December 2021, our MREL requirement will be equal to 18 per cent of our risk-weighted assets. This guidance has been fully reflected in our capital and funding plans;
- The Financial Services Banking Reform Act 2013 will result in the ring-fencing of retail banking operations to separate them from investment banking activities. We are in the process of agreeing our detailed ring-fence compliance plans with the PRA and do not anticipate any material change to our structure or business model as a result. We will, however, have to participate directly in inter-bank payments systems and work is well advanced to achieve this;
- IFRS 9 will be implemented in 2018 and will result in a new approach to provisioning and additional disclosure requirements. We have developed new models and business practices to meet these requirements. Additional information regarding IFRS 9 can be found in note 37 to the financial statements; and
- The Basel Committee published their final Basel III framework in December 2017. A key objective of the revisions is to reduce excessive variability of risk-weighted assets (RWAs) and improve the comparability of banks' capital ratios. Implementation dates range from 2022 to 2027 and transitional arrangements will be put in place regarding the new standards. Our initial analysis suggests that the impact of the new requirements will be broadly neutral for us from a capital perspective.

Regulatory change

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

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

Cyber-crime

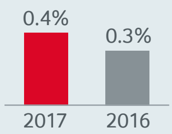
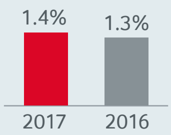
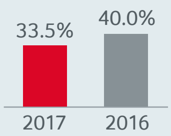
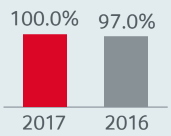
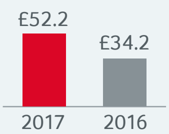
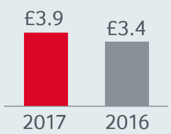
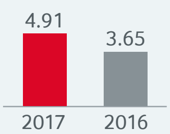
Cyber-crime remains a material risk for all banks and we recognise the pace of change in the external threat environment. We will continue to monitor the external threat landscape and develop our capability to protect against cyber-crime through ongoing enhancement of our control environment and protections.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

Third party administration

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

Risk overview

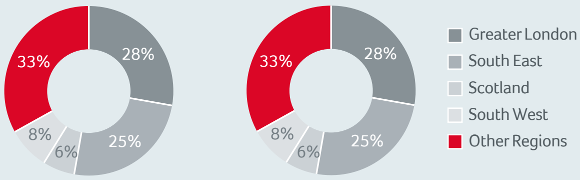
Principal risks	Key mitigating actions
Credit risk Credit risk is the risk of loss resulting from a borrower or counterparty failing to pay amounts due. We provide residential and buy-to-let mortgages and credit cards to customers across the UK. There is a risk that any adverse changes in the macro-economic environment and/or the credit quality or behaviour of borrowers results in additional impairment losses, thereby reducing profitability. Wholesale exposures arise through our liquid asset portfolio and the use of derivative instruments to manage interest rate risk.	> credit risk is managed through risk appetite and risk limits reflected in approved credit policy; > a robust credit risk framework helps ensure that the credit quality and composition of the portfolios remain within risk appetite limits. This is monitored and reported through governance committees regularly; > stress and scenario testing allows us to confirm portfolio resilience; > credit risk metrics are benchmarked against competitors and industry averages; > customer behaviour is closely monitored with timely action taken in response to any adverse change; and > credit risk arising from derivatives and from securities financing transactions is mitigated by collateralising exposures on a daily basis.
Market risk Market risk is the risk that unfavourable market movements lead to a reduction in earnings or value. We do not trade or make markets. Interest rate risk in the banking book is the only material category of market risk.	> market risk is managed through Board-approved risk appetite limits and policies; > exposures are mitigated through the use of natural offsets and derivatives; and > stress and scenario testing focuses on the impacts of differing interest rate environments.
Operational risk Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The management of third party relationships, cyber-crime and information security remains a key focus for Virgin Money.	> risk appetite is focused on maturing the control environment and therefore managing operational risk; > an ongoing programme of investment in security infrastructure is in place to mitigate threats including cyber-attack; > we will continue to invest in and develop risk management frameworks, systems and processes which strengthen operational resilience; and > we monitor external events impacting other financial services companies to inform stress testing.
Conduct risk and compliance Conduct and compliance risk is defined as the risk that our operating model, culture or actions result in unfair outcomes for customers. This could result in regulatory sanction, material financial loss or reputational damage if we fail to design and implement effective operational processes, systems and controls which maintain compliance with all applicable regulatory requirements.	> compliance is maintained through an effective and timely response to changes in the regulatory environment; > the customer is placed at the heart of decision-making by ensuring fair outcomes through comprehensive risk assessment and testing; > we continue to invest in and develop risk management frameworks, systems and processes; and > we focus on training to ensure colleague performance is aligned with the regulatory responsibilities and to enable an awareness of good customer outcomes.

Key risk indicators	Commentary	Future focus
 Impaired as a % of total secured balances;  Impaired as a % of total unsecured balances;  Provisions as a % of impaired balances;  Debt securities % AA or above	Impaired loans as a percentage of overall balances increased but remained at a low level in 2017. Wholesale credit quality remains strong with 100.0% of debt security counterparties rated AA or above. Provisions as a percentage of impaired loans reduced reflecting growth in secured loans with expired terms which do not require increased impairment provisions given the high level of collateral cover on these loans. Expired term loans which are more than six months past their maturity date have an average LTV of 25.8 per cent.	We will continue to deliver strong asset quality aligned to growth of the mortgage and credit card books. We will maintain our 'no loss' position for the wholesale credit portfolio.
 IRRBB – Capital at Risk (£m)	As a consequence of the increase in the size of the balance sheet, Capital at Risk has increased in a positive rate shock scenario. The interest rate risk exposure remains safely within limits.	We will look to refine our interest rate risk management systems and approaches to reflect the evolving regulatory landscape.
 Total operating losses (£m)	The absolute amount of losses has developed in line with business growth, but has remained low.	We will continue to invest in cyber-crime defense, fraud and anti-money laundering infrastructure.
 Total complaints (per 1,000 accounts)	Complaints per 1,000 accounts remained low at 4.91, compared to 3.65 in 2016.	We will focus on our Complaints Transformation project to continue to improve the volume of complaints resolved at first point of contact.

Risk overview

Principal risks	Key mitigating actions	
Strategic and financial risk Strategic risk is the risk of significant loss or damage arising from business decisions that impact the long-term interests of stakeholders or from an inability to adapt to external developments. Financial risk is focused primarily on concentration risk. Credit concentration risk is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels. Increased competition in our key lending markets is leading to a reduction in asset spreads, creating additional financial risk. There is also the potential for increased competition in the deposit taking market as Bank of England funding schemes come to an end. Financial performance can be impacted by adverse changes in customer behaviour.	> Board focus is on ensuring alignment of business development and planning with risk appetite; > we invest in processes, systems, recruitment and training to support new business developments; > we use robust risk and project management disciplines to ensure that implementation is delivered safely; > we continually monitor customer behaviour metrics to identify adverse trends;	> active focus is on asset origination and portfolio management to manage margins and eliminate inappropriate concentration risk; > we will maintain pricing discipline across our product range, ensuring that risk is appropriately rewarded within our Board approved risk appetite; and > regular validation and review of models is performed.
Funding and liquidity risk Liquidity risk represents the inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations to make payments as they fall due. Funding risk represents the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.	> Board-approved risk appetite and funding and liquidity policies define a limit structure; > liquid resources are maintained in adequate quantity and quality to meet stressed outflows;	> a prudent mix of funding sources is maintained with a maturity profile set in risk appetite and policy limits; and > stress and scenario testing considers threats to funding plans and changes in consumer behaviour.
Capital risk Capital risk is defined as the risk that we have a sub-optimal amount or quality of capital or that capital is deployed inefficiently across the Group.	> Board-approved risk appetite ensures we are holding sufficient capital within regulatory requirements; > the capital management policy sets out minimum standards for the management of capital;	> capital procedures are subject to independent oversight; and > stress and scenario testing assesses capital adequacy under a range of severe market wide stress scenarios and idiosyncratic stress events.

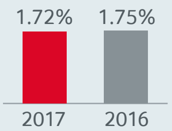
Key risk indicators



Mortgage concentration 2017

Funding mix 2016

Mortgage concentration 2016



Banking NIM

Commentary

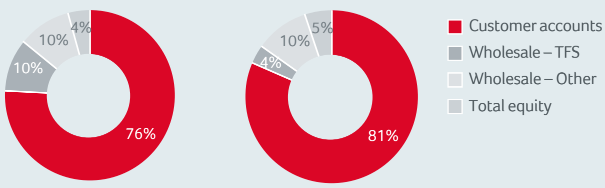
The development of the digital bank and SME propositions will ensure we provide services that meet the future needs of customers and further diversify our business and funding franchises.

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

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

Future focus

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



Funding mix 2017

Funding mix 2016

Commentary

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

Future focus

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

Capital metrics	2017	2016
CET1	13.8%	15.2%
Total capital ratio	18.1%	20.4%
Leverage ratio	3.9%	4.4%

Commentary

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

Future focus

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

Financial results

Daniel Wanjiru KEN, with Kenenisa Bekele ETH and Bedan Karoki Muchiri KEN stand on the podium after the Elite Men's Race. Photo: Virgin Money London Marathon

Summary of Group results

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

> Growth – our market share of new lending continued to outstrip our share of stock resulting in continued growth in balances, with loans and advances to customers increasing by 13.5 per cent. This growth was funded predominantly by the continued strength of the retail deposit franchise with customer deposits growing 9.6 per cent;

> Quality – we maintained a disciplined approach to managing balance sheet growth with consistently high underwriting standards leading to our low and stable cost of risk. Growth in retail deposits was supported by further diversification of our long-term wholesale funding, including additional RMBS and drawings from the Term Funding Scheme (TFS). Capital resources grew through retained earnings and enabled us to absorb additional investment in the build of our new digital bank; and

> Returns – higher balances drove income growth which, combined with disciplined cost control, resulted in strong operational leverage. As a consequence our cost:income ratio improved by 4.9 percentage points to 52.3 per cent for the year. Combined with our growth and low cost of risk, this resulted in a 28.1 per cent increase in underlying profit before tax with return on tangible equity (RoTE) increasing to 14.0 per cent, compared to 12.4 per cent in the prior year. Statutory profit after tax was £192.1 million, a 37.1 per cent increase on 2016.

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

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

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

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

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

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

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

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

Financial results

Summary of Group results

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

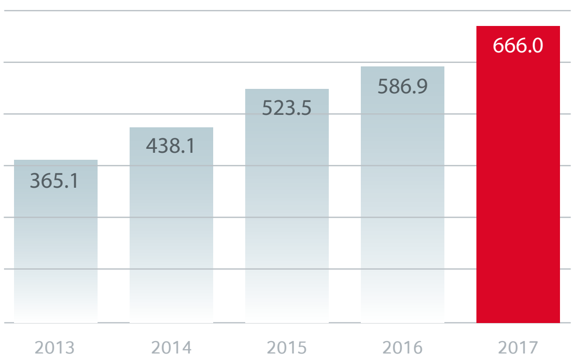
As a consequence of this continued progression, measures of shareholder returns were materially improved. Return on tangible equity increased to 14.0 per cent and underlying basic earnings per share rose by 21.7 per cent to 39.8 pence. Unburdened by legacy issues, growth in underlying profit before tax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

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

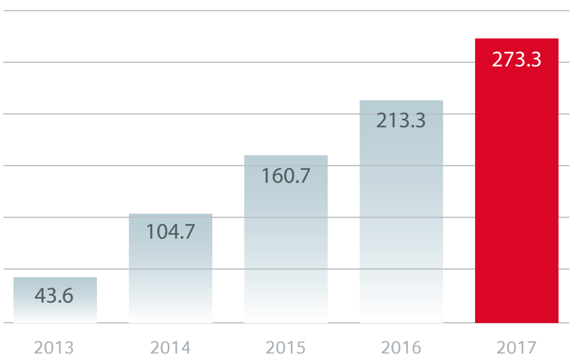
As a result of this strong financial performance, the Board has recommended a final dividend that takes the total dividend in 2017 to 6.0 pence per ordinary share, an increase of 17.6 per cent compared to 2016.

Summary income statement

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



Underlying total income (£m)



Underlying profit before tax (£m)

Consolidated balance sheet

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

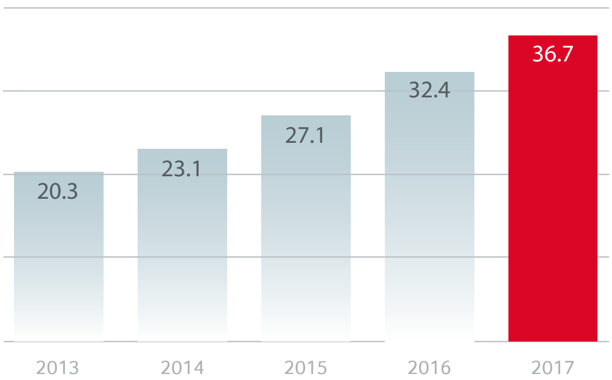
Key metrics

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

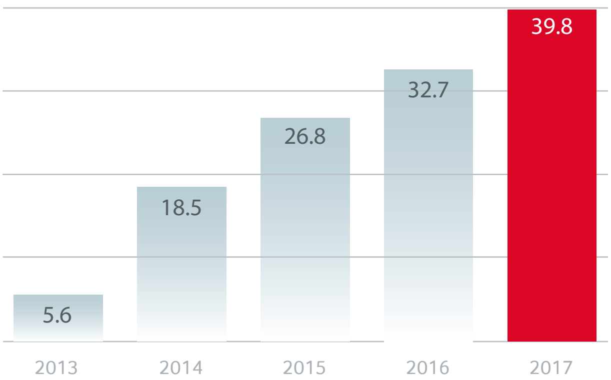
Key ratios are presented on an underlying basis except where stated. Definitions, including bases of calculation, are set out on page 262.

Financial results

Summary of Group results



Loans and advances to customers (£bn)



Underlying basic earnings per share (pence)

Balance sheet growth

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

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

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

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

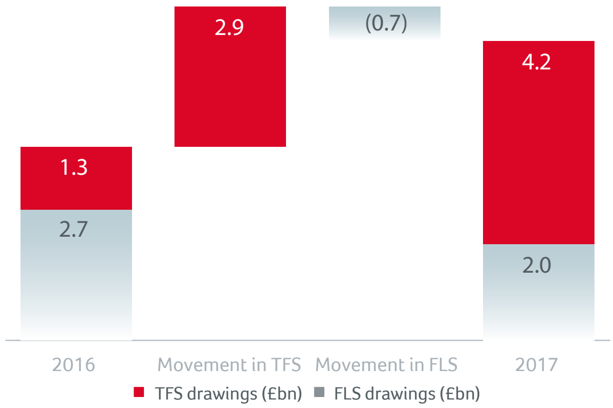
In September 2017 we completed a successful issuance of RMBS through our established 'Gosforth' franchise. This included dollar and sterling tranches and raised sterling equivalent funding of approximately £750 million. The issuance was significantly oversubscribed, delivering long-dated term funding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

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

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

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

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



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

Income benefitted from growth in asset balances

	2017 £m	2016 £m	Change
Net interest income	**594.6**	519.0	14.6%
Other income	**71.4**	67.9	5.2%
Total income	**666.0**	586.9	13.5%
Banking net interest margin	**1.72%**	1.75%	(3)bps
Average interest earning banking assets	**34,536**	29,691	16.3%
Net interest margin	**1.57%**	1.60%	(3)bps
Average interest earning assets	**37,991**	32,521	16.8%

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

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

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

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

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

Financial results

Summary of Group results

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

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

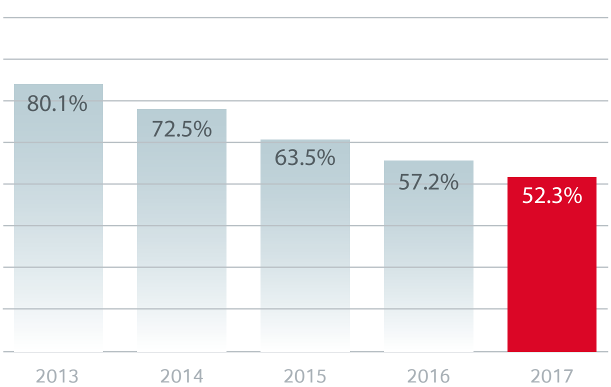
Costs remained tightly controlled

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

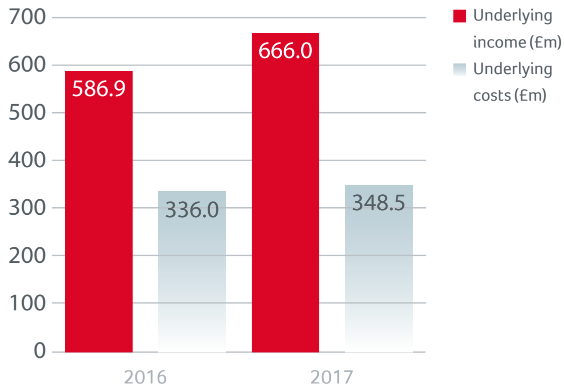
Cost growth in 2017 was constrained to just 3.7 per cent. Set against income growth of 13.5 per cent, this produced positive JAWS of 9.8 per cent and reduced the cost:income ratio by 4.9 percentage points to 52.3 per cent. This performance meant that we successfully achieved our stated target of exiting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

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

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



Cost:income ratio



Operating JAWS

Impairments reflected a resilient economy and rigorous credit risk management

	2017 £m	2016 £m	Change
Mortgages			
Impairment charge	**2.2**	2.8	(21.4)%
Cost of risk	**0.01%**	0.01%	–
Credit Cards			
Impairment charge	**42.0**	34.8	20.7%
Cost of risk	**1.51%**	1.70%	(19)bps
Group			
Impairment charge	**44.2**	37.6	17.6%
Cost of risk	**0.13%**	0.13%	–
Provisions as a % of arrears balances[1]	**32.9%**	29.4%	3.5pp
Impaired loans as a % of loans and advances	**0.5%**	0.4%	0.1pp
Provisions as a % of impaired loans	**33.5%**	40.0%	(6.5)pp

1 Arrears are defined in the risk report on page 140.

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

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

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

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

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

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

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

Financial results

Summary of Group results

Underlying profit before tax to statutory profit before tax reconciliation

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

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

> IPO share based payments

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

> Strategic items

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

> Simplification costs

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

> Fair value losses on financial instruments

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

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

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

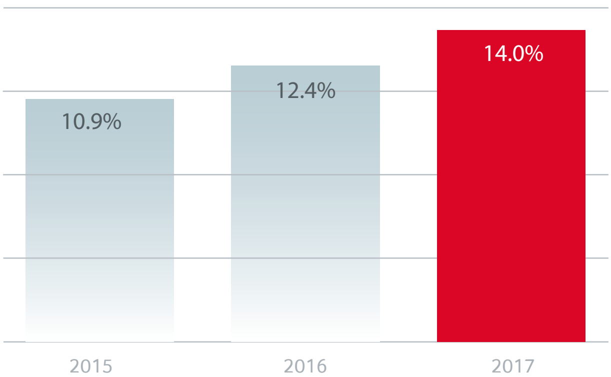
Continued strong progression in returns

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

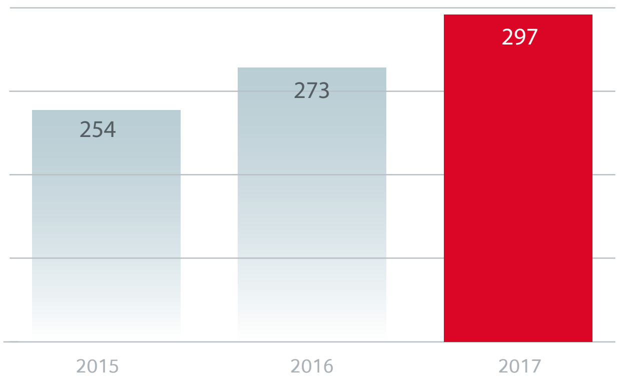
The strength of income growth and improved operational leverage, combined with our asset quality, has driven material enhancement to returns in 2017.

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

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



Return on tangible equity



Tangible net asset value per share (pence)

Financial results

Summary of Group results

Capital strength whilst investing in the future

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

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

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

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

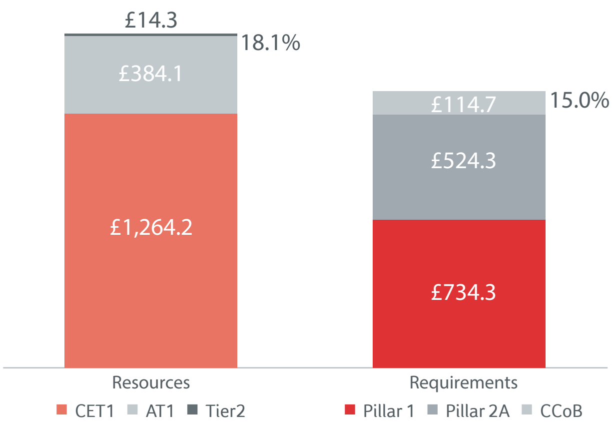
Lending growth resulted in a 19.3 per cent increase in RWAs to £9.2 billion. In mortgages, growth in credit risk RWAs of 21.5 per cent was higher than balance growth of 13.2 per cent as the average mortgage risk weight density, as a percentage of balance sheet assets, increased to 17.2 per cent from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

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

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

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

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



Capital Resources and Requirements – 31 Dec 2017 (£m)

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

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

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

Dividend

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

IFRS 9

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

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

Conclusion

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

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

Peter Bole
Chief Financial Officer
26 February 2018

Financial results

Business line results

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

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

1 Excluding fair value of portfolio hedging

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

Mortgages and Savings

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

Mortgage Strategy

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

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

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

Key developments – Mortgages

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

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

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

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

Prime residential balances grew by 12.5 per cent to £27.3 billion, representing 81.1 per cent of the overall mortgage book and 81.7 per cent of new lending in 2017.

Buy-to-let balances of £6.4 billion represented 18.9 per cent of the overall mortgage book at year end. The private rental sector remains a key component of meeting UK housing demand and we retained a strong presence in the buy-to-let market, particularly in the remortgaging segment.

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

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

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

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

Thanks to developments in our innovative Mortgage Lab, we also made progress on our proposition for customers who wish to use our direct channel. As a result, the proportion of new mortgage applications from direct customers increased

Financial results

Business line results

to 12 per cent in 2017 from 10 per cent in 2016, and exceeded £1 billion for the first time.

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

Savings Strategy

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

Key developments – Savings

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

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

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

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

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

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

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

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

2017 financial highlights – Mortgages and Savings

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

Performance summary – Mortgages and Savings

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

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

Financial results

Business line results

Credit Cards

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

Strategy

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

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

Key developments

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

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

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

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

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

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

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

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

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

2017 financial highlights – Credit Cards

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

Performance summary – Credit Cards

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

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

Financial results

Business line results

Financial Services

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

Strategy

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

Key developments

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

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

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

2017 financial highlights – Financial Services

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

Performance summary – Financial Services

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

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

Central Functions

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

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

Key developments

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

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

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

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

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

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

2017 financial highlights – Central Functions

> interest income and expense incurred from Treasury funding and liquidity operations is allocated to the Mortgage, Savings and Credit Cards businesses;

> other income is primarily driven by gains from the sale of available-for-sale assets and debt securities. In 2017 this included a gain of £6.1 million arising from the sale of our investment in Vocalink. 2016 other income included a gain of £5.3 million on the investment held in Visa Europe;

> operating costs remained tightly controlled with continuous improvement across the organisation. In our savings operation the implementation of additional automation led to a 21 per cent improvement in new accounts opened per FTE.

> an £8.5 million increase in depreciation and amortisation arose from capital expenditure in prior years, as we continued to invest in the future of the bank; and

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

Financial results

Business line results

Performance summary – Central Functions

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

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

Operating Costs

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

Governance

Virgin Money Lounge, Sheffield

Letter from the Chair

"Effective and transparent corporate governance is a priority of the Board, facilitating the delivery of our strategy and creating sustainable value."

Dear Shareholders

I am pleased to present our Corporate Governance Report for 2017. This report sets out our approach to governance in practice, the work of the Board in 2017 and includes reports from the Nomination Committee, the Audit Committee and the Board Risk Committee. The report from the Remuneration Committee is included in the Directors' Remuneration Report.

The Board's approach is to ensure that the Group applies the highest principles of corporate governance and that such principles are embedded into the culture and operations of the business. Our commitment to good governance underpins our strategy and ensures we continually challenge our assumptions and risks.

Board composition and succession

After three years as Chair, I confirmed my intention to retire from the Board in 2018 and return home to the USA. I am grateful to Norman McLuskie, our Senior Independent Director, for leading a rigorous process for the Nomination Committee to appoint my successor. The Board have unanimously chosen Irene Dorner as Virgin Money's next Chair. We were impressed with her character and integrity, her extensive business experience in the UK and abroad, and her detailed knowledge of retail banking. As announced on 15 February 2018, Irene will join the Board as Chair Elect on 1 March 2018 and will take over as Chair on 1 April 2018 following my retirement. I look forward to working with Irene to ensure a smooth handover. An overview of the recruitment process undertaken by the Nomination Committee is included on page 83.

Succession planning and the composition of the Board remained a key focus. During 2017, Darren Pope, Eva Eisenschimmel, Peter Bole and Amy Stirling joined the Board and Marilyn Spearing and Gordon McCallum retired from the Board. Further detail on Board and Committee changes in the year can be found at page 82.

We remain committed to increasing the diversity of the Board in the broadest sense while maintaining the necessary levels of skills and experience required to oversee a business operating in a heavily regulated industry. We are pleased to report we will achieve our stated goal of a balanced Board during 2018.

Strategic planning

A key focus for the Board this year has been the development of our refreshed strategic plan. The Board has a significant role to play in determining the purpose of the Group and ensuring that the Group's values, strategy and business model are all aligned so as to create sustainable value for our shareholders, customers, colleagues, corporate partners and the communities in which we operate. A summary of our strategy is outlined on page 18.

Against an increasingly competitive landscape, the Board has spent time discussing the risks arising from the current macro-economic environment and forthcoming structural and regulatory changes.

Culture

Virgin Money's culture is defined through our mission to make 'everyone better off' (EBO). Strong governance underpins a strong culture and it is important that the Board leads by example and ensures that good standards of behaviour permeate throughout all levels of the organisation. Virgin Money's culture provides the foundation for our strategy and the most recent results of the colleague engagement survey show that 90 per cent of our colleagues understand how the EBO culture applies to their role.

Board effectiveness

As Chair, my responsibility is to provide leadership and to ensure that the Board environment allows for effective challenge resulting in high quality decision-making. The annual Board effectiveness review continues to provide a valuable opportunity for the Board to reflect on how it operates and to propose any improvements. In line with the UK Corporate Governance Code (Code) requirements, we will undertake an external Board effectiveness review in 2018. This year I led an internal review with the assistance of the Company Secretary. Information on the process and outcomes can be found on pages 78 and 79.

Regulatory framework

Regulatory change remains a key focus of the Board. Details of our plans for the implementation of projects such as PSD2, GDPR, ring-fencing and MiFID II are set out on pages 32 and 130. In addition, we have participated in the FRC's consultation on changes to the Code and look forward to reviewing the outcome during 2018.

Looking ahead

Looking forward to 2018, our corporate governance priorities will be to ensure we are ready to comply with the provisions of the new Code and implement the actions from the 2017 internal Board effectiveness review.

It has been an honour to chair the Virgin Money Board over the past three years. I would like to thank each of the Directors for their continuous support and commitment throughout my time as Chair. I believe Virgin Money is very well placed to make the most of the many opportunities that exist, and offer all colleagues my best wishes for success in the years ahead.

Glen Moreno
Chair
26 February 2018

Relaxing in the Virgin Money Lounge, Manchester

Board of Directors


1


2


3


4


5


6


7


8


9


10

Company
Secretary

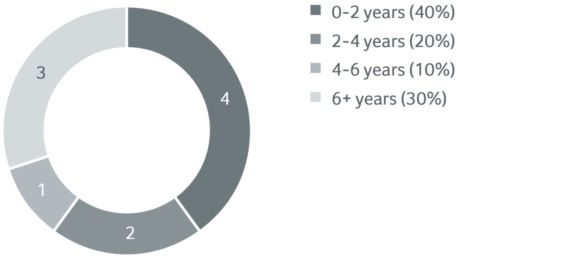
Chair Elect
to join the Board
1 March 2018


11


12

This information is provided as at 31 December 2017

Board composition by tenure

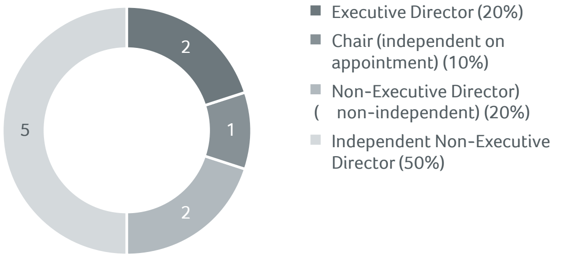


Board composition by gender

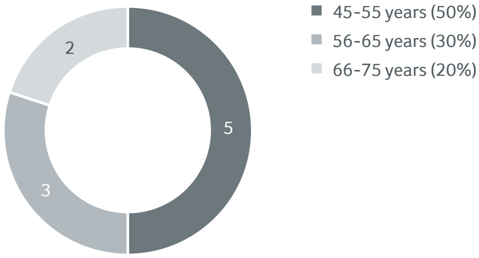
Proforma 2018 position

- Men (50%)
- Women (50%)

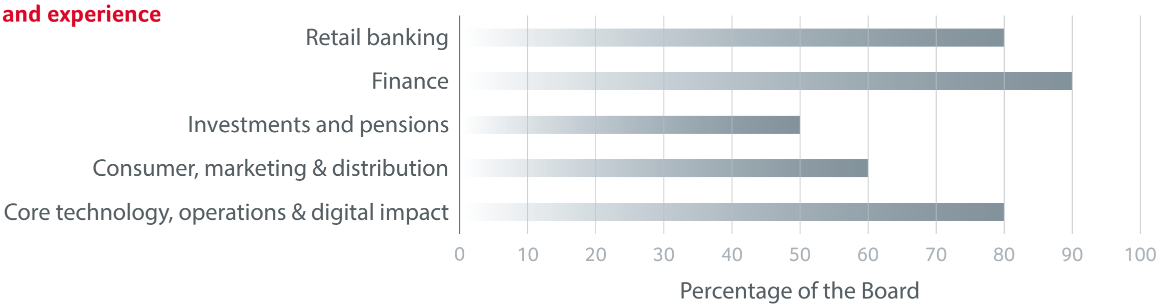
Board composition by role



Board composition by age



Skills and experience



Board of Directors

Directors

1 Glen Moreno

N

Chair

Appointed:
January 2015 (Board), May 2015 (Chair). Glen will retire from the Board on 31 March 2018.

Skills and experience:
Glen has almost 50 years of experience in business and finance. He spent his early career at Citigroup where he held senior positions in Europe and Asia and was a member of the Policy Committee. He was subsequently Chief Executive of Fidelity International Limited. Glen previously held Non-Executive Director roles as Chair of Pearson plc, Senior Independent Director at Man Group, Senior Independent Director and Deputy Chair at Lloyds Banking Group plc and Deputy Chair of the Financial Reporting Council. Glen has also served as a Non-Executive Director and Chair of the Audit Committee of Promotora de Informaciones SA.

External appointments:
Non-Executive Director and Chair of the Capital Committee of Fidelity International Limited.

2 Norman McLuskie

Re A N Ri

Senior Independent Director

Appointed:
January 2010

Skills and experience:
Norman has over 35 years of experience in financial services. He previously held a number of board positions at the Royal Bank of Scotland Group (RBS), including Deputy Chief Executive and a Non-Executive Director of RBS Insurance. He was also Chair of Mastercard Europe. He is a chartered accountant and a fellow of the Chartered Institute of Bankers in Scotland.

External appointments:
None.

KEY

Member of Audit Committee	A	Member of Remuneration Committee	Re
Member of Board Risk Committee	Ri	Committee Chair	
Member of Nomination Committee	N		

3 Colin Keogh

A N Ri

Independent Non-Executive Director

Appointed:
January 2010

Skills and experience:
Colin has over 30 years of experience in financial services, during which he has held a number of senior management and board positions. Colin was Chief Executive of Close Brothers plc. He previously held Non-Executive Director roles at Brait SE, New World Resources plc and Emerald Plantation Holdings Limited.

External appointments:
Senior Independent Director and Chair of the Remuneration Committee of Hiscox Limited, Chair of Premium Credit Limited and Non-Executive Director of M&G Group Limited.

4 Geeta Gopalan

Ri A N Re

Independent Non-Executive Director

Appointed:
June 2015

Skills and experience:
Geeta has over 25 years of experience of financial services and retail banking, particularly payments and digital innovation. Geeta was Director of Payment Services with HBOS plc and previously Managing Director, UK Retail Bank and Business Development Head EME at Citigroup. Geeta was formerly the Chair of Monitise Europe. She is a chartered accountant.

External appointments:
Non-Executive Director of Ultra Electronic Holdings plc and Wizink Bank SA, of which she is Chair of the Audit and Risk Committee. Geeta is also a Non-Executive Member and Vice Chair of the England Committee of the Big Lottery Fund.

5 Eva Eisenschimmel

Re A N Ri

Independent Non-Executive Director

Appointed:
January 2017

Skills and experience:
Eva has 30 years of experience as a brand and marketing professional. She was previously Managing Director of Marketing, Brands and Culture at Lloyds Banking Group plc, Chief Customer Officer at Regus plc, and Chief People and Brand Officer at EDF Energy. Eva has also held senior positions at Allied Domecq and British Airways.

External appointments:
Chief of Staff at Lowell.

6 Darren Pope

A Re N Ri

Independent Non-Executive Director

Appointed:
March 2017

Skills and experience:
Darren has over 30 years of experience in retail banking and financial services. Darren held the post of Chief Financial Officer of TSB Bank plc, having taken a lead role in the design and divestment of the TSB business from Lloyds Bank plc and its subsequent IPO and takeover. He previously held a number of executive and senior roles at Lloyds Banking Group plc including Retail Bank Commercial Director. He is a fellow of the Chartered Institute of Certified Accountants.

External appointments:
Independent Non-Executive Director and Chair of Audit Committee of Equiniti Group plc.

7 Patrick McCall[1]

Non-Executive Director/VEL Nominee Director

Appointed:
June 2012

Skills and experience:
Patrick is a senior executive in the Virgin Group. He has extensive board, financial and management experience across a range of sectors including financial services, retail, travel and healthcare. Patrick was previously an investment banker at SG Warburg.

External appointments:
Senior Managing Director of the Virgin Group and Non-Executive Director of Virgin Active and Virgin Trains East Coast, Co-Chair of Virgin Rail Group and Chair of Virgin Galactic and Virgin Orbit.

1 Appointed as the representative director of Virgin Enterprises Limited (VEL) pursuant to the terms of the Virgin Money Trade Mark Licence Agreement.

8 Amy Stirling[2]

N

Non-Executive Director/
Virgin Nominee Director

Appointed:
December 2017

Skills and experience:
Amy is Chief Financial Officer of the Virgin Group. She has extensive board, financial and management experience from senior and board roles in a range of sectors including telecommunications, financial services and commerce. She was previously Non-Executive Director at Pets at Home and the UK Cabinet Office. Amy is a chartered accountant.

External appointments:
Chief Financial Officer of the Virgin Group and Non-Executive Director and member of the Audit and Risk Committee and the Valuation Committee at RIT Capital Partners plc.

9 Jayne-Anne Gadhia CBE

Executive Director and Chief Executive

Appointed:
March 2007

Skills and experience:
Jayne-Anne has 30 years of experience in finance and banking. She was one of the founders of Virgin Direct, launching the Virgin One Account in 1998. Following the acquisition by RBS of the Virgin One Account, Jayne-Anne went on to lead a number of RBS business units, ultimately joining the RBS Retail Executive Board where she was responsible for RBS's mortgage business. Jayne-Anne re-joined Virgin Money as Chief Executive in 2007. She is a chartered accountant.

External appointments:
Trustee of Tate (Government appointment) and Chair of The Great Steward of Scotland's Dumfries House Trust[3]. Jayne-Anne has a number of advisory roles including as a director of UK Finance and on Mastercard Europe's Advisory Board. Jayne-Anne is the Government's Women in Finance Champion.

2 Appointed pursuant to the terms of the Relationship Agreement with Virgin Group Holdings Limited, as described on page 80.

3 Bodies not for commercial purpose.

Board of Directors

10 Peter Bole
Executive Director and Chief Financial Officer

Appointed:
July 2017

Skills and experience:
Peter has over 25 years of experience in financial services. Following roles with Deloitte and Standard Life, Peter joined RBS in 2001 where he held a variety of senior finance roles, latterly in RBS Insurance. In 2009, he joined Tesco Bank where he established the finance function as Chief Financial Officer and played a key role in the leadership of the business as it was migrated from RBS infrastructure. Peter joined Virgin Money in 2016. Peter became Chief Financial Officer in January 2017 and joined the Board in July 2017. He is a chartered accountant.

External appointments:
None.

Company Secretary

11 Katie Marshall
Company Secretary

Appointed:
September 2013

Skills and experience:
Katie joined Northern Rock in 2009, following ten years as a corporate lawyer at Eversheds LLP, and subsequently joined Virgin Money in January 2012. Katie was appointed Company Secretary in September 2013. She is a qualified solicitor.

Chair Elect

12 Irene Dorner
Chair Elect

Appointed:
To join the Board 1 March 2018. Will take over Chair on 1 April 2018.

Skills and experience:
Irene has over 30 years of experience in financial services. Irene was Group Managing Director of HSBC Group and CEO and President of HSBC USA, with responsibility for all of HSBC's operations in the USA, until December 2014. During a 29 year career at HSBC she held a number of senior roles including Deputy Chair and CEO, Malaysia and General Manager of Premier and Wealth Management in the UK.

External appointments:
Non-Executive Director and Chair of Control Risks International Limited and Non-Executive Director and member of the Audit Committee of AXA SA. Irene is also a Non-Executive Director and a member of the Nominations and Governance Committee, Safety and Ethics Committee and Audit Committee of Rolls-Royce Holdings plc. Irene is also a Trustee of SEARRP (the South-East Asia Rainforest Research Partnership) (Malaysia).

Virgin Money Executive


1


2


3


4


5


6


7


8


9


10


11

Board members

1 Jayne-Anne Gadhia CBE

Chief Executive

Jayne-Anne joined the Board in March 2007 as Chief Executive. Jayne-Anne is also an Executive Director of Virgin Money plc.

Further details can be found on page 67.

2 Peter Bole

Chief Financial Officer

Peter joined the Board in July 2017 as Chief Financial Officer. Peter is also an Executive Director of Virgin Money plc.

Further details can be found on page 68.

Non Board members

3 Marian Martin

Chief Risk Officer

Marian is a chartered accountant and qualified with Ernst & Young. She joined the Britannia Building Society where she was an Internal Audit Manager, before spending four years at the Britannic Group where she was Head of Group Audit and Risk. Marian joined RBS in 2004 and served as Risk Director of RBS's consumer finance businesses, the RBS mortgage business and then Tesco Personal Finance. Marian joined Virgin Money as Chief Risk Officer in 2007. Marian is an Executive Director of Virgin Money plc.

4 Matt Elliott

People Director

Matt's early career was at RBS, where he worked on HR policy and employment issues, before supporting the HR transformation programme following the acquisition of NatWest. Matt held senior HR roles in several RBS operating businesses including the Consumer Finance division and Tesco Personal Finance. In 2007 Matt moved to BP as Senior Manager for Corporate and Functions before becoming HR Vice President for BP in North Africa. Matt joined Virgin Money as People Director in 2011.

5 Michele Greene

Managing Director – Virgin Money digital bank

Michele is a chartered accountant and qualified with KPMG. She spent three years at Credit Lyonnais as a financial accountant before joining Goldman Sachs as group accountant. Michele then spent over 15 years at MBNA, most recently as Chief Finance Officer, where she was a member of the board and closely involved in setting the strategic direction of the business. Michele joined Virgin Money in October 2013.

Virgin Money Executive

6 Hugh Chater

Managing Director – Core Bank

Hugh has over 25 years of experience in financial services. He was an executive founder at MBNA Europe, joining in 1993 from KPMG Management Consulting. At MBNA Hugh held executive roles in HR, Credit Management, Customer Satisfaction and Marketing before becoming Chief Operating Officer and then UK Managing Director. In 2007 Hugh joined RBS Retail to run the consumer credit card business. He subsequently ran the current account, savings, investments and insurance products. Hugh joined Virgin Money in June 2016.

7 Mark Parker

Chief Operating Officer

Mark's first IT Director role was at British Sugar. In 2001, Mark joined the HBOS Group. After serving as Group Services Director and Chief Information Officer, he then became Managing Director of Intelligent Finance. Mark joined Northern Rock as Chief Operating Officer in 2009 and subsequently joined Virgin Money in January 2012.

8 Andrew Emuss

General Counsel

Andrew qualified as a solicitor in 1996. He started his career at Clifford Chance, qualifying as a corporate lawyer, and has spent over 20 years acting on corporate and capital markets deals. He spent over ten years at Nomura and served as its Head of Corporate Development for EMEA, executing strategic deals. Andrew joined Virgin Money as General Counsel in June 2014.

9 Caroline Marsh

Social Enterprise Director

Caroline has over 30 years of experience in banking. Her early career was at Barclays where she spent 12 years in management roles. In 1999, she joined Virgin One as Sales Director. Following the acquisition of Virgin One by RBS in 2001, Caroline became Sales and Operations Director for the RBS consumer finance business, before leading RBS's intermediary mortgage business. Caroline returned to Virgin Money in 2007 and led the cultural agenda for the Virgin Money business from the acquisition of Northern Rock in 2012 until the end of 2017.

10 Tim Arthur

Creative Director

Prior to joining Virgin Money, Tim was Global Chief Executive of Time Out. He led its expansion across Asia and the US and was responsible for transforming the brand from a print media business to a global digital platform. Before that, Tim was CEO of Cardboard Citizens and CEO/Artistic Director of two arts venues. He is also a playwright and author. Tim joined Virgin Money in 2016.

11 Ken Donald

Corporate Development Director

Ken is a chartered accountant and has over 10 years of experience in financial services. Ken started his career at RBS where he latterly worked in the Investment Banking Division, advising UK and Irish Banks, Building Societies and Insurance companies. He also held a number of roles across the retail, business services, group strategy and corporate finance areas of RBS. Ken joined Virgin Money in 2014. Prior to his current role he ran the Chief Executive's Office.

Corporate Governance Report

This report sets out Virgin Money's approach to governance in practice, the work of the Board and its Committees and explains how the Group applied the principles of the Code during 2017.

Leadership

Purpose and responsibilities

The Board is collectively responsible for the long-term success of Virgin Money. It achieves this by setting the strategy and overseeing delivery against it. It establishes the culture, values and standards of the Group, managing risk, monitoring financial performance and reporting and ensuring that appropriate and effective succession planning arrangements and remuneration policies are in place.

The role of the Directors and Company Secretary

Set out below are the key roles and responsibilities of the Chair, other Board members and the Company Secretary. There is a clear division of responsibility at the head of the Group. The Chair has overall responsibility for the leadership of the Board while the Chief Executive leads the business.

Chair	Chief Executive
The Chair has overall responsibility for the leadership of the Board and promotion of the highest standards of corporate governance. The Chair sets the Board's agenda to ensure focus on the right matters. The Chair plans Board and Executive succession and appointments in conjunction with the Nomination Committee and ensures effective communication with shareholders. The Chair leads the development of the Group's culture by the Board as a whole.	The Chief Executive leads the Group on a day-to-day basis in all areas affecting the operations, performance and strategy of the Group's business (with the exception of those matters reserved to the Board). The Chief Executive provides leadership and direction to senior management and co-ordinates all activities to implement the Group's strategy and to manage the business in accordance with risk appetite. The Chief Executive has responsibility for overseeing the adoption of the Group's culture in the day-to-day management of the Group.
Non-Executive Directors	**Senior Independent Director**
The Non-Executive Directors help to develop and set the Group's strategy. They provide constructive challenge, participate actively in the decision-making process and scrutinise the performance of management. The Non-Executive Directors provide entrepreneurial leadership of the Group within a framework of prudent and effective controls, satisfy themselves as to the integrity of financial information and systems of risk management and determine appropriate levels of remuneration of the Executive Directors via the Remuneration Committee.	The Senior Independent Director (SID) acts as a sounding board for the Chair and Executive Directors on Board and shareholder matters and is a conduit, as required, for the views of the other Directors. The SID conducts the Chair's annual performance review and is available to shareholders as required.
Chief Financial Officer	**Company Secretary**
The Chief Financial Officer (CFO) is responsible for the financial management of the Group and the day-to-day management of the balance sheet including ensuring the business remains well capitalised. The CFO ensures that the Group delivers statutory reporting obligations, meets regulatory capital and liquidity requirements and identifies opportunities to improve the commercial performance of the business within the agreed risk appetite.	The Company Secretary provides practical support to the Directors with particular emphasis on supporting the Non-Executive Directors in maintaining appropriate standards of probity and corporate governance and providing advice to Directors on the discharge of their duties. The Company Secretary is responsible for facilitating communications with shareholders as appropriate.

Corporate Governance Report

Board and governance structure

Board

Audit Committee
Please see page 86

Nomination Committee
Please see page 82

Remuneration Committee
Please see page 95

Board Risk Committee
Please see page 92

Chief Executive Jayne-Anne Gadhia
Manages the business of the Group in accordance with the strategy and long-term objectives approved by the Board

Executive and Executive Committees
Please see pages 69 and 70 for a list of the Executive and 128 for the key Executive Committees

Board authority

The Board authority sets out the matters reserved to the Board. This includes decisions concerning the strategy and long-term objectives of the Group, capital and financial budgets, significant contracts and transactions, and various statutory and regulatory approvals. The Board authority delegates responsibility for day-to-day leadership of the business to the Chief Executive and sets out the basis for delegation of authorities from the Board to Board Committees. The Chief Executive delegates aspects of their own authority, as permitted under the corporate governance framework, to members of the Executive and the Executive Committees. As well as regularly discussing business performance, the Executive Committees meet monthly to consider key business matters. Certain Executive Committees meet more frequently as required.

Details of Board reserved matters can be found at virginmoney.com/virgin/investor-relations.

The role of the Board Committees

The Board is supported by its Committees which make recommendations to the Board on matters delegated to them, in particular in relation to internal control, risk management, financial reporting, governance, succession planning and remuneration matters. The current Board Committees are set out above.

Each Board Committee comprises Independent Non-Executive Directors. The Nomination Committee also comprises the Board Chair and the Virgin Nominee Director.

Each Committee Chair reports to the Board on the activities of the Committee. The Terms of Reference for each Board Committee can be found at virginmoney.com/virgin/investor-relations.

Group entity governance

The Group's banking business of residential mortgages, savings and credit cards is conducted through Virgin Money plc (Bank) which is regulated by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA).

The composition of the board of the Bank replicates that of the Company, save for the following: the Virgin Nominee Director and the VEL Nominee Director are not members of the board of the Bank and the Chief Risk Officer (CRO) is an additional Executive Director.

The Group has two FCA regulated subsidiaries, Virgin Money Unit Trust Managers Limited (VMUTM) and Virgin Money Personal Financial Service Limited (VMPFS) which carry out the Group's financial services business of investments, insurance and other ancillary financial services. Two of the Company's Non-Executive Directors and each of the Bank's Executive Directors are on the VMUTM board. The VMPFS board is made up of the Bank's Executive Directors.

Virgin Money Giving Limited (VMG) is a not-for-profit company within the Group and the vehicle for Virgin Money's charity fundraising and donations website. VMG has two Independent Non-Executive Directors on its board, one of whom is Chair.

The Virgin Money Foundation (The Foundation) is an independent charity which awards grants aimed at tackling social and economic disadvantage and the sustainable regeneration of deprived communities. The Foundation is managed and controlled by a board of independent Trustees.

The Board

Board size

The Board is of sufficient size and composition to reflect a broad range of views and perspectives whilst allowing all Directors to participate effectively in meetings.

The number and quality of Independent Non-Executive Directors on the Board facilitates effective challenge to the Executive. As at 31 December 2017, the Board comprised two Executive Directors, seven Non-Executive Directors (five of whom are considered to be independent) and the Chair, who was independent on appointment. Details on Board changes in the year and up to the date of this report are included in the Directors' Report.

Further details on independence, succession planning and the appointment process are set out in the Nomination Committee Report.

Executive Director service agreements and Non-Executive Director terms of appointment

The Chair is appointed for an initial three year term which may be terminated on six months' notice by either the Chair or the Company. The Non-Executive Directors are appointed for a twelve month term and each of the Non-Executive Directors may have their appointment terminated in accordance with the Articles of Association of the Company, their letters of appointment or statute at any time without compensation.

The service agreements of the Chief Executive and CFO are terminable by either the Company or the individual giving twelve months' notice.

All Directors are subject to annual re-election by shareholders. The service agreements and letters of appointment of all Directors are available for inspection by shareholders at the Company's registered office.

Time commitments

Each Non-Executive Director is required to devote such time as is necessary for the effective discharge of their duties to a minimum of 36 days per year and may be expected to relinquish other appointments to ensure that they can meet the time commitments of their role. The Chair is committed to this being their primary role, limiting their other commitments to ensure they can spend as much time as the role requires. The time devoted to the Group's business by the Non-Executive Directors is in reality significantly more than the minimum requirements. In 2017 the SID devoted additional time to their role in leading the Chair succession process.

Executive Directors must seek authorisation from the Board before accepting any additional responsibilities or external appointments, and are restricted to holding no more than two Non-Executive Director roles (excluding roles with bodies not for commercial purposes). At 31 December 2017, the Executive Directors were compliant with this requirement and continue to be at the date of this report.

Conflicts of interest

The Directors must avoid any situation which might give rise to a conflict between their personal interests and those of the Group. Prior to appointment, potential conflicts of interest are disclosed and assessed to ensure that there are no matters that would prevent the incoming Director from taking the appointment.

Directors are responsible for notifying the Chair and the Company Secretary as soon as they become aware of any potential or actual conflicts.

In addition, changes to the commitments of all Directors are reported to the Board and a register of conflicts is regularly reviewed by the Chair to ensure the authorisation remains appropriate.

If any potential conflict arises, the relevant Director will excuse themselves from any meeting or discussions where the potential conflict is considered, and all relevant material will be restricted. All potential conflicts authorised by the Board are recorded in a register of Directors' Conflicts of Interest. The Group's conflict procedures will be revisited in early 2018 in light of the forthcoming Financial Services Banking Reform Act 2013 (ring-fencing).

At one Board meeting the VEL Nominee Director excused himself from discussions in relation to the Virgin Money Trademark Licence Agreement due to a potential conflict of interest as a result of Virgin Enterprises Limited (VEL) being a related party as detailed in note 35 to the Financial Statements.

Corporate Governance Report

Diversity policy

Diversity and inclusion are strategic priorities for the Group. Information on the Group's approach to diversity and inclusion, including its consideration in Board appointments, is set out in the Nomination Committee Report on page 85 and the Strategic Report on pages 14 to 15 and 22 to 23.

Key Board focus in 2017

The following table provides an overview of the key matters considered by the Board in 2017:

Financial	Strategy and customer focus	Culture and value
> Approval of 2018 budget > Approval of financial results and presentations > Approval of dividends > Approval of the Internal Liquidity Adequacy Assessment Process (ILAAP) > Oversight of the capital base > Approval of funding issuances > Oversight of implementation of IFRS 9 > Review of credit risk and customer behaviour metrics	> Review of progress against the Group's strategy > Approval of four-year strategic and funding plans > Oversight of Capital Markets Update > Consideration of potential acquisition opportunities and strategic initiatives > Oversight of the Virgin Money digital bank strategy	> Enhanced monitoring of conduct (including customer outcomes) > Monitoring of culture and values, including oversight of staff survey results > Oversight of the social enterprise agenda and community priorities

Risk management	Governance and shareholders	Regulatory
> Approval of risk appetite and risk management framework > Approval of the Internal Capital Adequacy Assessment Process (ICAAP) > Review of aggregate risk exposures, risk/return and emerging risks > Review of internal control systems > Approval of stress test results > Oversight of operational resilience including monitoring cyber resilience > Oversight of key partnership relationships	> Review of Board and Committee structure and composition > Review of the corporate governance framework > Overseeing Board and Executive succession planning and appointment > Overseeing Board effectiveness and Chair performance reviews > Receiving Investor Relations updates including oversight of investor reporting > Approval of AGM Notice of Meeting	Overseeing the implementation of measures to ensure compliance with: > Ring-fencing/structural reform > Recovery and resolution > Senior Managers and Certification Regime > GDPR, PSD2 (open banking) > MREL and other regulatory changes

How does the Board consider stakeholder views?

The Board understands the importance of its stakeholders to the business.

The Board:
- > Monitored customer satisfaction, retention, outcome (including complaints) metrics
- > Oversaw the broadening of the customer proposition (e.g. SME and digital bank plans)
- > Oversaw the rigorous programme of customer listening and operational improvements
- > Further detail on how Virgin Money d
  for its customers is included on

The Board:
- > Monitored colleague engagement
- > Monitored progress against the diversity and inclusion strategy to create a diverse Board and workforce
- > Reviewed talent, capabilty, succession and development programmes
- > Listened to colleagues through office and store visits
  nded annual colleague awards ceremony
- > on how Virgin Money delivered
  for its colleagues is included on page 22

The Board:
- > Received regular reports on the p
  of mortgage intermediary partne
  including the optimisation of op
  improvements
- > Monitored strategic and outsour
  partnerships, including the new p
  with Virgin Atlantic
- > Oversaw the development of the G
  policies and approach to anti-bribe
  rights and modern slavery
- > Further detail on how Virgin Money deli
  for its corporate partners is included on
  page 24

The Board:
- > he delivery of the Group's
  Community strategy
- > d progress against the Group's
  ental strategy to manage and reduce
  nental impacts
- > detail on how Virgin Money delivered
  Community is included on page 26

The Board:
- > Oversaw the delivery of the strategy
- > Engaged with the shareholders on a regular and ad hoc basis, through results briefings, the Capital Markets Update, individual investor meetings, roadshows and its Annual General Meeting (AGM)
- > Further detail on how Virgin Money delivered for the Company and its shareholders is included on page 80

Corporate Governance Report

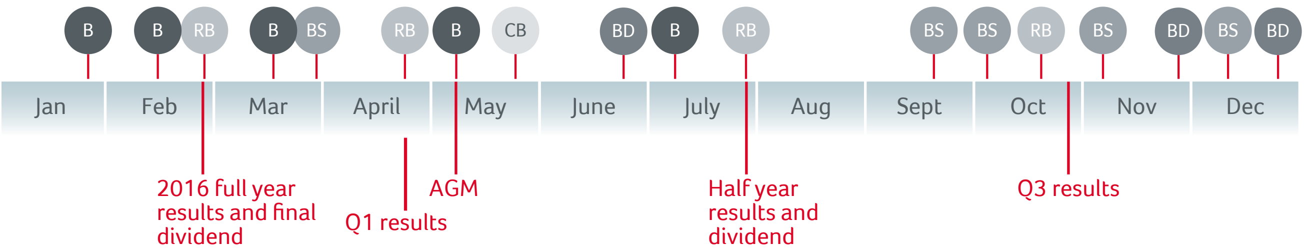
Board agenda and attendance

Setting the Board agenda

The Chair is responsible for setting the Board agenda. Prior to each Board meeting, the Chair reviews the agenda and time allocation with the Company Secretary and discusses key items of business with the Chief Executive. Board agendas are structured to allow adequate time for discussion, in particular of strategic matters and any other matters which the Non-Executive Directors wish to raise.

Board meetings and activity in 2017

The following timeline provides an overview of the Board meetings and activity in 2017:



Key

Key	
Board meeting (including site visits)	B
Board meeting and deep dive	BD
Board meeting and strategy discussion	BS
Results Board Meeting	RB
CEO Briefing Call	CB

Deep dives included:

- Credit cards
- Treasury
- Virgin Money digital bank
- Colleague Survey results
- IFRS 9
- ILAAP
- ICAAP

Site visits

- Mortgage Lab
- Mortgage Operations
- Contact Centre
- Security Operations
- Colleague Awards Ceremony
- Gosforth Office
- Edinburgh Office

Board Strategy Review

During 2017, the Board spent considerable time discussing the Group's strategy. The strategic review included the external environment, 2018 budget and the four year financial plans. Further detail on the Group's strategy is set out on pages 18 to 19.

The Board assessed the opportunities and challenges presented by the macro-economic, market and regulatory developments. These included risk appetite to ensure Virgin Money's lending discipline continues to support asset quality and delivery of sustainable returns through the cycle; funding plans; assessment of the impact of regulatory change of Open Banking, PSD2 and ring-fencing; and the investment required for the core business and the new initiatives. Further detail can be found on pages 30 to 39.

The Board also spent time considering updates received from the Board Committees on the Group's strategy (including funding and capital plans and organisational design changes to align to the future strategy).

The Board's key focus during these discussions was to ensure the refreshed strategy provides a strong platform for long-term success of business whilst also enabling the continued delivery of innovative products and outstanding service to customers.

Cyber resilience

It remains Virgin Money's goal to be consistently one of the safest banks in the UK. The Board continues to play an important role in overseeing the Group's cyber resilience approach and the level of investment in cyber security. Geeta Gopalan is the Board's accountable Non-Executive Director responsible for leading focus on cyber security at Board level.

The Board provides robust challenge and scrutiny to ensure that the Group is adequately mitigating the threats it faces. Virgin Money's cyber resilience strategy is reviewed by the Board on an annual basis with specific detailed reporting on progress provided regularly. The review takes into account the latest cyber threat intelligence assessment. This ensures that the strategy remains fit for purpose to combat the potential cyber threats the Group may face, as well as remaining aligned to the overall business objectives of the Group.

Attendance at meetings

In 2017, a total of 17 Board meetings were held consisting of: 13 that were scheduled (including four which approved release of the financial results) and four ad hoc meetings which were project and strategy related. Where a Director is unable to attend a meeting, they have the opportunity to review any papers and provide comments to the Chair, who then endeavours to represent the Director's views at the meeting.

The attendance of Directors at Board and Committee meetings during the year is set out below. The number of meetings held during the period that the Director held office is shown in brackets. The Chair attends all Committee meetings at the invitation of the Committee Chairs.

Virgin Money Holdings (UK) plc	Board meetings	Remuneration Committee	Nomination Committee	Board Risk Committee	Audit Committee
Directors who served during 2017					
Glen Moreno	17(17)	–	9(9)	–	–
Norman McLuskie	17(17)	4(4)	9(9)	5(5)	7(7)
Colin Keogh[1]	15(17)	–	7(9)	5(5)	7(7)
Marilyn Spearing[2]	5(6)	2(2)	1(2)	2(2)	2(2)
Geeta Gopalan	17(17)	4(4)	9(9)	5(5)	7(7)
Eva Eisenschimmel[3]	17(17)	3(3)	9(9)	5(5)	7(7)
Darren Pope[4]	13(13)	2(2)	8(8)	3(3)	5(5)
Gordon McCallum[5]	10(13)	–	6(8)	–	–
Patrick McCall	17(17)	–	–	–	–
Jayne-Anne Gadhia CBE	17(17)	–	–	–	–
Peter Bole[6]	7(7)	–	–	–	–
Amy Stirling[7]	0(0)	–	–	–	–

1 Colin Keogh was unable to attend two ad hoc Board and Nomination Committee meetings held on short notice due to a conflict with external appointments.

2 Marilyn Spearing retired from the Board on 3 May 2017 and was unable to attend the final Board and Nomination Committee meetings of her tenure due to a conflict with external appointments.

3 Eva Eisenschimmel was appointed to the Board on 25 January 2017.

4 Darren Pope was appointed to the Board on 1 March 2017.

5 Gordon McCallum resigned from the Board on 31 October 2017 and was unable to attend three Board and two Nomination Committee meetings held on short notice.

6 Peter Bole was appointed to the Board on 25 July 2017.

7 Amy Stirling was appointed to the Board on 20 December 2017.

Corporate Governance Report

Board effectiveness

Skills and experience of the Board

As illustrated by the Board biographies on pages 66 to 68, the Non-Executive Directors have a broad range of skills and experience. During 2017, the skills of the Board were enhanced by the appointment of Eva Eisenschimmel who brings extensive experience as a brand and marketing professional and Darren Pope who provides significant financial and retail banking experience (as well as transformational project experience). Additionally, Amy Stirling adds financial and management experience from a range of sectors and brings specific expertise in accounting, tax and treasury matters.

Annual effectiveness reviews

The 2017 internal Board effectiveness review, led by the Chair with support from the Company Secretary, took the form of interviews with each Board member and key stakeholders from across the business in December 2017 and January 2018. The review sought the Directors' views on a range of topics including the mix of skills, experience, independence and knowledge on the Board and Committees, Board culture and dynamics, the quality of information provided to the Board, the effectiveness of Committees (including composition and member contribution) and how they are connected with the Board and the quality of discussion (including areas of depth of engagement) and clarity of the decision-making process.

The review also assessed and sought views on the progress against the key recommendations and priorities identified in the 2016 effectiveness review.

The review of Committee performance also included an assessment of whether each Committee had met its required responsibilities.

The Chair met with each Non-Executive Director in early 2018 to discuss their contributions and effectiveness, and reported to the Nomination Committee on the output. The Chair also conducted the Chief Executive's annual performance appraisal. This activity supported the annual review of Board composition and recommendations on Director election/re-election to be put to the shareholders at the 2018 AGM. In parallel, the SID assessed the Chair's performance, seeking input from the other Directors.

Key themes were then collated together with the output from the Directors' individual performance reviews and presented to the Nomination Committee in February 2018 and discussed separately at the respective Committee meetings as appropriate. This was followed by a full discussion by the Board, reviewing what had worked well within the year and focus areas for 2018.

In line with best practice, the Group will undertake its next externally facilitated review of Board effectiveness in 2018. This exercise will serve as an invaluable tool for the new Chair providing independent insight on the Board and its effectiveness as well as informing and supporting future succession planning.

Strategic Report
Financial Results
Governance
Risk Management Report
Financial Statements
Other Information

A summary of the key findings and recommendations are set out below:

Key conclusions from 2017 Board Effectiveness Review

Board composition, Board culture, dynamics and contribution

- A well balanced and diverse Board in terms of skills, experience and independence; strengthened further by the 4 new Board appointments;
- Board culture of mutual trust and respect, open communication, commitment, improved challenge and support by all members; and
- Use of a variety of Board forums continues to work well.

Board focus and depth of engagement

- Good balance between strategic, operational and governance matters achieved in 2017, although will this remain an area of ongoing focus;
- Significant Board interaction and engagement on strategy, threats and opportunities and risk appetite;
- Increased focus on external landscape (market environment, competition, regulatory agenda), concluding a series of Board briefings (further detail on page 76);
- Significant focus in 2017 on funding, capital and liquidity as part of strategic planning, ICAAP and ILAAP processes with the risk agenda to remain a key focus for 2018 and beyond; and
- Increased 'line one' reporting and representation at Committees planned for 2018 to enhance the Board's assessment of risk and prioritisation of critical issues.

Board succession and leadership to ensure that talent development and succession planning are aligned with the current and future strategy

- Significant focus and progress focus in 2017 on Board leadership and succession matters. Highlights included four Directors joining the Board, together with a rigorous Chair search process leading to the appointment of Irene Dorner as Chair Elect;
- Board succession planning will remain a key focus for 2018 and beyond, led by the new Chair; and
- Comprehensive review of Executive talent, capability and succession plans to ensure aligned to current and future strategy.

Board basics: Board support, forward agenda and quality of information

- Continued high quality of Board information, with transparent information flow;
- Increased efficiency in Board processes and meetings;
- Continued focus required on the forward agendas; and
- 2018 Board schedule to accommodate increased time for Board discussion.

Board Committees

- Effective and well-balanced Board Committees, with a good mix of skills and experience; strengthened by the new Non-Executive Director appointments;
- Open and constructive contribution, engagement and challenge;
- Successful transition of new Committee Chairs; and
- Continued focus in 2018 required on Committee forward agendas, and opportunities for improved Committee reporting.

Board induction

The Chair, facilitated by the Company Secretary, ensures that all Directors receive a full induction tailored to their individual needs with regard to their specific role and experience. This ensures that Directors are able to make an informed contribution based on an understanding of the Group's business model and the challenges it faces.

During 2017 and up to the date of this report Darren Pope, Eva Eisenschimmel and Amy Stirling's induction processes comprised:

- a business introduction including a strategy overview containing business risks and opportunities;
- an introduction to operations, products, the customer and the competitive environment, along with a view of future product strategy;
- an overview of the Group's approach to governance, including training on the responsibilities of a Director in a listed company and the impact of the Senior Managers Regime on Non-Executive Directors;
- a detailed programme across Risk and Finance focusing on: risk appetite and profile, culture and framework, compliance and conduct risk, financial analysis and controls, capital, stress testing, liquidity, recovery and resolution planning and regulatory developments;
- an overview of the Legal and People functions, including the people and remuneration strategies and Remuneration Code requirements; and
- meet and greet sessions with the Board, Executive and senior management to understand the Group's culture along with visits to the Group's various sites including some stores and lounges.

Corporate Governance Report

Training

Professional development and training

The Chair is responsible for the training and professional development of Board members. The training programme, delivered throughout the year, comprises both formal and informal sessions on current or emerging issues. Tailored sessions on specific business topics are a key component of the programme. The Company Secretary maintains a training and development log for each Director.

Site visits also play an important role by helping to connect Directors with the business, colleagues and customers' needs. Directors are also invited to attend courses, management meetings and one-to-one meetings with Executives.

Shareholder/Stakeholder engagement and relationships

Details of how Virgin Money considers stakeholder views are included on page 75.

In respect of shareholders, the Board recognises the need for a programme of engagement which offers all shareholders opportunities to receive information directly and to enable them to share their views with the Board.

Controlling shareholder

During 2017 the Group's 'controlling shareholder' for the purposes of the Listing Rules was Virgin. Details of Virgin's shareholding can be found on page 123. The Company is party to a Relationship Agreement with Virgin. The principal purpose of the Relationship Agreement is to ensure that the Group is capable of carrying on its business independently of its 'controlling shareholder'. The Relationship Agreement provides for the appointment of a nominee director by Virgin through whom the Chair and other Non-Executive Directors are kept up to date during the year with the views of Virgin.

The Chair and Chief Executive have an ongoing dialogue with the Virgin Nominee Director throughout the course of the year. Gordon McCallum retired as the Virgin Nominee Director in October 2017 and the Group welcomed Amy Stirling in his place in December 2017.

The Company has complied with the terms of the Relationship Agreement and, so far as the Company is aware, the independence provisions contained in the Relationship Agreement have been complied with by Virgin (and its associates).

Investor relations and contact

The Investor Relations Director has primary responsibility for managing and developing the Group's external relationships with shareholders, potential investors and analysts. These communications are effected through a combination of briefings to analysts and institutional investors, individual discussions with shareholders and potential investors, regulatory announcements, press releases and updates on the Group's website.

The Board receives reports from the Investor Relations Director. This ensures that the Board are informed of significant market developments, share price performance and changes in the shareholder base.

In 2017, the Group engaged with corporate shareholders and potential investors on an individual basis through investor presentations and attendance at investor conferences. Additionally, the Chair hosted meetings with some of the Group's largest institutional shareholders focused on the

2017 Shareholder engagement

January to March

> Publication of the ARA
> Analyst briefings
> Publication of AGM Notice and voting materials
> Ad hoc proactive and reactive shareholder engagement via Chief Executive, CFO, and Remuneration Committee Chair

April to June

> Q1 trading statement
> AGM held
> Dividend (final)
> Ad hoc proactive and reactive shareholder engagement via Chief Executive, CFO and Chair

July to September

> Half year results
> Analyst briefings
> Dividend (interim)
> Corporate governance meetings with institutional shareholders
> Ad hoc proactive and reactive shareholder engagement via Chief Executive, CFO and Chair

October to December

> Q3 statement
> Capital Markets Update
> Ad hoc proactive and reactive shareholder engagement via Chief Executive, CFO and Chair

Group's corporate governance arrangements. The meetings were structured to allow for an open dialogue and discussion on the matters of importance to institutional shareholders including strategy, Board composition and succession.

The Group will maintain an active dialogue with shareholders, potential investors and analysts to discuss the performance of the Group, its strategy and new developments in 2018.

Company Secretary and retail shareholders

The Company Secretary oversees communications with individual retail investors.

The Group's registrar, Equiniti Limited, provides a dedicated shareholder online and telephone dealing service to assist shareholders in managing their investments.

Internal control

The Board is responsible for the Group's system of internal control. The system is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations.

The Group uses a 'Three Lines of Defence' model. Further detail can be found on page 127.

The Directors and Executive are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. The Directors acknowledge their responsibilities in relation to the Group's systems of risk management and internal control and for reviewing their effectiveness and conducted a review covering internal audit reports, risk assurance reports and an overall analysis of the risk management framework during the year.

In 2017, the Group completed its action plan to address all recommendations from the Deloitte LLP External Quality Assurance Review of the Group's Internal Audit function produced in 2015 and referred to in the 2016 Corporate Governance Report. In line with the Chartered Institute of Internal Auditors' Guidance on Effective Internal Audit in the Financial Services Sector, it is the intention that the function will be subject to an independent external assessment every five years.

In establishing and reviewing the system of internal control, the Directors consider the nature and extent of the risks facing the Group, the likelihood of a risk event occurring and the potential financial impact of failure. A system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. It therefore can provide only reasonable but not absolute assurance against the risk of material mis-statement or loss.

The policies supporting the Group's risk management framework define minimum standards for controls for all material risk classes.

Business areas and support functions assess on a quarterly basis the internal controls in place to address all material risk exposures across all risk classes. This review considers the effectiveness of these material controls, including financial, operational and compliance controls.

Further information on risk control and management is set out in the Risk Management Report.

Statement of compliance

UK Corporate Governance Code

The 2016 version of the Code, which can be accessed at www.frc.org.uk, applied to the Group's 2017 financial year. The Directors have considered the contents and recommendations of the Code and confirm that throughout the year the Group has applied the main principles and complied with the provisions of the Code.

The Group looks forward to the publication of the outcome of the FRC's consultation on changes to the Code.

Committee reports

The following pages contain reports from each of the Board's Committees with the report from the Remuneration Committee included in the Directors' Remuneration Report.

Corporate Governance Report

Nomination Committee Report

"We continue to focus on the composition, skills and experience of the Board. Chair succession has been a key focus for the Committee during 2017."

Glen Moreno
Chair, Nomination Committee

Membership and meetings

	Independent	Meetings attended (held) in 2017[1]
Committee Chair		
Glen Moreno	Yes (on appointment)	9(9)[2]
Committee members		
Norman McLuskie	Yes	9(9)
Colin Keogh[3]	Yes	7(9)
Marilyn Spearing[4]	Yes	1(2)
Geeta Gopalan	Yes	9(9)
Gordon McCallum[5]	No	6(8)
Eva Eisenschimmel	Yes	9(9)
Darren Pope[6]	Yes	8(8)
Amy Stirling[7]	No	0(0)

1 Number of meetings held during the period the member held office.

2 Norman McLuskie acted as Chair for all discussions in relation to Chair succession.

3 Colin Keogh was unable to attend two ad hoc meetings held on short notice due to a conflict with external appointments.

4 Marilyn Spearing retired from the Committee on 3 May 2017 and was unable to attend the final Committee meeting of her tenure due to a conflict with an external appointment.

5 Gordon McCallum retired from the Committee on 31 October 2017 and was unable to attend two prior meetings held on short notice.

6 Darren Pope joined the Committee on 1 March 2017.

7 Amy Stirling joined the Committee on 20 December 2017.

Chair's overview

Succession planning and the composition of the Board and its Committees were a key focus during 2017.

In July 2017, I confirmed my retirement from the Board in 2018 to return home to the USA. I considered it the right time, with the completion of my three year term due in January 2018, for the business to appoint a new Chair to oversee delivery of the next phase of Virgin Money's strategy. As announced on 15 February 2018, I will be retiring from the Board on 31 March 2018 and Irene Dorner will succeed me as Chair on 1 April 2018.

I am grateful to Norman McLuskie, our Senior Independent Director (SID), for leading such a rigorous process for the Nomination Committee to appoint my successor. An overview of the recruitment process undertaken by the Committee is provided on page 83.

As highlighted in my Chair's Statement, there have been a number of changes to the Board in 2017. Eva Eisenschimmel and Darren Pope joined the Board as Independent Non-Executive Directors in January and March 2017 respectively, and Marilyn Spearing retired from the Board in May 2017. Peter Bole joined the Board as Executive Director in July 2017 and Amy Stirling joined the Board in December 2017 as the Virgin Nominee Director, replacing Gordon McCallum following his retirement from the Board in October 2017.

As part of our medium-term Committee succession planning, a number of Committee Chair changes have also been made. On the Committee's recommendation, Norman McLuskie became Chair of the Remuneration Committee in May 2017; Darren Pope succeeded Norman as Chair of the Audit Committee in July 2017 and Geeta Gopalan succeeded Colin Keogh as Chair of the Board Risk Committee in January 2018 and Colin Keogh became Chair of VMUTM in June 2017. The Committee will continue to keep under review the structure, size and composition of the Board and its Committees and to make appropriate recommendations to the Board.

During 2018, the Committee will commission an externally-facilitated evaluation of the Board and Committees' effectiveness, led by the new Chair. This will offer an independent view of the Board's effectiveness building upon the progress made against the recommendations and priorities from the 2017 internal Board effectiveness review.

Glen Moreno
Chair, Nomination Committee

26 February 2018

Committee purpose and responsibilities

The purpose of the Committee is to keep the Board's composition, skills, experience, knowledge, independence and succession arrangements under review and to review the succession plans for the Executive. The Committee makes recommendations to the Board to ensure that the Group's arrangements are consistent with good corporate governance standards. The Committee's role also extends to appointments to the boards of the Group's material subsidiaries, including the Bank.

The key activities of the Committee during the year are summarised below. Full details of the Committee's responsibilities are set out in the Committee terms of reference which were updated during the year in accordance with best practice and can be found on the website at virginmoney.com/virgin/investor-relations.

During the year the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review. More details on the Committee evaluation can be found on pages 78 to 79.

Chair recruitment

In 2017, Glen Moreno indicated his intention to retire from the Board in 2018. A process to recruit and appoint a new Chair commenced. The search was undertaken by the Committee and led by myself as the SID. The Chief Executive was fully involved in the process although the decision rested with the Committee.

Heidrick & Struggles JCA Group (JCA) was appointed to support the search on the basis of their strength and depth of experience in Chair and Chief Executive searches and their overall market reputation. Aside from assisting with recruitment, JCA has no other connection with the Group.

The specification for the role was agreed by myself, in conjunction with the Chief Executive and Committee members. The Committee and individual Committee representatives had a number of discussions with JCA to scope out the key skills, experience, characteristics and requirements for the role. Key attributes for the position included retail banking or financial services experience, strong corporate governance and/or chair experience, cultural fit and strong stakeholder skills.

A structured timetable was adopted for the process and regular Committee discussions and updates held throughout. From a detailed understanding of our requirements and specification for the role, JCA conducted extensive research analysing the market and put together an extensive range of potential candidates for the Committee to consider. After much debate this was narrowed down to a shortlist for interview. These candidates were interviewed by JCA and further due diligence carried out. Shortlisted candidates then met initially with myself and the Chief Executive and also, to ensure consistency, the same Committee members as those involved in the initial discussions with JCA. The Chair's involvement in the search was limited to meeting the shortlisted candidates, as part of their due diligence.

On 25 October 2017, in response to media speculation, we announced that we were in advanced discussions with Irene Dorner. On 15 February 2018, following receipt of regulatory approval, we were delighted to announce Irene's appointment as Chair Elect with effect from 1 March 2018. Irene will become Chair and Chair of the Nomination Committee on 1 April 2018.

Irene was an ideal match to our requirements with strong and extensive retail banking experience, gathered over 30 years with HSBC. Further detail is included in Irene's biography on page 68. We believe Irene is an excellent cultural fit for Virgin Money and we are confident she has the attributes to lead the Board and support the Chief Executive and the Executive as they deliver the next phase of Virgin Money's strategy.

Corporate Governance Report

Nomination Committee Report

A comprehensive and structured induction process is under way to ensure Irene has a thorough understanding of our business, the market environment and our stakeholders prior to taking up her appointment as Chair. Further detail on her induction will be provided in our 2018 Annual Report and Accounts.

Norman McLuskie
Senior Independent Director

Committee composition, skills and experience

To ensure a broad representation of independent views, including perspectives from each of the Committees, membership of the Committee comprises the Board Chair, all Independent Non-Executive Directors and the Virgin Nominee Director. The Chief Executive, the Virgin Nominee Director and, if required, the People Director attend meetings by invitation as appropriate.

How the Committee spent its time in 2017

Board and Executive succession

Approach

The Committee recognises that good succession planning contributes to the delivery of the Group's strategy by ensuring the desired mix of skills and experience of Board members now and in the future. Just as importantly, internal talent needs to be recognised and nurtured within Executive and management levels across the Group. The Group's annual talent and capability reviews and leadership programmes allow the Group to identify talent and have the right succession plans and development programmes in place to ensure the Group creates opportunities for current and future leaders.

Process

The Committee supports the Chair in keeping the composition of the Board and its Committees under regular review and in leading the appointment process for nominations to the Board.

Following the review undertaken by the Chair in 2016 of Board tenure, succession planning and an assessment of the collective technical and governance skills required from the Non-Executive Directors to support the future business strategy, the Committee oversaw the Board and Committee Chair changes that were approved in 2016, and set out on page 121. Further information on the process for appointing Eva Eisenschimmel and Darren Pope can be found on page 95 of the 2016 Annual Report and Accounts. The changes take into account the need to refresh the intake of Non-Executive Directors to bring new and diverse perspectives to the Board and decision-making and ensure appropriate succession planning for the Committees. Robust and comprehensive handover processes, as required by the Senior Managers and Certification Regime, were undertaken for each Committee Chair transition.

The Chair is responsible for developing a succession plan in relation to the Chief Executive, who is in turn primarily responsible for developing and maintaining a succession plan for key leadership positions in the Executive. The Committee considers the adequacy of such succession arrangements.

To support the continued development of the business, the Executive was strengthened by the appointment of Ken Donald to the role of Corporate Development Director on 1 July 2017.

The Board is well placed to meet the challenges and opportunities ahead, and the Committee and the Board are satisfied that the Executive is staffed appropriately. The Committee will continue to ensure that succession planning remains under review.

Effectiveness

Details of the 2017 Board Effectiveness Review, overseen by the Committee, and key recommendations are set out on pages 78 to 79. The Committee will monitor the Board's progress against the agreed roadmap in 2018.

Independence and time commitments

The independence of the Non-Executive Directors and the election or re-election of Directors and their suitability to continue in office, were reviewed. As in 2016, a rigorous independence review was undertaken in respect of Norman McLuskie and Colin Keogh, given that both have just completed the eighth year of their tenure.

In assessing independence, the Committee did not rely solely on the Code criteria but considered whether the Non-Executive Director was demonstrably independent and free of relationships and other circumstances that could affect their judgement. Based on its assessment for 2017, the Committee is satisfied that, throughout the year, Colin Keogh, Norman McLuskie, Geeta Gopalan, Eva Eisenschimmel and Darren Pope remained independent as to both character and judgement.

Amy Stirling is not considered to be independent due to her relationship with Virgin. Patrick McCall is also not considered to be independent since he was appointed to the Board as the representative director of VEL pursuant to the Virgin Money Trade Mark Licence Agreement.

The Committee reviewed the roles, including capabilities and time commitments, of the Chair, SID, Non-Executive Directors, Chief Executive and CFO, considering amongst other matters, the impact of limits placed by CRD IV on the number of directorships that can be held by the Directors, and found them to be appropriate.

The Committee is recommending the re-election of all Directors who served during 2017 and who wish to continue to serve, together with the election of Peter Bole, Amy Stirling and Irene Dorner to shareholders at the 2018 AGM.

Diversity

The Board places great emphasis on ensuring that its members reflect diversity in its broadest sense. As set out in the Board approved Diversity Policy (available at virginmoney.com/virgin/investor-relations) the Group's aim is to nurture a skilled, committed and diverse workforce where every individual, regardless of background, can share the Group's purpose, reach their potential and be rewarded appropriately for their contribution to the Group's success. Whilst all Board appointments are made on merit, a diverse combination of demographics, skills, experience, knowledge and background on the Board is important in providing a range of perspectives, insights and challenge needed to support good decision-making.

During the course of the year, the Board reviewed the Group's performance against the Board approved Diversity Policy which sets out the approach to diversity for each of the main boards within the Group. Information on Board composition as at 31 December 2017 is included on page 65.

In respect of gender diversity, the Committee approved a revised objective for a balanced Board with representation of either gender making up no less than 33% (one in three) of the Board. In addition, the Group has a stated goal that by 2020 the Board's gender balance should be 50/50. Female representation on the Board was 40% at 31 December 2017; this will increase to 50% representation on the appointment of Irene Dorner to, and Glen Moreno's retirement from, the Board.

The Group supports the Women in Finance Charter and the Parker Review 'Beyond One by '21' recommendation that FTSE 100 and 250 company boards should have at least one director which makes the Board composition ethnically diverse by 2021 and 2024 respectively. The Board currently meets this minimum recommendation.

Please see pages 14 to 15 and 22 to 23 of the Strategic Report for details of the Group's approach to diversity and inclusion initiatives which includes statistics on Board and Executive diversity.

Corporate Governance Report

Audit Committee Report

"It is the Audit Committee's role to review the integrity of the financial statements. A key focus for the Committee during 2017 has been oversight of key accounting judgements and the preparations for IFRS 9 implementation".

Darren Pope
Chair, Audit Committee

Membership and meetings

	Independent	Meetings attended (held) in 2017[1]
Committee Chair		
Norman McLuskie[2] (to July 2017)	Yes	7(7)
Darren Pope[3] (from July 2017)	Yes	5(5)
Committee members		
Colin Keogh	Yes	7(7)
Geeta Gopalan	Yes	7(7)
Eva Eisenschimmel	Yes	7(7)
Marilyn Spearing[4]	Yes	2(2)

1 Number of meetings held during the period the member held office.

2 Norman McLuskie remains a member of the Committee following handover of the Chair to Darren Pope.

3 Darren Pope joined the Committee on 1 March 2017 and was appointed as Chair of the Committee on 21 July 2017.

4 Marilyn Spearing retired from the Committee on 3 May 2017, on her retirement from the Board.

Chair's overview

Having succeeded Norman McLuskie as Chair of the Committee in July 2017, I would like to take this opportunity to thank him for his strong leadership as Chair, his consideration and insight in achieving a smooth transition process and his continuing contribution as a Committee member. I would also like to thank the other Committee members for their contribution and challenge throughout the year.

I am pleased to report that, throughout 2017, the Committee continued to focus on its key objectives: overseeing financial reporting, internal controls, whistleblowing, and internal and external audit, as well as specific attention on IFRS 9.

Oversight of financial reporting requires an assessment of key accounting judgements and related disclosures. Effective Interest Rate (EIR) accounting methodology and the underlying assumptions, including expected customer behaviour, have remained a key area of focus. The Committee has carefully reviewed and challenged all accounting judgements, as well as ensuring appropriate disclosures have been made that reflect the underlying potential volatility of the EIR method.

The Committee also oversaw the IFRS 9 programme delivery, approving the methodology, policies and assumptions that drive the final calculations.

Oversight of the Internal Audit function is also a key aspect of the Committee's role. This has included monitoring of the control framework with particular focus on the Information Technology (IT) control framework and completion of all final recommendations arising from the External Quality Assurance Review (EQAR) undertaken in late 2015. The Committee also oversaw the appointment of a transitional Internal Audit Director and is progressing the recruitment of a permanent replacement.

During the year a team from the Financial Reporting Council (FRC) undertook an Audit Quality Review (AQR) inspection of PwC's audit of the Group's 2016 financial statements. The Committee satisfied itself that all improvements identified have now been actioned.

Darren Pope
Chair, Audit Committee

26 February 2018

Committee purpose and responsibilities

The purpose of the Committee is to monitor and review the Group's financial reporting arrangements, the effectiveness of its internal controls and risk management framework, its internal and external audit processes and its whistleblowing procedures. The Committee reports to the Board on its activities and makes recommendations, all of which have been accepted during the year.

The key activities of the Committee are set out below and full details of the Committee's responsibilities are detailed in the Committee terms of reference which can be found at virginmoney.com/virgin/investor-relations. The Committee refreshed its terms of reference in November 2017 to reflect industry guidance on best practice. In 2017, the Committee met its objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review detailed on pages 78 to 79.

Committee composition, skills and experience

The Committee acts independently of management. This ensures that the interests of shareholders are properly protected in relation to financial reporting and internal control.

The Committee now comprises five Independent Non-Executive Directors. Eva Eisenschimmel became a member of the Committee on 25 January 2017. Darren Pope joined the Committee on 1 March 2017 and, on 21 July 2017, as part of the medium term succession plan, took over as Committee Chair from Norman McLuskie who is currently in his ninth year as a Non-Executive Director. Mr McLuskie remains a member of the Committee. Marilyn Spearing retired from the Committee on 3 May 2017, following her retirement from the Board.

Each Committee member has extensive experience of banking and financial services, and therefore, as a whole, the Committee has recent and relevant competence in the financial sector. The Chair is a fellow of the Chartered Institute of Certified Accountants and has significant financial experience in the UK listed environment, including formerly as a CFO of a listed bank, enabling him to fulfil the role of Audit Committee Chair for the purposes of the Code.

Relevant members of the Executive, the Internal Audit Director and external auditors attend Committee meetings by invitation. During the year, the Committee held a number of private Committee sessions, including with the external audit team (without Executives present) and with each of the Chief Executive, CFO and the Internal Audit Director.

Corporate Governance Report

Audit Committee Report

How the Committee spent its time in 2017

Financial reporting

During 2017, the Committee considered the following key financial issues and judgements in relation to the Group's financial statements and disclosures, with input from management and the external auditors:

Key issues/judgements in financial reporting	Audit Committee review and conclusions
Effective interest rate (EIR) Interest earned on loans and receivables is recognised using the EIR method. The application of the EIR method of accounting is judgemental and requires management to make a number of assumptions.	The Committee had a number of detailed sessions to review EIR methodology and understand the judgements applied by management, including expected future customer behaviours. EIR accounting for unsecured lending remains an area of significant judgement. During the year, the Committee reviewed management's view of the current and future expected cash flows and the appropriate modelling period. This was supported by an independent external assessment and report. The Committee concluded that the accounting approach remains appropriate and will be monitored on an ongoing basis. Given the potential future volatility that may be driven by the accounting approach, particular attention has been given to the disclosures relating to EIR which are set out in the Financial Results section and in note 1.10 to the financial statements.
Allowance for impairment losses on loans and receivables Determining the appropriateness of impairment losses is judgemental and requires the Group to make a number of assumptions.	The Committee considered and challenged the provisioning methodology applied by management and the level of provisions. The Committee considered the calibration of model parameters in the light of economic indicators including house price movements and underlying book performance. Consideration was also given to the appropriateness and use of post model adjustments, which reflect management's view of the risks in the portfolio not adequately covered by the models due to historically benign macro-economic factors. The Committee was satisfied that the impairment provisions, including management's judgements, were appropriate. The disclosures relating to impairment provisions are set out in note 1.10 to the financial statements.
Capitalisation and impairment of intangible assets Determining the appropriateness of costs that qualify for recognition as intangible assets requires management judgement. Management is also required to make ongoing assessments of whether any assets are impaired.	Over the course of 2017 a wide range of change projects was delivered including a number with significant capital spend, in particular in relation to digital development, fraud and cyber-crime. As in prior years, the Committee has considered and is satisfied with the appropriateness of the accounting recognition of these investment costs, including that those costs qualify for recognition as intangible assets in line with the criteria prescribed by accounting standards. The Committee considered management's reviews for indicators of impairment and oversaw the impairment of a previous software development in light of the strategic decision to consolidate activity within the digital banking programme. No assets were identified as impaired through reviews for indicators of impairment. The disclosures relating to the movement in intangible asset balances during the year are set out in note 1.10 to the financial statements.

Key issues/judgements in financial reporting	Audit Committee review and conclusions
Fair value of financial assets and liabilities The Group uses estimates and judgements in the calculation of fair values for assets and liabilities where not all inputs to calculations are observable in the market, or where there are factors specific to an individual instrument that impact fair values.	The Committee spent time understanding and assessing judgements applied (including the use of appropriate market rates) and, following review, agreed with management's judgement regarding the calculation of fair values. The Committee also reviewed the accounting treatment for the gains on disposal of assets, including treasury instruments and the sale of Vocalink shares. The Committee was satisfied that the accounting treatment was appropriate. The disclosures relating to fair value are set out in note 1.10 to the financial statements.
IFRS 9 – Implementation and disclosure IFRS 9 is a significant accounting development which came into effect on 1 January 2018. The standard introduces new accounting policies and judgements with the key changes relating to the calculation of the impairment of financial assets on an expected credit loss basis.	The Committee had a number of detailed briefing sessions to understand the requirements of this new standard. An impact analysis was conducted to ascertain the changes required and to aid development of the implementation plan which was reviewed and agreed with the Committee. The Committee also considered the model methodology, accounting assumptions and financial reporting and approved the accounting policies which will be adopted on implementation of IFRS 9. The disclosures relating to the impact of adoption of IFRS 9 are set out in note 37(a) to the financial statements.
Going concern and viability The Board is required to confirm whether it has a reasonable expectation that the Company and the Group will be able to continue to operate and meet their liabilities as they fall due for a specified period.	The Committee reviewed and challenged the going concern and viability assessment undertaken by management. The assessment was based on the Group's capital, funding and strategic plans and included consideration of the principal and emerging risks set out on pages 36 to 39, which could impact the performance of the Group and the liquidity and capital projections over the period. Based on a combination of strong capital and liquidity forecasts, the Committee advised the Board that it was satisfied with the viability statement, and that three years was a suitable period of review. Further details of the viability assessment can be found on pages 120 and 129.
Fair, balanced and understandable The Group must ensure that the Annual Report and Accounts are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.	The Committee reviewed the Annual Report and Accounts and challenged management on the presentation of financial and non-financial information. The Committee considered management's own assessment of compliance with alternative performance measures guidelines and the fair, balanced and understandable requirements. The Committee concluded that, based on the information provided by management and in its judgement, the Annual Report and Accounts, when taken as a whole, were fair, balanced and understandable.

Internal control and risk management

Details of the internal control and risk management systems in relation to the financial reporting processes are given within the Corporate Governance Report on page 81 and the Risk Management Report on pages 126 to 188. Specific matters that the Committee considered during the year included:

> the effectiveness of systems for internal control, financial reporting and risk management, including a review of all material financial, operational and compliance controls;

> the major findings of internal reviews into control weaknesses, fraud or misconduct and management's response alongside any control deficiencies identified; and

> continued focus on the IT control environment in light of the increased threat from cyber-crime, incorporating an interim audit of the IT control environment by PwC which identified potential improvements in certain areas.

The Committee is satisfied that internal controls over financial reporting and risk management systems were appropriately designed and operating effectively.

Corporate Governance Report

Audit Committee Report

Internal audit

In monitoring the activity, role and effectiveness of the Internal Audit function and its audit programme, the Committee:

> oversaw the ongoing process of succession for the Internal Audit Director following the departure of the previous role holder during the year. This resulted in the appointment of an Interim Internal Audit Director in January 2018, pending recruitment of a permanent Internal Audit Director. The Interim Internal Audit Director has been seconded from Deloitte, where he is Head of the Financial Services Internal Audit Practice;

> oversaw completion of the action plan to address observations from the EQAR of the Internal Audit function carried out in 2015 by Deloitte;

> approved the annual audit plan and budget and monitored progress against the plan throughout the year, confirming that appropriate resources and capability were in place to execute the plan effectively, and considered Internal Audit to have sufficient standing in the Group;

> refreshed the Internal Audit Charter; and

> considered the major findings of Internal Audit and management's responses.

Whistleblowing

The Committee continued to receive and consider reports from Internal Audit on the Group's whistleblowing arrangements including summaries of reported cases. The Committee was satisfied with the action taken, with the reports having been considered and approved by the Board's whistleblowing champion, the Committee Chair. The Committee also reviewed the Whistleblowing Policy and concluded that the policy and procedures in place comply with the PRA and FCA policy statements on whistleblowing. During 2018 the Committee will oversee further enhancements to the Group's whistleblowing arrangements including improving profile and ease of access.

External auditors

The Committee oversaw the relationship with the external auditors. It approved the interim and annual audit plan and negotiated and agreed the scope of the auditors' engagement (including remuneration), reviewed their audit findings and considered management's responses to such findings and recommendations.

The Committee concluded that it was satisfied with the auditors' performance and recommends their re-appointment by shareholders at the 2018 AGM for the year ending 31 December 2018. The Committee believes the independence and objectivity of the external auditors and the effectiveness of the audit process remain strong.

The Committee also considered the continued effectiveness of the audit process and the external auditors' performance during the period by means of a questionnaire seeking feedback from Committee members and senior management on technical competence, strategic knowledge, quality control, communication, independence and objectivity. This found the external auditors and the audit process to be both robust and effective. Areas for development included provision of greater benchmarking against peer approaches and industry best practice.

During the year a team from the FRC undertook an AQR inspection of PwC's audit of the Group's 2016 financial statements. On completion of its review in January 2018, the FRC wrote to the Committee Chair and provided a copy of its final report. The Committee discussed the contents of the report and the actions arising from the review findings with PwC at the January 2018 Committee meeting. The Committee was satisfied that PwC has taken all necessary actions to address the FRC review findings as part of its audit of the 2017 financial statements. The Chair will meet with the FRC in 2018 to discuss the AQR findings.

External auditors independence and remuneration for non-audit services

Both the Board and the external auditors have safeguards in place to protect the independence and objectivity of the external auditors. A robust policy is in place to regulate the use of the auditors for non-audit services which:

- details the nature of work that the external auditors may not undertake and sets a limit (£25,000) under which permissible non-audit work may be undertaken without prior permission from the Committee. All other non-audit services are subject to prior approval by the Committee;
- determines that the overall fee level for non-audit services will continue to be monitored by the Committee and should not exceed 70% of the average audit fee over the prior three year period; and
- includes restrictions on the employment of the external auditors' former staff to preserve further the independence of the external auditors.

In some cases, the external auditors may be selected over another service provider for a particular engagement due to their detailed knowledge and understanding of the business. As an example, in 2017, the Committee considered proposals that PwC be selected to provide non-audit services in relation to the assurance work concerning the implementation of IFRS 9 and in the development of the Group's Covered Bond programme. PwC was considered to be optimal for the role, due to the value and operational synergies brought by its understanding of the Group's systems, processes and personnel. The provision of the service for these programmes was not considered to have a material effect on the audited financial information nor to impede the auditors' independence or objectivity, due to the precise scope of the work. The Committee is satisfied that the Group was compliant during the year with both the Code and the FRC's Ethical and Auditing Standards in respect of the scope and maximum permitted level of fees incurred for non-audit services provided by PwC. Where non-audit work is performed by PwC, both the Group and PwC ensure adherence to robust processes to prevent the objectivity and independence of the auditors from being compromised.

The total amount paid to the external auditors in 2017 was £1.6 million of which £0.3 million related to non-audit services. In 2016 the total paid to the external auditors was £1.2 million of which £0.3 million related to non-audit services. Details of the payments for audit and non-audit services provided in 2017 is shown in note 6 to the financial statements.

External auditors tenure

A formal audit tender process was conducted in 2015, with PwC appointed as external auditors at the AGM in 2016. The external audit contract will be put out to tender at least every ten years. The Committee is satisfied that the Company has complied with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitor Tender Processes and Audit Committee Responsibilities) Order 2014, during the financial year under review and up to the date of this report.

Regulatory change

The Committee also monitored emerging regulation and legislation, assessed the impact on the business and oversaw the development of models, policies and procedures to comply. Compliance with IFRS 9 was a key area of focus with the Committee holding sessions with the Group finance team and the external auditors to review and discuss the requirements of IFRS 9 and the implementation plan to meet the Group's obligations under the revised standard.

Corporate Governance Report

Board Risk Committee Report

"The Committee continues to focus on strong risk management culture as a fundamental part of achieving our strategic objectives."

Geeta Gopalan
Chair, Board Risk Committee

Membership and meetings

	Independent	Meetings attended (held) in 2017[1]
Committee Chair		
Geeta Gopalan (from January 2018)	Yes	5(5)
Colin Keogh[2] (to January 2018)	Yes	5(5)
Committee members		
Norman McLuskie	Yes	5(5)
Eva Eisenschimmel[3]	Yes	5(5)
Darren Pope[4]	Yes	3(3)
Marilyn Spearing[5]	Yes	2(2)

1 Number of meetings held during the period the member held office.

2 Colin Keogh remains a Committee member following handover of the Chair to Geeta Gopalan.

3 Eva Eisenschimmel joined the Committee on 25 January 2017.

4 Darren Pope joined the Committee on 1 March 2017.

5 Marilyn Spearing retired from the Committee on 3 May 2017, on her retirement from the Board.

Chair's overview

Having last month succeeded Colin Keogh as Chair of the Committee, I would like to take this opportunity to thank Colin for his strong leadership and judgement and I look forward to his continuing contribution as a Committee member.

During 2017, the Board Risk Committee assisted the Board in consideration of all aspects of risk management across the Group, balancing its agenda between existing and emerging risks. The Committee has exercised close oversight of the Group's asset quality and retail credit risk performance, including detailed discussion on credit card quality and performance with respect to customer behaviour and margins. Whilst the UK economy and housing market remained resilient in 2017, the Committee introduced enhanced monitoring of the macro-economic environment and customer behaviour, to ensure early identification of any emerging risks in these areas.

Through the strategic planning round, the Committee supported the work of the Board in re-assessing the Group's risk appetite, capital and liquidity adequacy and associated stress and scenario testing. This included oversight of the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). This also included a review of wholesale funding maturity transformation and refinancing risk.

The Committee has monitored the Group's risk management and governance framework continuing to build on the good progress reported last year around managing risks relating to IT systems, cyber security and financial crime.

The Committee has also maintained its emphasis on conduct risk, including the monitoring of outsourcing arrangements and oversight of key strategic programmes, with enhanced reporting on customer outcomes. Focus has also been on maintaining the Group's risk culture and values throughout the Group, including reviewing and supporting key policy changes and oversight of the risk adjustment elements of Executive incentive schemes.

Finally, the Group continues to operate in a regulatory environment which is subject to considerable change and another key area of activity for the Committee has been the monitoring of ongoing developments including the Financial Services Banking Reform Act (ring-fencing), Open Banking, the Second Payment Services Directive (PSD2) and General Data Protection Regulation (GDPR).

Geeta Gopalan
Chair, Board Risk Committee
26 February 2018

Committee purpose and responsibilities

The purpose of the Committee is to monitor and review the Group's compliance with the Board approved risk appetite and risk management framework, and to ensure that the risk culture is embedded throughout the Group.

This includes carrying out the annual review of risk appetite alongside the strategic plan to reflect the Group's latest commercial, economic and regulatory views, and considering the statements and risk appetite metrics under each category of identified risk. The Committee has oversight of balance sheet risks, including the adequacy of liquidity and capital.

The Committee monitors the Group's risk management framework, including policies and methodologies, overseeing proposed changes and any actions arising from material breaches. Details of the Group's approach to risk management can be found on pages 126 to 188.

The Committee reports to the Board on its activities and makes recommendations, all of which have been accepted during the year. Full details of the Committee's responsibilities are set out in the Committee terms of reference which were updated during the year (in accordance with best practice) and can be found on the website at virginmoney.com/virgin/investor-relations.

The Committee is pleased to report that, during the year, the Committee met its objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review. More details on the Committee evaluation can be found on pages 78 to 79.

Committee composition, skills and experience

The Committee now comprises five Independent Non-Executive Directors who have a wealth of risk management experience across various industries including strong representation in retail banking and financial services. The Committee Chair is also a member of the Audit Committee.

Eva Eisenschimmel and Darren Pope became members of the Committee on 25 January 2017 and 1 March 2017 respectively. Marilyn Spearing retired from the Committee on 3 May 2017, following her retirement from the Board.

As part of the medium term succession plan, and following an orderly transition, Geeta Gopalan took over as the Chair in January 2018. Colin Keogh, who is in his eighth year as a Non-Executive Director, remains a member of the Committee. Geeta has been a member of the Committee since June 2015 and has a strong background and experience in financial services and risk management, with particular expertise in operational resilience, IT systems, payments, digital and cyber.

In addition to relevant members of the Executive, the Internal Audit Director attends the meetings, by invitation, so that attendees from all three lines of defence are represented. The external auditors also attend meetings as appropriate and by invitation. During the year, the Committee held private sessions with the Chief Risk Officer (without other Executives present).

Significant risks considered by the Committee

Further details of the Group's principal risks can be found in the Risk Overview on pages 36 to 39.

How the Committee spent its time in 2017

Over the course of the year, the Committee considered a wide range of risks facing the Group, both existing and emerging, across all key areas of risk management. As part of the review, certain risks were identified which required further detailed consideration. A summary of these matters is set out below and includes the key considerations and conclusions of the Committee.

In respect of the Group's approach to risk management, the Committee also reviewed the capability, resources, remit and authority levels of the risk function. The Committee concluded that the risk function was adequately resourced and continued to be sufficiently independent with appropriate authority and standing within the Group.

Retail credit risk

The Committee monitored retail credit risk performance against the Group's risk appetite metrics and policies. The Committee introduced external early warning and key performance indicators in response to the changing macro-economic outlook and increasing consumer indebtedness in the UK market as a whole. The Committee also considered the risk of adverse change in customer behaviour and its potential resultant impact on impairment losses. Whilst the Group is not exposed to the unsecured personal loan or motor finance market, the Committee monitored the quality of the Group's credit card lending which has remained strong. In response to the changing macroeconomic outlook, the Committee oversaw further tightening of lending criteria in the first half of 2017. This will remain an area of focus in 2018.

Corporate Governance Report

Board Risk Committee Report

Market risk
The Committee monitored and reviewed monthly interest rate risk positions against risk appetite metrics and policies. Additional scenario planning and stress testing was also undertaken to inform the Group's strategic planning and assist in the management of capital at risk driven by base rate changes.

Operational risk
Regular updates across all aspects of operational risk were considered by the Committee, including financial crime, incident management, outsourcing management and security infrastructure. The Committee continued to oversee the delivery of the Group information security programme with a particular focus on cyber resilience strategy to mitigate the threat of cyber-attack. In particular, the Committee was pleased to note the progress made in the year to improve financial crime capability.

Conduct risk and compliance
The Committee considered reports on the proactive identification and resolution of conduct related activity. In addition, the Committee considered developments in the Group's conduct culture and reports on complaints and product governance. The Committee also monitored risks inherent in major outsource arrangements and received regular updates on their performance and resilience. Where deficiencies in operation and/or performance were identified, the Committee increased the focus to ensure resolution was prioritised. Compliance matters were also monitored, including the oversight of the FCA's Client Asset Sourcebook (CASS) regulatory attestation exercises and CASS remediation in the investment business.

Strategic and financial risk
The Committee undertook a review of the risks inherent in the strategic plan and provided input and support on their mitigation and management. The quality of lending and credit concentration risk is reviewed regularly against risk appetite metrics and challenged by the Committee. The quality of new lending, the credit performance of the portfolio and risk adjusted returns were reviewed by the Committee resulting in it recommending changes to Group policy or risk appetite to manage exposures and balance risk/reward in these areas. The Committee also introduced additional monitoring of the performance against the assumed behaviours of the credit card portfolio as that book matures.

Funding and liquidity risk
The Group Treasurer provided regular updates on balance sheet management. The Committee challenged the current and forecast funding and liquidity positions, and considered reports on funding sources (including retail deposits, TFS, RMBS and the establishment of a Covered Bonds programme) to ensure a prudent mix is maintained within risk appetite and policy limits. This included a particular focus on maturity transformation and refinancing risk of maturing funding schemes, and review of the funding plans carefully structured to avoid undue refinancing risk.

Capital
The Committee considered the quality of the capital base and the projected capital resources to ensure that the Group complies with current regulatory capital requirements, is within the risk appetite set by the Board and is well positioned to meet future requirements. The Committee reviewed and challenged management's development of scenario planning and stress testing as part of its assessment of the regulatory capital requirements and preparation of the ICAAP and Recovery and Resolution Plan (RRP). Further details on stress testing can be found within the Risk Management Report on page 129. The Committee concluded that the Group's capital remained well above minimum regulatory requirements and within the risk appetite set by the Board.

Emerging risks
Emerging risks are those which have the potential to increase in significance and affect the performance of the Group. Further details can be found in the Risk Management Report on pages 130 to 131.

The Committee oversaw the Group's contingency planning designed to respond to and mitigate the impact of adverse macro-economic conditions.

Risks arising from the implementation of Financial Services Banking Reform Act 2013 (which will require the ring-fencing of retail banking operations) have also been considered, ensuring forward planning is undertaken to address any anticipated risks in implementation and compliance. The Committee concluded that it was satisfied with the implementation to ensure compliance by January 2019.

Minimum Requirement for Own Funds and Eligible Liabilities (MREL) will be phased in by January 2022. The Committee monitored the Group's approach and the guidance was fully reflected in the strategic planning process with the Committee's input.

Directors' Remuneration Report

Statement by the Chair of the Remuneration Committee

Dear Shareholder,

On behalf of the Board and as Chair of the Remuneration Committee I am pleased to present the Directors' Remuneration Report for the year ending 31 December 2017.

I was appointed as Committee Chair on 3 May 2017 having been a member of the Committee since 2010. I would like to take this opportunity to thank Marilyn Spearing for her previous leadership of the Committee as well as her support during the transfer of Chair responsibilities.

The Committee was strengthened this year with the appointment of Eva Eisenschimmel and Darren Pope who have already made significant contributions to the Committee's work. Eva and Darren also joined Geeta Gopalan and me as members of the Board Risk Committee ensuring strong alignment between risk and remuneration.

In July 2017 Peter Bole, the Chief Financial Officer, was appointed to the Board. This report will therefore include his remuneration arrangements and share interests from that date.

2017 Executive Director outcomes

The performance of the Group in 2017 in a challenging external environment once again reflects strong delivery against the objectives set for the year.

The Committee has determined annual bonus outcomes based on the financial and non-financial targets set at the beginning of the year. Details of performance against these targets are disclosed on page 108 of this report.

Annual Bonus awards for 2017 are 95.2% of maximum for the Chief Executive and 91.7% of maximum for the Chief Financial Officer reflecting the strong performance of the Group within the year.

These awards will be subject to our deferral policy which was reviewed during the year following a clarification of regulatory expectations and practice by other large UK banks. Therefore, for 2017 bonuses, 80% will be paid upfront (half in cash, half in shares) with the remaining 20% delivered in share awards deferred for between three and seven years. Bonus awards delivered in shares will be subject to a 12-month hold period. This approach continues to provide significant alignment between Executive Director and shareholder interests over an extended deferral period, and remains in line with regulatory requirements.

The performance period for the 2015 Long Term Incentive Plan ("LTIP"), the first such award granted following the Group's admission to the stock market, ended on 31 December 2017. Based on the achievement of performance targets 65.3% of the shares under award will vest.

This outcome is a reflection of the Group's delivery against the growth, quality and returns targets set out in 2015 following the Initial Public Offering (IPO). The Committee is satisfied these performance conditions have remained relevant and appropriate throughout the performance period.

Measure	Weighting	Outcome
Growth	30%	19.1%
Quality	20%	20.0%
Returns	30%	11.2%
Corporate Scorecard	20%	15.0%
	100%	**65.3%**

Vested awards under the 2015 LTIP are delivered in shares and will be released in three equal instalments up until 2020.

In March 2017 new share awards were granted to the Chief Executive and the Chief Financial Officer under the 2017 LTIP based on 100% of fixed pay.

Executive Directors continue to have the majority of their variable pay delivered in Virgin Money share awards (80% for 2017), maintaining the strong alignment with the long-term performance of the Group and shareholder interests.

2018 LTIP performance measures

The Committee will continue to operate within the current approved Directors' Remuneration Policy in 2018. However, to ensure our remuneration approach remains aligned to our strategy, we will be making changes to the LTIP performance measures for 2018 awards. We have finalised these proposals after reflecting on feedback from major shareholders.

The recent refresh of Group strategy highlighted two key strategic developments: the build of the digital bank and entry into the Small and Medium Enterprise (SME) market. Given the importance of these initiatives to shareholder value, the 2018 LTIP award is being rebalanced to ensure that sufficient focus is placed on both the continued performance of the core business and the delivery of the strategic initiatives.

Directors' Remuneration Report

2018 fixed pay

After careful consideration the Committee has determined that the Chief Executive will receive an increase in base salary of 2.6% to £800,000 for 2018. The Chief Financial Officer's salary will remain unchanged, however, he will receive an allowance of £100,000 in recognition of the additional responsibilities accompanying his appointment to the Board. Taking account of his current shareholding, this will be delivered in shares.

Considerations for other colleagues

The remuneration of colleagues across the Group is a key consideration when determining Executive Director outcomes. The average colleague salary will increase in the forthcoming pay round by 1.9%, with the highest performers receiving an increase of up to 6%.

The Group continues to pay all staff above the National Living Wage which is in excess of the National Minimum Wage. During 2018 the Group will apply to become a Living Wage Accredited employer.

The Committee is mindful of the proposed changes to the Corporate Governance Code. During the course of 2018 it will review how effective engagement with colleagues and across all stakeholders is maintained.

2018 policy review and consideration of shareholders' views

The current remuneration policy will reach the end of its three-year term at our 2019 AGM. During 2018 the Committee will therefore consider if any changes to the Policy are required ahead of a new binding shareholder vote in 2019. As part of this process we will engage with shareholders to ensure their views are taken into consideration.

Shareholder views relating to remuneration are an important part of the Committee's discussions. Having engaged with a number of the Company's largest shareholders recently, I am confident that the approach outlined is aligned to the interests of all shareholders.

I am pleased to recommend this statement and the 2017 Remuneration Implementation Report on page 103 to shareholders, ahead of the 2018 AGM.

Norman McLuskie
Chair, Remuneration Committee
26 February 2018

Directors' Remuneration Policy – abridged

Directors' Remuneration Policy and Principles

The current Directors' Remuneration Policy was formally approved by shareholders at the AGM on 4 May 2016. It is intended that approval of the Remuneration Policy will be sought at three-yearly intervals, unless amendments to the policy are required in the interim, in which case appropriate shareholder approval will be sought.

The full policy is set out on pages 112 to 121 of the 2015 Annual Report and Accounts which is available at: http://uk.virginmoney.com/virgin/investor-relations/results-and-presentations/. For ease of reference, the remuneration policy tables for Executives and Non-Executive Directors from the policy are included in the following pages.

Information on how the policy will be applied in 2018 is included on pages 105 and 106 of the Implementation Report.

As set out in the previous Directors' Remuneration Reports, the Group seeks to reward colleagues fairly for their contribution, whilst ensuring they are always motivated to deliver the best outcomes for stakeholders. To achieve this, colleagues are rewarded in line with UK listed financial services sector best practice, with no reward for inappropriate risk taking.

The Group's approach to remuneration for all colleagues, including Executive Directors, is designed to promote the long term success of Virgin Money for customers, corporate partners, shareholders and wider society. This reflects the culture and supports the delivery of the business strategy:

> to maintain capacity for growth, Virgin Money ensures it remains competitive in the financial services market through regular market reviews. The Group's remuneration strategy aims to motivate individual out-performance against transparent and challenging objectives that are rigorously applied;

> to ensure an appropriate approach to remuneration, and in particular variable pay, clear risk principles are applied which aim to drive sustainable growth. Risk considerations are a material factor in the determination of pay. Malus adjustments and clawback apply to all variable pay;

> the Group aims to treat its colleagues in the same way that it serves customers – with honesty, transparency and fairness. Virgin Money believes in creating a culture where customer service is the priority. To achieve this, all colleagues receive an annual bonus opportunity, with no product-focused sales incentives in place. Balanced objectives are used to assess annual performance; and

> to ensure the approach to senior remuneration is fair, competitive and supportive of the Group's strategy, Virgin Money undertakes annual reviews of its remuneration approach. This also ensures that the Group's position remains appropriate relative to competitors.

Virgin Money aims to support colleagues and their families whilst enabling them to plan for the future through a competitive benefits package. The benefits package helps ensure low staff turnover, higher engagement and supports the Group's overall operational and financial efficiency.

Directors' Remuneration Report

Summary of Remuneration Policy for Executive Directors

Base salary

Purpose and link to strategy	Base salary reflects the role of the individual taking account of responsibilities and experience.
Operation	Base salaries are normally reviewed annually. When determining and reviewing base salaries, the Committee considers: > corporate and individual performance; > the skills, experience and responsibilities of the Executive Director and their market value; > the scope and size of the role; > base salary increases for colleagues throughout the Group; and > external market factors.
Maximum potential	Whilst there is no maximum base salary, any salary increases in percentage terms will normally be in line with increases awarded to other colleagues, but may be higher in certain circumstances. The circumstances may include but are not limited to: > where a new Executive Director has been appointed at a lower salary, higher increases may be awarded over an initial period as the Executive Director gains experience in the role; > where there has been an increase in the scope or responsibility of an Executive Director's role; or > where a salary has fallen significantly below market positioning given current size and scale of the Group. Base salary levels may be amended to take into account any regulatory changes.
Performance measures	N/A

Fixed Allowance

Purpose and link to strategy	To ensure that total fixed remuneration is commensurate with the role and to provide a competitive reward package for Executive Directors with an appropriate balance of fixed and variable remuneration. Also to facilitate recruitment of an Executive Director if required.
Operation	The Fixed Allowance will be delivered in cash and /or shares normally on a monthly basis. The Fixed Allowance is not pensionable.
Maximum potential	The maximum allowance is 100% of base salary.
Performance measures	N/A

Pension

Purpose and link to strategy	To support the Executive Directors in building long-term retirement savings in a manner which does not expose the Group to any unacceptable financial risk.
Operation	Executive Directors are eligible to participate in the Group's defined contribution pension scheme. Alternatively, Virgin Money may make contributions to an Executive Director's personal pension arrangement. Only base salary is pensionable. An individual may elect, with the Group's consent, to receive some or all of their pension contribution as a cash allowance.
Maximum potential	The maximum allowance for Executive Directors is 30% of base salary.
Performance measures	N/A

Benefits

Purpose and link to strategy	To provide a competitive and cost effective flexible package delivered in a way which does not expose the Group to any unacceptable financial risk.
Operation	Virgin Money provides a range of benefits which may include private medical insurance, permanent health insurance and life assurance. The Committee retains the discretion to provide additional benefits as may be reasonably required. These may include national and international relocation benefits such as (but not limited to) accommodation, family relocation support and travel. The Executive Directors are entitled to a maximum of 30 days' holiday and any unused holiday may be bought back at the standard daily salary rate.
Maximum potential	The maximum value of benefits is based on the cost to the Group of providing each of the benefits in the 'Operation' section immediately above.
Performance measures	N/A

Annual Bonus and Deferred Bonus Share Plan

Purpose and link to strategy	The annual bonus is designed to reward performance, scored against annual weighted financial and non-financial measures.
Operation	Annual bonuses are discretionary and are based on Group and individual performance within the year. The determination of measures and their weighting are set annually and awards are determined by the Remuneration Committee at the end of the financial year. The Committee has discretion, in exceptional circumstances, to amend targets, measures, or number of shares under award if an event happens (for example a major transaction or capital raising) that in the opinion of the Committee, causes the annual targets or measures to no longer be appropriate or such adjustment to be reasonable. The Committee also has the discretion to reduce the vesting level of any award if it deems that the outcome is not consistent with performance delivered. The annual bonus may be delivered partly in cash and partly deferred into cash, shares or other instruments. The mechanism for making the bonus deferral is the Deferred Bonus Share Plan (DBSP). Deferral levels are set at the time of award and in line with regulatory requirements. At present this means that at least 60% of total variable pay is deferred, at least 50% of variable pay is paid in shares or other instruments, and vested shares (post taxation) are subject to a retention period. The deferral and holding periods may be amended to take into account any regulatory changes over the life of the policy. The Remuneration Committee may adjust awards or amend the terms of the awards in accordance with the DBSP rules. At the time of the shares being released and as long as this remains permissible under the regulatory rules, Executive Directors may receive an amount (in cash or in shares) equal to the dividends paid or payable between the date of grant and the vesting of the award on the number of shares which have vested. All awards will be subject to malus and clawback provisions.
Maximum potential	The normal maximum bonus for Executive Directors is 100% of fixed pay. Under the DBSP rules, there is scope to award a bonus up to 300% of total fixed remuneration in exceptional circumstances, normally linked with recruitment. Any such Award would however remain subject to the overall regulatory rules.
Performance measures	Performance measures are determined by the Remuneration Committee each year. At least 50% of the annual bonus opportunity is based on performance against key financial measures determined at the beginning of each financial year. The remainder of the annual bonus is based on performance against non-financial measures, which will normally include a scorecard of brand, culture, control measures and personal strategic objectives.

Directors' Remuneration Report

Long Term Incentive Plan (LTIP)

Purpose and link to strategy	The plan is designed to reward delivery of the Group's strategy and growth in shareholder value over a multi-year period and aligns senior colleagues' interests with those of shareholders.
Operation	Awards are granted in the form of nil cost options or conditional shares, subject to performance conditions aligned to long-term strategy. The Committee has discretion, in exceptional circumstances, to amend targets, measures, or number of shares under award if an event happens (for example a major transaction or capital raising) that in the opinion of the Committee, causes the targets or measures to no longer be appropriate or such adjustment to be reasonable. The Committee also has the discretion to reduce the vesting level of any award if it deems that the outcome is not consistent with performance delivered. Performance conditions will normally be tested over a period of three financial years. Deferral terms are set at the time of award and in line with regulatory requirements. Vested shares (post taxation) will be subject to a holding period. The performance, vesting and holding periods may be amended to take into account any regulatory changes over the life of the policy. At the time of the shares being released and as long as this remains permissible under regulatory rules, Executive Directors may receive an amount (in cash or in shares) equal to the dividends paid or payable between the date of grant and the vesting of the award on the number of shares which have vested. All awards will be subject to malus and clawback provisions.
Maximum potential	The normal maximum award for Executive Directors is 100% of fixed pay. There is scope to increase awards up to 300% of total fixed remuneration in exceptional circumstances, normally linked with recruitment. Any such award would remain subject to the overall regulatory rules.
Performance measures	Performance measures are determined by the Remuneration Committee each year.

All-colleague plans

Purpose and link to strategy	If operated in the future, Executive Directors will be eligible to participate in HMRC approved all-colleague schemes which encourage share ownership, as approved by shareholders.
Operation	Executive Directors may participate in these plans if operated in the future in line with the prevailing HMRC guidelines (where relevant), on the same basis as other eligible employees.
Maximum potential	Participation levels will be in line with HMRC limits as amended from time to time.
Performance measures	N/A

Legacy awards and restrictions on payments

The Remuneration Committee reserves the right to honour any remuneration payments or awards and any payments or awards for loss of office, notwithstanding that they are not in line with the policy set out above where the terms of the payment or award were agreed before the policy came into effect (as set out in the 2014 Directors' Remuneration Policy or the Listing Prospectus where relevant). Such payments or awards are set out in the Implementation Report for the relevant year. This includes payments in relation to legacy deferred bonus awards and long-term incentive awards and share options (including exceptional awards vesting on the listing of the Company) granted prior to listing of the Company.

Service Agreements

The notice period and date of the current Executive Directors' service agreements are shown below:

	Notice period	Date of service agreement
Jayne-Anne Gadhia	12 months	18 November 2014
Peter Bole	12 months	1 November 2016

The Group policy is that the Chair will normally have a six-month notice period, to be served by either party.

Colleague remuneration and engagement

When reviewing and setting Executive Director remuneration, the Remuneration Committee takes into account the pay and employment conditions of all colleagues. Specifically, the level of any Group-wide pay review is a key determinant when setting the level of any increase to Executive Directors' salaries. Discussion on the Group's approach to remuneration and relevant colleague reward matters takes place with union representatives during the annual pay review cycle.

There is no colleague representative on the Remuneration Committee. Instead, time is taken to meet and listen to the views of many colleagues. One of the duties of the People Director is to brief the Board on colleague views and, as a regular invitee to Remuneration Committee meetings, he ensures that decisions are made with appropriate insight to colleagues' views.

Colleague engagement is a measure within the scorecards for both the annual bonus and the LTIP. The structure of the Executive Directors' remuneration packages cascades down to other colleagues. Particular points to note are:

> LTIP awards are granted to the wider Virgin Money Executive Team;

> all colleagues are eligible to participate in an annual bonus arrangement, with no product-focused sales incentives. Instead, all bonuses are subject to a balanced scorecard of measures with particular emphasis on customer experience; and

> colleagues in certain roles may receive a fixed allowance where this is considered appropriate taking into account pre-determined criteria.

Directors' Remuneration Report

Chair and Non-Executive Director fees in 2018

Purpose and link to strategy	To ensure the Group is able to engage and retain highly skilled and experienced individuals who can provide a valuable contribution, having a significant range and depth of expertise.
Operation	Fees payable to the Chair are determined by the Remuneration Committee, whilst the fees paid to the Non-Executive Directors are set by the Board. The Board undertakes periodic reviews, at least annually, of Non-Executive Director fees and this may lead to fee increases. The fees are set at a rate that reflects the individual's experience, value to the Group and the expected time commitment of them. The regulatory regime and the practical aspects of running a complex financial services company are important inputs to remuneration decisions. For the Non-Executive Directors, there is a base fee which is then supplemented by additional fees in respect of chairing and being a member of Board committees. Incremental fees will be paid for additional duties and time commitment, such as those of the Senior Independent Director. The current fees are set out on page 106. From time to time, new Board Committees may be established and/or responsibilities distributed between Committees, at which point fees for Committee membership and Chairmanship may be reviewed. The Chair and Non-Executive Directors are reimbursed for expenses (grossed-up where taxable) incurred in performing their duties. For individuals based outside of the UK this will include travel to and from the UK. The Chair has access to a vehicle for personal use, which is a taxable benefit, and may be offered access to private medical insurance.
Maximum limit	The maximum aggregate value of fees payable to the Chair and the Non-Executive Directors is capped at £2 million under the Articles of Association.
Performance metrics	No remuneration payable to the Chair and the Non-Executive Directors has performance conditions.

Implementation Report

Purpose and membership of the Remuneration Committee

The primary role of the Remuneration Committee is to determine and recommend to the Board a fair and responsive remuneration framework to ensure that the Group's most senior Executives are appropriately rewarded and incentivised for their contribution to the Group's performance. The Remuneration Committee's primary purpose is to formulate policies that ensure a clear link between reward and performance and are compliant with regulatory requirements.

The Committee reports to the Board on its activities and makes recommendations, where required, all of which have been accepted during the year.

Full details of the Committee's responsibilities are set out in the Committee terms of reference which can be found on our website at virginmoney.com/virgin/investor-relations.

In 2017 the Committee met its objectives and carried out its responsibilities effectively as confirmed by the annual effectiveness review. More details on the Committee evaluation can be found on pages 78 and 79.

Remuneration Committee membership in 2017

Norman McLuskie	Independent member	Joined 27 January 2010 (and Chair from 3 May 2017)
Marilyn Spearing	Independent member	Joined 29 January 2014, Chair from 1 January 2016 to 3 May 2017 on which date she retired from the Board and the Committee
Geeta Gopalan	Independent member	Joined 25 June 2015
Eva Eisenschimmel	Independent member	Joined 25 January 2017
Darren Pope	Independent member	Joined 1 March 2017

Other attendees (by invitation from time to time) included: the Chair, the Chief Executive, the People Director, and the Reward Director. To manage potential conflicts of interest, those four individuals did not attend at times when their own remuneration outcome was discussed and approved. Deloitte (the Committee's independent consultants in relation to Directors' remuneration) and a Virgin NED also attended meetings where invited. The Company Secretary attended meetings to record minutes and advise on governance matters.

The Group manages the link between risk and remuneration carefully and all current members of the Remuneration Committee are also members of the Board Risk Committee. In addition, representatives from the Risk function may attend meetings where appropriate. In advance of a share award vesting or a bonus being awarded, the Chief Risk Officer provides the Remuneration Committee with a detailed risk assessment. This is also considered separately by the Board Risk Committee.

Directors' Remuneration Report

Remuneration Committee activity in 2017

There were four meetings of the Remuneration Committee during 2017. The key matters were as follows:

Date	Pay / bonus	Policy / Governance
Q1	> 2016 pay and bonus outcomes > Performance conditions for the 2017 Annual Bonus and LTIP > Release of deferred bonus awards	> 2016 Directors' Remuneration Report and Pillar 3 > 2016 PRA Remuneration Policy Statement > Review of Committee Terms of Reference > Review of Group-wide Remuneration Policy
Q2	> Release of shares vesting under Buy-out Award	
Q3	> Market update	> Material Risk Taker population for 2017 > 2017 PRA Remuneration Policy Statement
Q4	> Release of Executive awards vesting under the IPO Share Award > Review of performance measures for the 2018 Annual Bonus and LTIP > Review of deferral approach for 2018	> Living Wage Accreditation > 2017 Directors' Remuneration Report > Remuneration Committee Terms of Reference > Determination of Group-wide pay and bonus budgets

Advisors to the Remuneration Committee

The Remuneration Committee took external advice from Deloitte, the Committee's independent consultants in relation to Directors' remuneration.

Deloitte's appointment as consultants was made by the Remuneration Committee. Deloitte are members of the Remuneration Consultants Group and comply with the professional body's code of conduct. This supports the Remuneration Committee's view that the advice received was objective and independent.

Deloitte's fees in 2017 amounted to £52,350. Deloitte also provide co-sourced internal audit services. Deloitte do not have any other connection with the Group.

Statement of voting at Annual General Meeting

The Group's remuneration policy, which was effective during 2017, was detailed within the Directors' Remuneration Report for 2015 and voted on at the 2016 AGM. The remuneration awarded to the Executive Directors in 2016 was disclosed in last year's Remuneration Implementation Report and was voted on at the 2017 AGM. The shareholder votes submitted at the meetings, either directly, by mail or by proxy, were as follows:

	Votes in favour		Votes against		Votes withheld
	Number of shares	Percentage of votes cast	Number of shares	Percentage of votes cast	Number of shares
Remuneration Policy (2016 AGM)	349,102,101	91.79%	31,219,817	8.21%	83,374
Remuneration Implementation Report (2017 AGM)	353,955,397	98.86%	4,083,364	1.14%	4,084,068

Implementation of the policy in 2018

The following sets out how the Directors' Remuneration Policy will be applied in 2018:

Fixed Pay

Base salary	Jayne-Anne Gadhia (Chief Executive): £800,000 Peter Bole (Chief Financial Officer): £500,000
Fixed Allowance	Jayne-Anne Gadhia (Chief Executive): £100,000 (paid in cash) Peter Bole (Chief Financial Officer): £100,000 (paid in shares)
Pension and other benefits	Jayne-Anne Gadhia (Chief Executive): 30% of base salary. Peter Bole (Chief Financial Officer): 20% of base salary.

Annual Bonus

Opportunity	Maximum annual bonus opportunity is 100% of fixed pay.
Deferral terms	For the 2018 performance year, annual bonus opportunity will be awarded in a combination of cash and shares. Deferral will be consistent with regulatory requirements. Any shares released are subject to a further holding period in line with regulatory requirements and market practice. Deferred share awards will not receive dividends or dividend equivalents.
Performance measures and targets	The Remuneration Committee has determined that for 2018 the annual bonus will be based on: > financial measures (underlying profit before tax) – 50% weighting > non-financial measures (personal strategic objectives and a series of risk, brand, culture and control measures) – 50% weighting. The Board considers the targets that apply to these measures to be commercially sensitive at this time but will provide information on the targets alongside the level of payout relative to the performance achieved in next year's Implementation Report. The Remuneration Committee has determined that 60% vesting is justified for target performance and 0% is justified for threshold performance. All awards will be subject to malus and clawback provisions.

Long Term Incentive Plan

Opportunity	LTIP awards in 2018 will be granted over shares worth 100% of fixed pay.
Vesting terms	The performance period will be the three years commencing on 1 January 2018. An assessment of performance in the financial year preceding the date of grant will be taken into account before awards are made. The intended date of grant is March 2018. To the extent that the performance measures are satisfied, awards will vest equally from the fourth anniversary of the date of grant to the eighth such anniversary. At each vesting date the resultant number of shares (post taxation) will be subject to a further holding period in line with regulatory requirements and market practice. LTIP awards will not receive dividends or dividend equivalents.
Performance measures and targets	The Remuneration Committee has chosen performance measures that are based on delivering the Company's strategic objectives, and the continued creation of shareholder value. This choice and the calibration of the targets is consistent with the strategic plan. The Remuneration Committee has determined that 80% vesting is justified for target performance and 20% is justified for threshold performance. Performance against the targets will be subject to a risk assessment review. The following table outlines the weightings and measures for the 2018 awards. All awards will be subject to malus and clawback provisions.

Directors' Remuneration Report

FY18 LTIP Performance Measures

Measure	Target	Weighting
Underlying basic earnings per share	Threshold: 35p Maximum: 46p	30%
Return on tangible equity	Threshold: 10% Maximum: 13%	30%
Scorecard – relative to business strategy and external comparators	a) Strategic delivery (including digital bank and SME) b) Customers (Advocacy) c) Customers (Complaints) d) Colleagues (Engagement)	40%

Outcomes will be disclosed on a retrospective basis after the end of the three-year performance period.

Chair and Non-Executive Director fees in 2018

The annual fees for the Chair and Non-Executive Directors are unchanged to that specified in the 2016 Annual Report. A review of the Chair fee was carried out in 2017 and a review of the Non-Executive Director fees was carried out in early 2018.

2018 fee policy	2018	2017
Chair fee[1]	**£350,000**	£350,000
Non-Executive Director basic fee	**£80,000**	£80,000
Senior Independent Directorship	**£20,000**	£20,000
Chair of Audit Committee	**£25,000**	£25,000
Chair of Remuneration Committee	**£25,000**	£25,000
Chair of Board Risk Committee	**£25,000**	£25,000
Chair of Nomination Committee	**N/A**	N/A
Audit Committee Membership	**£10,000**	£10,000
Remuneration Committee Membership	**£10,000**	£10,000
Board Risk Committee Membership	**£10,000**	£10,000
Nomination Committee Membership	**N/A**	N/A

1 The Chair has access to a vehicle for personal use, which is a taxable benefit and is offered access to the Group's private medical insurance scheme which he has accepted and chosen to personally fund.

Non-Executive Directors may receive more than one of the above fees. During 2018, Colin Keogh will be appointed as Chair of the Board of Virgin Money Unit Trust Management (VMUTM), a regulated subsidiary of Virgin Money Holdings (UK) plc. In line with this Remuneration Policy, Mr Keogh will receive a Non-Executive Director fee of £15,000 to take account of this additional responsibility.

Remuneration outcome for 2017

Executive Directors (audited)

The following table summarises the total remuneration awarded in relation to Executive Directors' services during 2017. In respect of the Chief Financial Officer, the figures relate to the period from appointment to the Board on 25 July 2017.

	Jayne-Anne Gadhia		Peter Bole	
	2017 £'000	2016 £'000	Income from 25 July – 31 December **2017 £'000**	2016 £'000
Salary	**780**	750	**219**	–
Fixed Allowance	**100**	100	**–**	–
Taxable benefits[5]	**1**	1	**–**	–
Pension allowance	**234**	225	**44**	–
Total fixed	**1,115**	**1,076**	**263[2]**	**–**
Bonus	**1,060**	1,000	**241[3]**	–
LTIP	**512[6]**	N/A	**N/A**	–
Other	**N/A**	N/A	**282[4]**	–
Total remuneration	**2,687[1]**	**2,076**	**786**	**–**

1 The Chief Executive's total remuneration has increased year-on-year by 29% in 2017. 84% of this increase is attributable to first vesting of share awards made under the LTIP scheme granted in 2015 but where performance conditions ended on 31 December 2017.

2 The Chief Financial Officer became an Executive Director on 25 July 2017. The figures shown for fixed remuneration in 2017 are pro-rated for the period 25 July 2017 to 31 December 2017.

3 Figure represents the proportion of the bonus award for 2017 that relates to duties performed as an Executive Director.

4 'Other' relates to the element of the Chief Financial Officer's buy-out award, granted in 2016 prior to his appointment as an Executive Director. This award was subject to performance conditions that ended on 31 December 2017. The average share price between 1 October 2017 and 31 December 2017 (281.2p) has been used to indicate the value.

5 Taxable benefits consist of Private Medical Insurance (Chief Executive: £715; Chief Financial Officer: £124).

6 The 2015 LTIP vesting outcome was confirmed by the Remuneration Committee at its meeting on 21 February 2018. The average share price between 1 October 2017 and 31 December 2017 (281.2p) has been used to indicate the value. The shares were awarded in 2015 based on a share price of 409p.

Directors' Remuneration Report

Variable Awards

Annual Bonus

For 2017, Executive Directors had a maximum annual bonus opportunity of 100% of fixed pay.

The Executive Directors' 2017 annual bonus determination was based on performance against:

- financial measures (50% of overall award): underlying profit before tax;
- risk, brand, culture, control objectives (25% of overall award): based on performance against objectives from the Group's corporate scorecard; and
- personal strategic objectives (25% of overall award): based on performance against pre-determined personal strategic objectives.

Actual performance against the 2017 bonus targets was as follows (audited):

					Chief Executive		Chief Financial Officer	
Performance measure	Threshold (0%)	Target (60%)	Maximum (100%)	Actual performance	Weighting at maximum	Bonus score	Weighting at maximum	Bonus score
Underlying profit before tax	£213.3m	£231m	£277m	£273.3m	50%	48.9%	50%	48.9%
Risk & Corporate Scorecard		as explained below			25%	21.3%	25%	21.3%
Personal strategic objectives		as explained below			25%	25%	25%	21.5%
Total bonus					100%	95.2%	100%	91.7%

Risk, Brand, Culture and Control Scorecard (25% weighting)

- enhanced customer satisfaction and advocacy with position as one of the leading UK banks for customer satisfaction maintained;
- improvement in intermediary relationships reflected in increased Net Promoter Score to +40;
- progress to achieving the aim of 50%/50% gender balance by 2020, with women in senior leadership roles increasing from 22% to 29%;
- Donations of £95 million (including gift aid) made to charities via Virgin Money Giving demonstrating continued support to the communities in which we operate;
- Focus on quality achieved with liquidity coverage ratio at 203% and cost of risk at 13bps; and
- A continued focus and drive to ensure our customers have been treated fairly measured by the Treating Customer Fairly (TCF) scorecard.

2017 Final outcome: 21.3% out of a maximum 25%

Personal strategic objectives (25% weighting)
Jayne-Anne Gadhia

- Updated long-term strategy agreed with the Board and communicated to the market, including entry to the SME market and ground breaking digital bank proposition;
- Delivered financial targets set out at IPO and in the annual plan, in particular a RoTE of 14%;
- Efficiency improved with a cost:income ratio of less than 50% in Q4 2017;
- Profit attributable to shareholders increased by 37% to £192.1m, resulting in underlying EPS growing by 22% to 39.8p;
- Group succession plan in place with strong and improved coverage. Senior capability enhanced, including the successful appointment of Peter Bole to the Board;
- Significant delivery of activities to enhance colleague diversity, with increased representation across all minority groups (disability, ethnicity, gender, LGBT+) in 2017; and
- Enhancing the company reputation and brand, for example through the success of the 'Women in Finance Charter' and Board membership of UK Finance.

2017 Final outcome: 25% out of a maximum 25%

Peter Bole

- Enhanced financial control capabilities including disciplined cost control and heightened monitoring and reporting of key areas of accounting judgement;
- Further diversification of funding mix with successful RMBS transaction, regulatory approval of covered bond programme and implementation of second investment grade credit rating;
- Led debt and equity investor engagement with particular focus on Group performance and strategy; and
- Ensured continued compliance with all statutory and regulatory reporting and prepared the Group for transition to IFRS 9 from January 2018.

2017 Final outcome: 21.5% out of a maximum 25%

2017 Deferral (audited)

Overall at least 60% of the Executive Directors' 2017 variable pay is deferred from 2021 through 2025 (via a combination of deferred bonus and LTIP awards). For the 2017 annual bonus, 80% of the annual bonus will be paid in 2018 (half shares/half cash). The remaining 20% will be deferred over seven years with one-fifth vesting in March 2021, one-fifth vesting in March 2022, one-fifth vesting in March 2023, one-fifth vesting in March 2024 and the final one-fifth vesting in March 2025. Bonus awards delivered in shares will be subject to a 12-month holding period. No further performance conditions apply although awards remain subject to service conditions and clawback provisions, in line with the Group policy, which includes arrangements for good leavers.

The Chief Executive and Chief Financial Officer received 2017 LTIP awards in March 2017 (100% of fixed pay). Awards will be assessed against performance at 31 December 2019 based on the performance conditions set out in detail in the 2016 Directors' Remuneration Report. One-fifth of the award will vest after four years in March 2021, one-fifth after five years in March 2022, one-fifth after six years in March 2023, one-fifth after seven years in March 2024 and one-fifth after eight years in March 2025. Further details on these awards are set out on page 117.

Directors' Remuneration Report

LTIP Awards Vesting (audited)

2015

The Group has delivered strong performance during the period of the 2015 Long Term Incentive Plan, meeting or exceeding the majority of the targets that were set at the IPO.

Alongside this strong financial performance, the Group has also made considerable progress against scorecard objectives during the performance period:

- Enhanced satisfaction and advocacy is evidenced through increased Customer NPS scores: Since 2014 Customer NPS has risen by 26 points;
- Intermediary Sales NPS has risen by 36 points since 2014 to +61 representing upper quartile performance;
- Consistent delivery against Virgin Money Giving donations targets (£88 million in 2014; £95 million in 2017. Numbers include gift aid); and
- Strong engagement scores throughout performance period.

Performance was measured from 1 January 2015 to 31 December 2017 for which, based on the outcomes detailed below, the Remuneration Committee recommends that 65.3% of the maximum award will vest. Shares will be released to participants of the plan, including the Chief Executive, in equal instalments, subject to malus and clawback, over three years with the first vesting scheduled for March 2018.

			Performance achievement versus targets			
Weighting	**Category**	**Measure**	**Threshold**	**Target**	**Maximum**	**Vesting as % maximum**
30%	**Growth**	Scorecard of: a) Mortgage market share (gross lending)	2.5%	3%	3.5% Actual: 3.3%	9.1%
		b) Cards growth (assets)	£2,200m	£2,450m	£2,700m Actual: £3,024m	10%
		c) Current account, Insurance and Investments Income	-2%	Income growth rate (CAGR) in line with net interest	+2% Actual: Below Threshold	0%
20%	**Quality**	Capital Strength (CET1 ratio)	12.0%	12.5%	>12.5%, and up to 15% Actual: 13.8%	10%
		Cost of Risk	22bps	20bps	18bps Actual: 13bps	10%
30%	**Returns**	Underlying Cost: Income ratio[1]	52.5%	50.0%	47.5% Actual: 51.8%	5.4%
		Underlying Return on Tangible Equity	13.5%	15.0%	16.5% Actual: 14.0%	5.8%
20%	**EBO**	Scorecard of measures relative to external comparators and internal scores	Continuous improvement toward top decile performance on Customers, Colleagues, Community, and Corporate Partners			15%
LTIP Vesting (as a percentage of maximum)						**65.3%**

1 The FSCS Levy was previously excluded from underlying performance measures but it is now included as it is considered to be a recurring cost to the Group however for the 2015 LTIP performance measures have not been adjusted to reflect this change and outcomes are reported in the table excluding the FSCS Levy.

Chief Financial Officer – Legacy Award

On joining the Group, and prior to his appointment to the Board, the Chief Financial Officer received share awards to compensate for remuneration forfeited as a result of leaving his previous employment. This included an LTIP buy-out award to which performance conditions based on growth, quality, returns and scorecard measures were applied. The Remuneration Committee determined that 65.3% of the maximum award will vest based on performance to 31 December 2017. Shares will be released to the Chief Financial Officer in July 2018, in line with Mr Bole's forfeited awards from his former employer.

Chief Executive remuneration compared with the wider employee population

The table below compares the percentage change in remuneration of the Chief Executive with all colleagues. Figures for 'All Colleagues' are calculated using salary figures excluding the Chief Executive, which is considered to be the most appropriate approach for these purposes.

	% change in base salary (2016-2017)[1]	% change in annual bonus (2016-2017)[2]	% change in taxable benefits (2016-2017)
Chief Executive	4%	6%	11%
All Colleagues	4%	18%	11%

Note the percentages for 'All Colleagues' included in the table above represent the year-end position as at 31 December 2017 compared with the year-end position as at 31 December 2016. The percentages are adjusted for movements in colleague numbers and other impacts to ensure a like for like comparison.

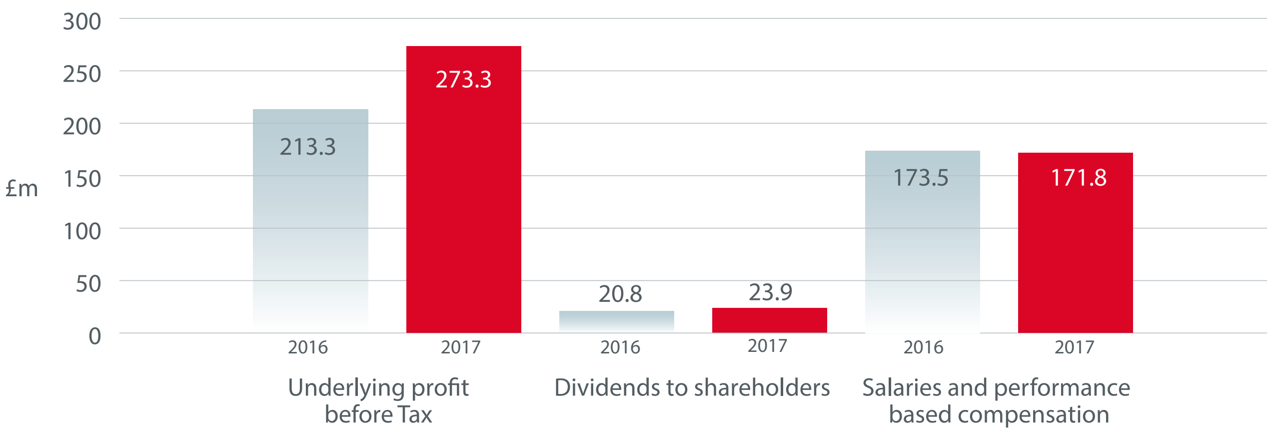
1 The percentage change for the Chief Executive's salary represents the difference between the 2017 salary included in the single figure table on page 107 (£780,000) with the corresponding figure in 2016 (£750,000).

2 This figure represents the average percentage change in full year 2017 Annual Bonuses when compared with full year 2016 Annual Bonuses.

Directors' Remuneration Report

Relative spend on pay

A year-on-year comparison of the relative spend on pay is shown below. Underlying profit before tax has been used for comparison on the basis that it reflects performance, excluding one-off events. Total spend on salaries and performance based compensation in 2017 decreased by 1% as a result of organisational changes in 2016, especially at senior levels. Underlying profit before tax increased by 28%. Dividend distributions in 2017 were £3.1 million higher compared with 2016.



Total Pension Entitlements (audited)

The Executive Directors do not have a right to a defined benefit pension in respect of qualifying service.

External Appointments

The Chief Executive undertakes a number of external appointments (as set out on page 67). The Chief Executive does not receive any earnings in respect of these appointments.

Payments within the reporting year to past Directors (audited)

As part of arrangements on leaving the Company:

> the second and final tranche of a 2012 deferred bonus payment totalling £250,312 was released to Finlay Williamson; and

> a 2013 deferred bonus payment totalling £187,767 was released to Lee Rochford.

Each of the above amounts were delivered in shares, with the net number of shares subject to a six-month hold period.

Loss of office payments (audited)

There were no payments for the loss of office made to former Directors during 2017.

Chair and Non-Executive Directors' fees (audited)

	Fees paid in 2017 (£000s)	Fees paid in 2016 (£000s)
Glen Moreno[1]	**350**	253
Colin Keogh	**115**	111
Norman McLuskie	**145**	125
Marilyn Spearing (to 3/5/17)	**43**	124
Patrick McCall	**80**	80
Gordon McCallum (to 31/10/17)	**67**	80
Geeta Gopalan	**110**	109
Eva Eisenschimmel (from 25/1/17)	**103**	–
Darren Pope (from 1/3/17)	**99**	–
Amy Stirling (from 20/12/17)	**–**	–

1 Glen Moreno has access to a vehicle for personal use, which is a taxable benefit (£1,228). (£5,618 in 2016).

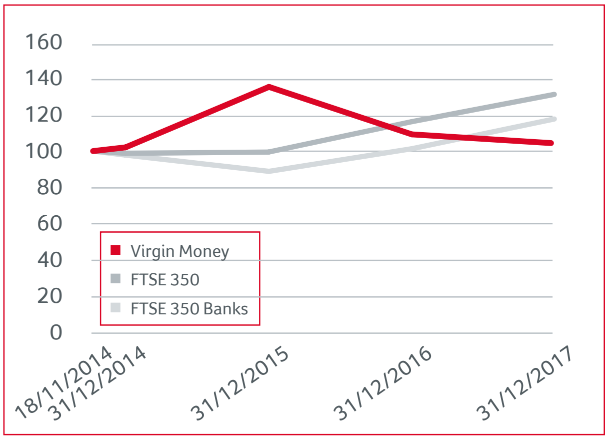
Breakdown of Non-Executive Directors' fees

Non-Executive Directors receive specific committee fees, as set out in the table on page 106. There were no changes to fees during 2017.

Historical TSR performance and Chief Executive pay

The graph opposite shows the total shareholder return (TSR) of the Company for the period from the date when shares were listed on the London Stock Exchange (18 November 2014) to the end of the 2017 financial year, and the performance of the FTSE 350 Index over the same time period. As a recently listed company, a five-year TSR graph cannot be included. The FTSE 350 Index has been chosen as the comparative broad equity index because the Company is a member of that index. For further context and comparison to some competitors, the graph also shows the Company's TSR performance against the FTSE 350 Banks Index over the same period.

Virgin Money TSR v FTSE 350



Chief Executive remuneration outcomes – since Initial Public Offering

Financial year ending	31/12/2014	31/12/2015	31/12/2016	**31/12/2017**
Chief Executive	Jayne-Anne Gadhia	Jayne-Anne Gadhia	Jayne-Anne Gadhia	**Jayne-Anne Gadhia**
Total remuneration single figure (£000)	3,647	1,617	2,076	**2,687**
Annual bonus awarded (% of maximum opportunity)	95%	88%	93%	**95%**
Long term Incentive Award vesting	–	–	–	**65.3%**

Directors' Remuneration Report

Outstanding share awards (audited)

Directors' share interests

The table below summarises shareholdings and share interests as at 31 December 2017.

	Owned outright	Number of shares[1,2,3]		Total
		Unvested (not subject to performance conditions)	Unvested (subject to performance conditions)	
Jayne-Anne Gadhia				
Ordinary shares	2,016,558			
Breakdown of unvested shares:				
(A) Phantom Share Awards (pre-IPO)		101,710		
(B) Deferred Bonus Share Plan Awards		366,938		
(C) Long Term Incentive Plan Awards			904,211	
				3,389,417
Peter Bole				
Ordinary shares	67,690			
Breakdown of unvested shares:				
(B) Deferred Bonus Share Plan Awards		209,783		
(C) Long Term Incentive Plan Awards			369,743	
				647,216

1 The Executive Directors do not hold any vested or unvested options.

2 All unvested awards above will be subject to tax upon vesting.

3 Unvested shares subject to performance conditions include shares awarded under the 2015 LTIP, the performance period in respect of which expired on 31 December 2017.

Breakdown of share interests

Further details in respect of the unvested shares included in the Directors' share interest table are provided in the following tables. The details are in relation to the current Executive Directors and no other Directors have rights to shares. For awards granted prior to 2015, the share numbers referred to in this section are adjusted for the effect of the re-organisation of the Company's share capital on listing in 2014.

(A) Phantom Share Awards

Awards were granted prior to IPO under a deferred bonus plan known as the 'Phantom Incentive Plan'. No further phantom share awards have been granted since listing. No further performance conditions apply, although the awards remain subject to malus and clawback. Holding periods of six months apply to each deferred tranche.

	At 1 Jan 2017	Awarded during the year	Vested during the year	Lapsed during the year	Unvested as at 31 Dec 2017[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia 2012 deferred bonus	242,580	–	242,580	–	–	18 July 2013	n/a	
Jayne-Anne Gadhia 2013 deferred bonus	203,420	–	101,710	–	101,710	27 February 2014	n/a	Vests March 2018
Total					**101,710**			

1 The Company was in private ownership at the date of grant and therefore no market value was available at that time.

2 All unvested awards above will be subject to tax upon vesting.

Directors' Remuneration Report

(B) Annual Bonus – Deferred Bonus Share Plan (DBSP)

Conditional Share Awards were granted under the Deferred Bonus Share Plan in March 2017 in respect of 2016.

For the Chief Executive, the portion of the annual bonus converted into shares had a face value of £680,000. This value was converted into the number of shares shown using the share price on the day immediately preceding grant. No further performance conditions apply, although awards remain subject to malus and clawback provisions. Holding periods of six months apply to each deferred tranche. Details of this award are included in the table below alongside the awards made in respect of 2014 and 2015. The table also sets out awards made to the Chief Financial Officer prior to his appointment as an Executive Director including awards made as part of his joining arrangements (as detailed in the 2015 Directors' Remuneration Report).

	At 1 Jan 2017[3]	Awarded during the year	Vested during the year	Lapsed during the year	Unvested as at 31 Dec 2017[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia 2014 deferred bonus	221,570	–	–	–	221,570	26 March 2015	409p per share	Vests 26 March 2018 and 2019
Jayne-Anne Gadhia 2015 deferred bonus	52,965		17,655	–	35,310	15 March 2016	377.5p per share	Vests 15 March 2018 and 2019
Jayne-Anne Gadhia 2016 deferred bonus		207,887	97,829		110,058	15 March 2017	327.1p per share	Vests 15 March 2020, 2021, 2022, 2023 and 2024
Total					**366,938**			
Peter Bole Deferred Bonus Buy-out	217,889		15,810		202,079	1 December 2016	307.5p per share	Vests May and July 2018, December 2019
Peter Bole 2016 deferred bonus	7,704				7,704	15 March 2017	327.1p per share	Vests 15 March 2020, 2021, 2022, 2023 and 2024
Total					**209,783**			

1 Awards are made based on the market value of ordinary shares determined on the dealing day preceding the date of grant.

2 All unvested awards above will be subject to tax upon vesting.

3 Reflects the position for the Chief Financial Officer at the time of appointment to the Board, 25 July 2017.

(C) Long Term Incentive Plan

Conditional Share Awards were granted under the 2017 Long Term Incentive Plan on 15 March 2017. Awards are subject to performance conditions (as described in last year's report) that will apply from 1 January 2017 to 31 December 2019, with threshold performance resulting in 20% of the award vesting.

The face value of the award made to the Chief Executive was £1,114,000. This value was converted into the number of shares shown using the share price on the day immediately preceding grant. One-fifth of the award will vest after four years in March 2021, one-fifth after five years in March 2022, one-fifth after six years in March 2023, one-fifth after seven years in March 2024, and the final one-fifth after eight years in March 2025 (each with a 12-month holding period). Details of this award are included in the table below alongside the awards made in respect of 2015 and 2016. The table also sets out awards made to the Chief Financial Officer prior to his appointment as an Executive Director including awards made as part of his recruitment (as detailed in the 2015 Directors' Remuneration Report). All awards are subject to malus and clawback provisions.

	At 1 Jan 2017[3]	Awarded during the year	Unvested as at 31 Dec 2017[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia 2015 LTIP	278,875	–	278,875	26 March 2015	409p per share	Vests 26 March 2018, 2019 and 2020
Jayne-Anne Gadhia 2016 LTIP	284,768	–	284,768	15 March 2016	377.5p per share	Vests 15 March 2020, 2021, 2022, 2023 and 2024
Jayne-Anne Gadhia 2017 LTIP	–	340,568	340,568	15 March 2017	327.1p per share	Vests 15 March 2021, 2022, 2023, 2024 and 2025
Total			**904,211**			
Peter Bole LTIP Buy-out[4]	153,793	–	153,793	1 December 2016	307.5p per share	Vests 15 July 2018
Peter Bole 2016 LTIP[4]	32,520	–	32,520	1 December 2016	307.5p per share	Vests 15 March 2020, 2021, 2022, 2023 and 2024
Peter Bole 2017 LTIP[4]	183,430	–	183,430	15 March 2017	327.1 per share	Vests 15 March 2021, 2022, 2023, 2024 and 2025
Total			**369,743**			

1 Awards are made based on the market value of ordinary shares determined on the dealing day preceding the date of grant.

2 All unvested awards above will be subject to tax upon vesting.

3 Reflects the position for the Chief Financial Officer at the time of appointment to the Board, 25 July 2017.

4 The Chief Financial Officer's LTIP Buy-out Award, 2016 LTIP Award and 2017 LTIP Award were granted prior to his appointment in to the Board. The awards are subject to performance measures.

Directors' Remuneration Report

Additional disclosures (audited)

Shareholding guidelines

Executive Directors are expected to hold 200% of salary in shares in the Company built up over five years from listing or recruitment, whichever is the later.

As a result of the shareholdings in the table on page 119, the position for Executive Directors in 2017 is as follows:

		Shareholding requirement		Current shareholding		
Executive Directors	Base salary	% of base salary	Number of shares (at 31.12.17 closing price of 284.2p)	% of base salary (at 31.12.17 closing price of 284.2p)	Value of shares held (at 31.12.17 closing price of 284.2p)	Requirement met Yes/No
Jayne-Anne Gadhia	£780,000	200%	548,909	735%	£5,731,058	Yes
Peter Bole	£500,000	200%	351,864	38%	£192,375	No

Directors' interests – summary of awards vested and purchases and sales made by directors in 2017 (audited)

	Holding at 1 January 2017 (or appointment date)	Transactions during year	Number of shares	Notes	Holding at 31 December 2017
Jayne-Anne Gadhia	**2,438,275**	15 March 2017	242,918	Number of shares from vesting of deferred bonus shares (2012 and 2013 Phantom Incentive and 2015 and 2016 DBSP) after tax	**2,016,558**
		16 May 2017	700,000	Disposal of shares	
		25 July 2017	35,365	Purchase of shares	
Peter Bole	**59,338**[1]	25 July 2017	8,352	Number of shares from vesting of deferred bonus shares (DBSP Buy-out Award) after tax	**67,690**
Glen Moreno	**71,164**			–	**71,164**
Geeta Gopalan	**–**	–	–	–	**–**
Colin Keogh	**157,260**	–	–	–	**157,260**
Patrick McCall	**–**	–	–	–	**–**
Gordon McCallum	**18,983**	10 January 2017	18,983	Disposal of shares for nil consideration by way of donation to charity	**–**
Norman McLuskie	**90,080**	–	–	–	**90,080**

1 Holding at 25 July 2017

Marilyn Spearing, Eva Eisenschimmel, Darren Pope and Amy Stirling did not hold shares in the Company during the year. There have been no other changes to the above interests between 31 December 2017 and 25 February 2018.

On behalf of the Board

Norman McLuskie
Chair, Remuneration Committee
26 February 2018

Directors' Report

Corporate governance statement

The Corporate Governance Report, together with this report of which it forms part, fulfils the requirements of the Corporate Governance Statement for the purpose of the Disclosure Guidance and Transparency Rules (DTR).

Profits and dividends

The consolidated income statement shows a profit before tax for the year ended 31 December 2017 of £262.6 million.

The Directors have declared/recommended dividends as follows:

Type of dividend	Amount per ordinary share	Payment date
Interim (2016)	1.6p	23 September 2016
Final (2016)	3.5p	10 May 2017
Interim (2017)	1.9p	22 September 2017
Final (2017)	4.1p	16 May 2018 (subject to approval by shareholders at the 2018 AGM)

Post balance sheet events

Post balance sheet events are disclosed in note 36 to the financial statements.

Going concern

The going concern basis of the Company and the Group is dependent on successfully funding the balance sheet and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for a period of at least twelve months from the date of approval of this report, the Directors have considered a number of key dependencies which are set out in the Risk Overview and Risk Management Report under Principal Risks on pages 36 to 39 and 132, Funding and Liquidity on page 38 and pages 170 to 181 and Capital position on pages 182 to 188, and additionally have considered projections for the Company and the Group's capital and funding position.

Having considered these and made appropriate enquiries, the Directors consider that the Company and Group have adequate resources to continue in business for a period of at least twelve months from the date of approval of this report. As a result, it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Viability statement

In accordance with the 2016 UK Corporate Governance Code (Code), the Directors have assessed the viability of the Group. Their assessment has taken into account the Group's current financial position, assessment of the Group's prospects and the potential impact of the principal risks, which are set out on pages 36 to 39. The Directors have determined that a three year period to 31 December 2020 constitutes an appropriate period over which to perform this assessment. This period presents a reasonable degree of confidence, while providing a longer-term perspective.

In making this statement, the Directors have considered the principal and emerging risks facing the Group, including those that could potentially threaten the Group's business model, future performance, solvency or liquidity. The Group's current and projected capital and liquidity positions have been assessed in comparison to risk appetite, early warning indicators and regulatory minima.

The Group's strategy is set out on pages 18 to 19 of the Strategic Report. The key factors which support the future prospects of the Group are:

- the Group's strong balance sheet position. The Group has strong capital and liquidity, well in excess of regulatory minima;
- the Group has high-quality assets and diversified funding sources. The business delivered strong financial performance in 2017, with continued improvement in operational leverage;
- the Group has a number of established and new partnership arrangements providing opportunity for growth in other income streams; and
- the Group's long-term strategy includes the development of the SME proposition and the digital bank during 2018, which provide significant future opportunities.

As described in the Corporate Governance Report on page 81, the Audit Committee Report on page 89 and the Risk Management Report on pages 126 to 188, the Board monitored the Group's risk management and internal control systems, and oversaw their effectiveness. The monitoring and review covered all material controls, including financial, operational and compliance controls.

The Board considers its strategic plan at least annually and monitors it on an ongoing basis. This plan is stress tested and includes a review of the sensitivity of the Group to business as usual risks and other severe but plausible events. The Board considers the ability of the Group to raise finance and deploy capital. These results take account of the availability and likely effectiveness of the mitigating actions that could be taken to avoid or reduce the impact or occurrence of underlying risk.

The Group performs a range of macro-economic, idiosyncratic and income stress tests, the most material of which relate to rising unemployment, increased base rate and a reduction in HPI. The results show that sufficient capital and liquidity is held to cover the stress scenarios, both in amount and quality. Supporting capital and funding plans are developed to survive the impact of the stress scenarios over the planning horizon. This is captured in the Group's ICAAP and ILAAP.

Information relevant to the Board's assessment of viability can be found on the following pages:

- the Group's principal activities, business model and strategy are described on pages 18 and 19;
- the Group's emerging risks are disclosed on pages 130 to 131;
- the Group's principal risks, including mitigating actions, are described on pages 132 to 188; and
- the Group's approach to stress testing and reverse stress testing is described on page 129.

The Directors confirm they have reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due in the period to 31 December 2020.

Directors

The names and biographical details of the current Directors are shown on pages 66 to 68. Changes to the composition of the Board since 1 January 2017, and up to the date of this report, are shown in the table below.

Name	Role	Date of appointment/retirement
Eva Eisenschimmel	Non-Executive Director	appointed 25 January 2017
Darren Pope	Non-Executive Director	appointed 1 March 2017
Marilyn Spearing	Non-Executive Director	retired 3 May 2017
Peter Bole	Executive Director	appointed 25 July 2017
Gordon McCallum	Non-Executive Director	retired 31 October 2017
Amy Stirling	Non-Executive Director	appointed 20 December 2017

Directors' Report

Appointment and retirement of Directors

The appointment, retirement and/or replacement of Directors is governed by the Articles of Association of the Company (Articles), the Code and the Companies Act 2006 (Act). The Articles may be amended only by a special resolution of the shareholders in a general meeting.

The Directors appointed to the Board since the 2017 AGM will stand for election by shareholders at the 2018 AGM. In the interests of good governance, all of the other Directors will also retire and those wishing to serve again will submit themselves for re-election at the 2018 AGM.

Virgin will be entitled to vote on the ordinary resolutions at the AGM for the re-election of the Independent Non-Executive Directors. However, for the purposes of the Listing Rules, each such resolution will also require approval by a majority of the votes cast by the Company's independent shareholders (being the shareholders excluding Virgin) in order to be valid. The outcome of both of these vote counts will be announced following the 2018 AGM.

Directors' indemnities

The Directors and former directors have entered into individual deeds of indemnity with the Group which constitute 'qualifying third party indemnity provisions' for the purposes of the Act. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force for the duration of a Director's period of office and for a six-year period thereafter. The deeds were in force during the whole of the financial year and remain in force at the date of this report.

Deeds for current Directors, and the former directors who retired during the year, are available for inspection at the Company's registered office. In addition, the Group had appropriate Directors and Officers' liability insurance cover, as well as Professional Indemnity insurance cover, in place throughout 2017.

Information included by reference

The following information forms part of the Directors' Report and is incorporated into the report by reference.

Subject matter	Page/note reference
Colleague engagement and remuneration	101
Dividends	Note 11
Directors' interests in shares	118 and 119
Internal control and risk management systems in relation to financial reporting	81, 89 and 126 to 188
Information in relation to the use of financial instruments	126 to 188
Share capital and control	Share capital and restrictions on the transfer of shares or voting rights - Note 27, page 237 to 238 Special rights as regards control of the Company – Note 27, page 237 to 238

Information included in the Strategic Report

Subject matter	Page reference
Future developments	18 to 29
Inclusion and diversity (including employment of disabled people)	14 to 15 and 22 to 23
Emissions reporting	28 to 29

Colleague engagement

Information of matters relevant to employees, including financial and economic factors affecting the performance of the Group, is communicated on a regular basis, with engagement measured through an annual third-party survey.

Disclosures required under LR 9.8.4R

Subject matter	Page reference
Relationship agreement	80
Publication of unaudited financial information	133
Dividend waivers	Note 11, page 266
Allotment of equity securities	Note 27, page 237
Allotment of other equity securities (ATI securities)	Note 28, page 238
Significant contracts	Note 35, page 247

Voting and Directors' powers

The Company operates an employee benefit trust (EBT), which holds ordinary shares on trust for the benefit of employees and former employees of the Group, and their dependants, and which is used in conjunction with the Group's employee share schemes. Whilst ordinary shares are held in the EBT, the voting rights in respect of these ordinary shares are exercised by the trustees of the EBT.

The powers of the Directors, including in relation to the issue or buy back of the Company's shares, are set out in the Act and in the Articles and in certain circumstances, including in relation to the issuing or buying back by the Company of its shares, are subject to authority being given to the Directors by shareholders in general meeting. The Company did not repurchase any of the issued ordinary shares during 2017 and up to the date of this report pursuant to the authority granted at the 2017 AGM (where the Company was authorised to buy back up to 44,494,200 ordinary shares, representing 10% of the Company's issued ordinary share capital as at 23 March 2017).

Shareholders will be asked at the 2018 AGM to renew the authorities granted at the 2017 AGM to allot, issue and buy back shares, taking into account the latest institutional shareholder guidelines.

Substantial shareholders

Information provided to the Company by substantial shareholders pursuant to the DTR is published via a Regulatory Information Service. As at 31 December 2017, the Company has been notified under DTR Rule 5 of the interests in its issued share capital as set out below. All such share capital has the right to vote in all circumstances at general meetings.

As at 31 December 2017 Shareholder	Ordinary shares held	% of voting rights	Direct/ indirect interest
Virgin Group Holdings Limited	155,120,454	34.86%	Direct
Standard Life Aberdeen plc	53,756,010	12.08%	Indirect
Prudential plc group of companies	29,475,132	6.62%	Indirect

In the period from 31 December 2017 to the date of this report, the Company has received a notification from Standard Life Aberdeen plc. This notification indicates that the Standard Life Aberdeen plc shareholding as at the date of this report is 52,988,708 ordinary shares representing 11.91% of the total voting rights attached to issued share capital. The holding is indirect.

Information provided to the Company under the DTR is publicly available via the regulatory information service and on the Company's website.

Directors' Report

Change of control

The Company is not a party to any significant contracts that are subject to change of control provisions in the event of a takeover bid, other than the Virgin Money Trademark Licence Agreement. This is the agreement under which Virgin Enterprises Limited (VEL) grants a perpetual licence to Virgin Money providing the right to use the 'Virgin' and 'Virgin Money' trademarks. VEL has the right to terminate the agreement in the event of a change of control, other than a change of control pre-approved by VEL. VEL shall be entitled to withhold consent only in the event of a takeover by a third party who, in VEL's reasonable opinion, is a direct competitor of VEL or any Virgin entity in the UK, or whose reputation or financial standing is reasonably likely to damage materially the value or reputation of the Virgin brand.

There are no agreements between Virgin Money and its Directors or employees which provide compensation for loss of office or loss of employment that occurs because of a takeover bid.

In the event of a takeover or other change of control (excluding an internal reorganisation), outstanding awards under the Group's share plans vest to the extent any applicable performance conditions have been met and, subject to applicable time pro-rating, in accordance with the rules of the plans.

Research and development activities

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

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group financial statements and the Company financial statements in accordance with IFRS as adopted by the European Union (EU). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period. In preparing the financial statements, the Directors are required to:

> select suitable accounting policies and then apply them consistently;

> state whether applicable IFRS as adopted by the EU have been followed for the Group and Company financial statements, subject to any material departures disclosed and explained in the financial statements;

> make judgements and accounting estimates that are reasonable and prudent; and

> prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Act and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the Annual Financial Report

Each of the Directors who is in office at the date of this report and whose names and functions are listed on pages 66 to 68, confirms that, to the best of their knowledge:

> the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and

> the management report contained in the Strategic Report and the Directors' Report includes a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that they face.

The Directors consider that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group and Company's position and performance, business model and strategy.

Independent auditors and audit information

Each of the Directors who is in office at the date of this report and whose name is listed on pages 66 to 68 confirms that:

> so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and

> they have taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the Audit Committee to set the auditors' remuneration will be proposed at the 2018 AGM.

On behalf of the Board

Katie Marshall
Company Secretary
26 February 2018

Virgin Money Holdings (UK) plc
Registered No. 03087587

Risk Management Report

Virgin Money Lounge, Glasgow

The Group's approach to risk management

Risk management is at the heart of the Group's strategy to enable profitable, long-term growth. This is achieved through a clearly defined risk appetite and informed risk decision-making, supported by a consistent risk-focused culture across the Group.

Risk culture and values

The Group has a customer-focused business model built on a prudent risk culture that reinforces accountability. The Group's risk values, outlined below, describe how all colleagues, suppliers and partners are expected to operate.

Risk appetite

Risk appetite is the amount and type of risk that the Group is prepared to seek, accept or tolerate. It is reflected in frameworks and policies that either limit or, where appropriate, prohibit activities that could be detrimental to the Group. The Group's strategy is developed in conjunction with risk appetite. The Group's risk appetite is approved by the Board with each strategic planning cycle.

Governance and control

Delegation of authority from the Board to Executive Committees and Senior Management establishes governance and control. Issues are escalated promptly and remediation plans are initiated where required.

The key responsibilities of the Board and senior management include setting risk appetite, agreeing the risk management framework, and approving policies and practices.

Accountability

The Group uses a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities. This ensures effective independent assurance over key business activities.

> line management (first line) have primary responsibility for risk decisions; measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective controls in line with policy, to maintain appropriate risk management skills, practices and tools, and to act within Board-approved risk appetite parameters. All Executives undertake a monthly control effectiveness review and a quarterly risk and control attestation;

> the Risk function (second line) provides proactive advice and constructive challenge on the effectiveness of risk decisions taken by line management. It is responsible for the design and development of the risk management framework and risk appetite. It provides a view of the Group's risk profile while reporting against risk appetite to the Board. It also oversees the Group's internal stress testing framework and maintains the Group's relationship with regulators; and

> Internal Audit (third line) provides independent, objective assurance to improve operations. It helps the Group achieve its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Risk Management Report

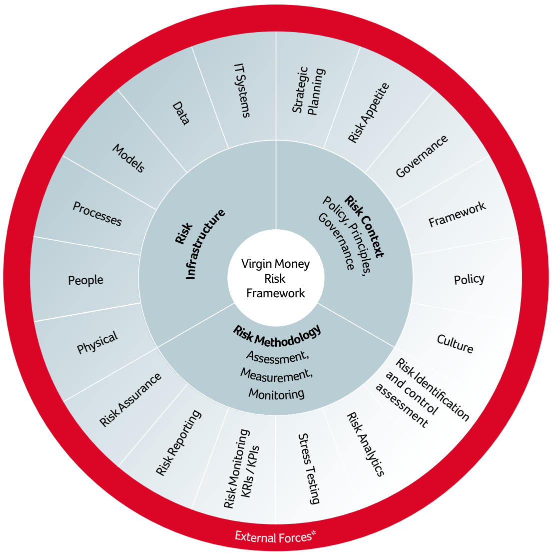
The Group's approach to risk management

1 In addition, there is a Board Nomination Committee.

2 Geeta Gopalan was appointed Chair of the Risk Committee with effect from 8 January 2018. Prior to that the Committee was chaired by Colin Keogh.

Risk management framework

The Group's risk management framework is the foundation for the delivery of effective risk management and is structured around the following components:



* **External forces**

Legal	Customer	Political
Regulatory	Competitor	Technological
Economic	Supplier/Partner	

Risk identification and control assessment

The process to identify, measure and control risk is integrated into the overall risk governance framework. Risk identification processes are forward-looking to ensure emerging risks are identified. Risks are captured in risk logs and measured using consistent methodologies. Risk measurement includes the application of stress testing and scenario analysis, and considers whether relevant controls are in place.

Risk decision-making and reporting

A current and forecast view of the Group's overall risk profile, key exposures and management actions is reported to the Risk Management Committee, the Board Risk Committee and the Board. The Chief Risk Officer is a member of the Executive and has direct access to the Chair of the Board Risk Committee.

Stress testing

Stress testing is an essential risk management tool which examines the sensitivities of the strategic plan and business model and supports the development of management actions and contingency plans. It is overseen by the Board Risk Committee.

Sensitivity analysis and scenario stress testing are used to:

> monitor compliance with the Group's risk appetite and ensure that the Group can meet any unexpected demands on financial resources without threatening the viability of the business;

> inform decision-making, ranging from underwriting decisions to ensuring the sufficiency of capital and liquidity over the planning horizon. This involves the use of a variety of macro-economic, operational, liquidity and financial market disruption scenarios;

> support the Internal Capital Adequacy Assessment Process (ICAAP), the Internal Liquidity Adequacy Assessment Process (ILAAP) and inform the setting of regulatory guidance; and

> develop the Recovery Plan for the business including the identification of material recovery options.

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans in extreme adverse situations with the aim of improving contingency planning.

The Senior Managers and Certification Regime outlines stress testing as a prescribed responsibility, with clear accountabilities and responsibilities assigned to senior management and the Risk and Finance functions. The Chief Risk Officer is the Executive accountable for stress testing.

Risk Management Report

Emerging risks

The Group considers the following to be key emerging risks that have the potential to affect the performance of the Group.

Macro-economic environment

The UK economy remained resilient through 2017 and performed better than markets had expected at the beginning of the year. The economic outlook for 2018 has been strengthened by global growth. Whilst there continues to be no evidence of material changes in customer behaviour, the potential risks around inflation, a slowing housing market and rising unemployment remain.

The Bank of England increased interest rates from 0.25 per cent to 0.50 per cent in November 2017, and there is the expectation that rates will continue to rise gradually over the next three years. Low wage growth and higher inflation may put pressure on some household budgets and the Group remains alert to signs of customers in financial distress. The commercial performance of the credit card portfolio is exposed to changes in consumer behaviour and the Group continues to monitor this closely. In addition, changes to central bank rates can represent risk to future financial performance.

The mortgage market saw heightened competition in the second half of 2017 which may continue in 2018.

Political and economic uncertainty, including the impact of the UK leaving the European Union, could impact the wholesale funding markets. In addition, the closure of the Bank of England's Term Funding Scheme (TFS) has led to cumulative refinancing risk across the industry. The Group's drawings from the TFS will be refinanced in the medium term. The Group has a well-diversified wholesale funding portfolio and further issuances of Residential Mortgage Backed Securities, Global Medium Term Notes and Covered Bonds are planned for 2018.

Key mitigating actions

- there is an ongoing programme of stress testing to assess vulnerability to changing macro-economic conditions and to inform the strategic planning process;
- the Group continues to monitor key exposures in light of the prevailing and forecast economic outlook, and tests its readiness to respond to future changes in the economy;
- additional oversight activities have been implemented, alongside contingency plans, which are designed to respond to and mitigate the impact of adverse conditions that may emerge;
- the Group monitors its credit and liquidity positions, operational capability and risk of disruption to payment and other systems, to ensure it remains responsive to changes in the macro-economic environment;
- the Group continues to review its capital plan in light of market conditions; and
- retail funding is supplemented by a diversified wholesale funding programme and the Group is planning its inaugural Covered Bonds issuance in H1 2018.

Macro-structural landscape

There is a significant volume of regulatory change which will impact the Group over the coming year. These changes may also lead to increased competition.

Changes to capital requirements include an increase to the countercyclical buffer, implementation of Structural Reform and the introduction of Minimum Requirements for Own Funds and Eligible Liabilities (MREL). Further information regarding these changes can be found on page 183.

Open Banking and the second Payment Services Directive (PSD2) came into force in January 2018, and General Data Protection Regulation (GDPR) is due to follow in May. These regulatory change programmes are aimed at protecting the consumer and introducing greater choice. Consequently, they are expected to have a material impact on the competitive environment in which the Group operates, with non-bank firms potentially entering the market.

IFRS 9 is effective from 1 January 2018 and will result in new calculations of expected credit loss and additional disclosure requirements.

The EU's Markets in Financial Instruments Directive (MiFID II) reforms are effective from January 2018. They are designed to promote investor protection and increase market transparency and efficiency. The Group is compliant with the new regulations.

Key mitigating actions

> the Board is focused on responding effectively and efficiently to changes in the regulatory environment and overseeing the delivery of these regulatory changes;

> the business planning process incorporates the Group's view of emerging capital requirements;

> stress and scenario testing forms an integral part of the Group's strategic and capital planning;

> the Group actively participates in regulatory developments, engaging with HM Treasury, the PRA, the FCA and the Bank of England on the evolving UK regulatory framework and the impact of EU directives; and

> new impairment models and business processes have been developed and embedded to meet the requirements of IFRS 9.

Balance sheet risk

Credit

Low wage growth and higher inflation could cause a reduction in household real earnings. In a rising interest rate environment, the cost of borrowing may increase. Combined with potential concern around consumer indebtedness, these factors could lead to increases in defaults and impairments.

In relation to the housing market, although the potential for the weakening of regional house prices exists, inflation, low unemployment and record low mortgage rates support consumer affordability while supply shortages continue to support house prices.

Key mitigating actions

> the Group has well-established early warning indicators to highlight signs of regional stress in the housing market;

> the Group has tightened credit card scorecard cut-offs and implemented policy restrictions during the year to protect the credit quality of new card lending; and

> the Group will continue to protect asset quality.

Cyber-crime and financial crime risk

The external threat of cyber-crime continues with reports of data and security breaches increasing in frequency and severity across all industries. Ongoing evidence of ransomware attacks emphasises the need for firms to remain alert to the emerging threat environment with detective and preventative processes and systems.

The FCA regards financial crime risk as a significant threat to realising their objective to promote and enhance the integrity of the UK financial system and emphasises the need for firms to ensure they have adequate and effective systems and controls to manage this.

Key mitigating actions

> the Group has a Cyber Security Strategy to enhance its control environment, IT resilience and information security capability, taking account of both the external threat environment and the changing risk profile of the business;

> the Group remains responsive to newly identified external vulnerabilities, increasing monitoring where required to mitigate risk to the Group; and

> the Group has in place a strategic financial crime programme designed to enhance the Group's systems and controls.

Supplier partnerships

The Group works with mortgage intermediaries and manages outsourced relationships with third parties who support the credit card, investment and insurance business lines. The Group has strategic suppliers for key components of its infrastructure. Reliance on key corporate partners and strategic suppliers gives rise to risks in relation to operational continuity.

Key mitigating actions

> the Group develops its supplier partnership and oversight capability to minimise the risk of service disruption caused by the failure of a third party;

> the Group engages specialist third parties to undertake targeted reviews of supplier performance as required; and

> the Group outsources the administration of its unit trust and pension business to DST (formerly IFDS). During 2017, DST progressed a significant programme of remediation relating to compliance with client asset regulations which will continue into 2018. The Group continues to strengthen its oversight of DST.

Risk Management Report

Exposure to risk by business activity

The table below provides a high-level illustration of how the Group's business activities are reflected in risk-weighted assets.

Virgin Money Group

Total risk-weighted assets £9,179m

Residential mortgages
Buy-to-let mortgages
Customer deposits
Current accounts

Risk-weighted assets	£m
Credit risk	5,790
Operational risk	518

Credit cards

Risk-weighted assets	£m
Credit risk	2,283
Operational risk	185

Pensions
Insurance
Investments

Risk-weighted assets	£m
Operational risk	53

Central functions

Shared support functions
Interest Rate Risk in the Banking Book[1]

Risk-weighted assets	£m
Credit risk	339
Credit value adjustments	11

1 Virgin Money does not have a trading book and, as such, does not have material exposure to market risk. Interest Rate Risk in the Banking Book is captured as part of Pillar 2 capital and therefore does not give rise to risk-weighted assets.

Principal risks

The Board have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. The Group's principal risks are shown in the Risk overview on pages 36 to 39.

The Group's emerging risks are shown on pages 130 and 131. Full analysis of the group's risk classes is shown on pages 134 to 188.

Risk classes

The Group's risk framework covers all types of risk which affect the Group and could impact on the achievement of strategic objectives. A detailed description of each category is provided on pages 134 to 188.

All disclosures in the Risk Management Report are unaudited, unless otherwise stated. Additional information can be found in the Pillar 3 disclosures on the Group's website.

Risk Values and Licence to Operate

Capital Pillar 1

- **Credit Risk**
  - Retail
    - Mortgage
    - Personal Current Accounts
    - Credit Cards
    - Collections & Recoveries
  - Wholesale
    - Wholesale Credit Risk
    - Large Exposures
- **Market Risk**
  - Foreign Exchange Risk
- **Operational Risk**
  - Operational Risk

Capital Pillar 2

- **Infrastructure Risk**
  - Business Resiliance
  - Technology Risk
  - Information Security & Cyber-crime
  - Information Management
  - Financial Crime
  - Payment & Market Infrastructure Risk
  - Physical Security & Environmental Risk
  - Non-financial Counterparty Risk
- **Conduct Risk and Compliance**
  - Conduct
    - Partner Conduct
    - Colleague Competence
    - Incentives and Reward
    - Accessible Banking & Financial Inclusion
    - Sales Practices & Advice
    - Product Design
    - Post sale Administration
    - Customer Outcomes, Complaints & Remediation
    - Financial Promotions & Marketing
  - Compliance
    - Upstream Regulation
    - Regulatory Reporting
    - Critical and Important Outsourcing
    - Sourcebooks CASS COLL MCOB BCOB BIPRU COB CCA REMCODE
    - Senior Persons
    - Markets Compliance
    - Anti Money Laundering
    - Fund Governance
    - Privacy and Data Protection
- **Strategic and Business Risk**
  - Macro-economic Risk
  - Transformation Risk
  - Legal Risk
  - Reputation Risk Management
  - Competitive Environment
  - Political Risk
- **Financial Risk**
  - Interest Rate Risk in the Banking Book
  - Retail Concentration Risk
  - Secured Wholesale Debt
  - Pricing
  - Model Risk
  - Wholesale Credit Concentration Risk
  - Under-estimation of Credit Risk
  - Settlement Risk

Liquidity

- Retail Funding Risk
- Off-Balance Sheet Liquidity Risk
- Marketable Asset Risk
- Franchise Viability Risk
- Wholesale Funding Risk
- Funding Concentration Risk
- Intra-Day Liquidity Risk
- Replenishment Risk and Collateral

Capital

- Capital Sufficiency
- Capital Efficiency

Risk Management Report

Full analysis of risk classes

Credit risk

Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off-balance sheet).

Risk appetite

The Group has appetite for high-quality credit exposures including retail lending and liquid wholesale investments.

Exposures

The principal credit risks arise from loans and advances to customers, debt securities and derivatives. The credit risk exposures of the Group are set out on page 138. Credit risk exposures are categorised as retail (secured and unsecured) and wholesale.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Retail mortgages expose the Group to customer re-mortgage risk. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. The debt management strategies employed by the Group are detailed on page 151.

The Group's buy-to-let lending policy is targeted towards retail customers rather than professional landlords, with specific restrictions in place on total exposures by loan amount and number of properties.

The Group's unsecured portfolio has grown in line with expectations and within strict underwriting criteria. The Group has increased scorecard cut-offs for some customer segments during 2017. The Group assesses customer affordability rigorously and takes into account the total unsecured debt held by a customer, and their ability to repay existing debt as well as the additional credit requested.

Credit risk in the wholesale portfolio arises from debt securities and derivatives. The Group's wholesale credit risk exposure is covered on page 153.

Measurement

The Group uses statistical models, supported by both internal and external data, to measure retail credit risk exposures.

The models reflect three components: (i) the 'probability of default' (PD) by the borrowers on their contractual obligations, (ii) current exposures to the borrowers and their likely future development ('exposure at default'), and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default'). These parameters are used in order to derive an expected loss and assess capital allocation.

Portfolios are assessed by using segmentation for measurement and reporting purposes. Details of the classifications used for asset quality can be found on page 137.

The Group uses Advanced Internal Ratings Based (AIRB) models in measuring the credit risk of secured loans and advances to customers. All retail unsecured and wholesale exposures are measured under the Standardised Approach for regulatory capital.

The Group's credit portfolios are subject to regular stress testing. Further information on the stress testing process, methodology and governance can be found on page 129.

Page 143 provides details of the Group's approach to the impairment of financial assets. Refer to note 1 to the financial statements. From 1 January 2018, the Group will transition to the new accounting requirements of IFRS 9.

Mitigation

The Group uses a range of approaches to mitigate credit risk.

Credit policy

The Risk function uses risk appetite to set the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, and key risk indicators, and review and challenge exceptions to planned outcomes. Counterparty exposures are regularly reviewed and action taken where necessary. Risk Assurance perform independent risk-based reviews to provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

Controls over AIRB rating systems
The Group has an established Independent Model Validation team that sets common minimum standards for predictive modelling development and operations. The standards are designed to ensure risk models and associated AIRB rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements.

Credit underwriting
The Group uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits on permitted indebtedness which take into account the debt customers hold with other lenders.

The Group rejects any application for a product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group's approach to underwriting applications takes into account the total unsecured debt held by a customer and their ability to afford that debt.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value (LTV) of less than 95%[1]. The Group has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Loan size from	To	Maximum LTV
£1	£500,000	95% (purchase) 90% (re-mortgage)
£500,001	£1,000,000	80%

1 All originations included in the comparative period to 31 December 2016 which were between 90% and 95% LTV were only permitted under the Help to Buy loan guarantee scheme.

Buy-to-let is limited to a maximum of 75% LTV and residential interest only is limited to a maximum of 70% LTV, regardless of loan size. Residential mortgage applications in excess of £1 million are approved by exception.

The PRA introduced more rigorous stress testing for landlords with four or more mortgaged buy-to let properties, effective from September 2017. The Group has taken a conservative approach to applying these minimum standards and will continue to review buy-to-let lending policy. The number of buy-to-let mortgages held by a customer is capped at three and the maximum customer exposure is capped at £2 million.

The Group's approach to underwriting applications for unsecured products takes into account the total unsecured debt held by a customer and their ability to afford to repay that debt.

The Group uses statistically based decisioning techniques (primarily credit scoring models) for its retail portfolios.

Debt management for customers in financial difficulty
The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's responsibilities to support customers and act in their best long-term interests. This allows customer credit facilities to be brought back into a sustainable position. The Group offers a range of tools and assistance to support customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken designed to be affordable and sustainable for the customer.

Customers are assisted by the Debt Management function where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies in instances where they have multiple credit facilities, including those at other lenders, which require restructuring.

Specific tools are available to assist customers which vary by product and the customer's status. Further details can be found on page 151.

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan. This ensures that customers are provided with a sustainable and affordable solution that allows them a realistic opportunity to repay their debt in the short to medium term. In addition, the Group will advise customers to contact debt management companies such as Citizens Advice Bureau, StepChange and PayPlan. These companies do not charge any fees and will

Risk Management Report

Full analysis of risk classes

offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Collateral for secured retail and wholesale exposures
The sole collateral type for secured loans is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement.

All new eligible derivative transactions with wholesale counterparties are centrally cleared with cash posted as collateral to further mitigate credit risk. Residual and non-eligible trades are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement. The Group will receive additional collateral from certain counterparties in the event their external credit rating falls below contractually set triggers as agreed in the Credit Support Annex. It is the Group's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

Monitoring
The Group produces regular portfolio monitoring reports for review by Senior Management. The Risk function produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

> appropriate risk differentiation capability is provided;

> generated ratings remain as accurate and robust as practical; and

> appropriate risk estimates are assigned to grades and pools of accounts.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Forbearance and provisioning
The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses behavioural scoring to assess customers' credit risk and the models take into account a range of potential indicators of customer financial distress.

Impaired assets are reviewed on an ongoing basis. Regular detailed analysis of impairment provisions is undertaken recognising the impact of forbearance activities. Further details on forbearance can be found on page 151.

Credit quality of assets

Loans and receivables

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

Secured credit exposures are segmented according to the credit quality classification and a point-in-time PD. The point-in-time PD is an internal parameter used within the Group's AIRB capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where the borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. Exposures are categorised as:

> higher risk where assets are past due or have a point in time PD greater than 2%;

> medium risk where assets are not past due and have a PD greater than 0.8% and less than or equal to 2%; and

> low risk where assets are not past due and have a PD less than or equal to 0.8%.

Unsecured exposures are categorised as:

> higher risk where assets are past due;

> medium risk where assets are currently not past due but are benefitting from a forbearance solution; and

> low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. The Group's wholesale exposures are investment grade and therefore classified as low risk.

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

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

Risk Management Report

Full analysis of risk classes

Credit risk portfolio as at 31 December 2017

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

	Secured		Unsecured		Wholesale		
2017 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Credit cards £m	Overdrafts £m	Treasury assets £m	Derivative exposures £m	Total £m
Total gross loans and advances to customers	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**–**	**–**	**36,755.9**
> of which are low risk	*26,770.5*	*6,322.5*	*3,025.2*	*0.1*	*–*	*–*	*36,118.3*
> of which are medium risk	*220.0*	*11.7*	*3.5*	*–*	*–*	*–*	*235.2*
> of which are higher risk	*326.7*	*33.1*	*42.6*	*–*	*–*	*–*	*402.4*
Loans and advances to banks	**–**	**–**	**–**	**–**	**359.4**	**–**	**359.4**
Cash and balances at central banks	**–**	**–**	**–**	**–**	**2,579.0**	**–**	**2,579.0**
Debt securities classified as loans and receivables	**–**	**–**	**–**	**–**	**0.3**	**–**	**0.3**
Available-for-sale financial assets	**–**	**–**	**–**	**–**	**1,051.8**	**–**	**1,051.8**
Gross positive fair value of derivative assets	**–**	**–**	**–**	**–**	**–**	**78.8**	**78.8**
Total	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**3,990.5**	**78.8**	**40,825.2**

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

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

In addition, the maximum credit risk exposure of the Group includes off-balance sheet items.

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

Risk Management Report

Full analysis of risk classes

Loans and advances to customers comprise:

(audited)	2017 £m	2016 £m
Advances secured on residential property not subject to securitisation	**21,878.7**	19,375.2
Advances secured on residential property subject to securitisation	**5,438.5**	4,907.8
Total advances secured on residential property	**27,317.2**	24,283.0
Residential buy-to-let loans not subject to securitisation	**6,367.3**	5,468.4
Total loans and advances to customers secured on residential property	**33,684.5**	29,751.4
Allowance for impairment – secured	**(12.1)**	(10.6)
Total loans and advances to customers – secured	**33,672.4**	29,740.8
Credit cards	**3,071.3**	2,486.5
Overdrafts	**0.1**	0.1
Unsecured receivables not subject to securitisation	**3,071.4**	2,486.6
Allowance for impairment – unsecured	**(47.3)**	(39.5)
Total loans and advances to customers – unsecured	**3,024.1**	2,447.1
Total loans and advances to customers excluding portfolio hedging adjustment	**36,696.5**	32,187.9

The mortgage portfolio is secured on residential and buy-to-let properties and represented 91.6% of total loans and advances to customers at 31 December 2017. Residential lending grew by 12.5% (£3.0 billion) during the year and credit quality remained strong with 99.0% of loans classified as neither past due nor impaired. Buy-to-let loans grew by 16.4% (£0.90 billion) to £6.4 billion and remained low as a percentage of total secured loans at 18.9% (31 December 2016:18.4%).

The Group's credit card portfolio represented 8.4% of total loans and advances to customers at 31 December 2017 (2016: 7.7%). Unsecured credit card lending increased by £584.8 million since 31 December 2016 to £3.1 billion and the quality of new business remained strong. New lending was well within approved policy, lending and concentration limits. Further details on impaired assets and impairment allowances can be found on page 143.

Credit risk categorisation	Description	Reference
Arrears	For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.	
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.	Page 142
Neither past due nor impaired and in forbearance	Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions. Further information on forbearance solutions can be found on page 151.	Page 142
Past due and not impaired	Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets, as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending.	Page 143
Impaired assets	Loans that are in arrears and where the carrying amount of the loan exceeds the expected recoverable amount. All mortgage expired terms, fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due.	Page 143

The overall credit quality of retail assets has remained stable and is detailed in the tables below. Analysis of the movement in impaired assets is provided on page 144.

	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
2017 (audited)	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	**27,026.2**	**99.0**	**6,336.5**	**99.5**	**3,028.7**	**98.6**	**0.1**	**100.0**	**36,391.5**	**99.0**
> *of which in receipt of forbearance*[1]	**133.8**	**0.5**	**15.8**	**0.2**	**3.5**	**0.1**	**–**	**–**	**153.1**	**0.4**
Past due and not impaired	**168.2**	**0.6**	**18.7**	**0.3**	**–**	**–**	**–**	**–**	**186.9**	**0.5**
Impaired	**122.8**	**0.4**	**12.1**	**0.2**	**42.6**	**1.4**	**–**	**–**	**177.5**	**0.5**
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**3,071.3**	**100.0**	**0.1**	**100.0**	**36,755.9**	**100.0**

1 This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Full forbearance disclosures can be found on page 151.

	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
2016 (audited)	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	24,047.8	99.1	5,441.8	99.5	2,454.1	98.7	0.1	100.0	31,943.8	99.1
> *of which in receipt of forbearance*[1]	108.6	0.4	12.2	0.2	2.9	0.1	–	–	123.7	0.4
Past due and not impaired	151.3	0.6	17.6	0.3	–	–	–	–	168.9	0.5
Impaired	83.9	0.3	9.0	0.2	32.4	1.3	–	–	125.3	0.4
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**2,486.5**	**100.0**	**0.1**	**100.0**	**32,238.0**	**100.0**

1 This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Forbearance disclosures have been restated to remove term extensions captured as part of the mortgage review process. Full forbearance disclosures can be found on page 151.

The criteria the Group uses to determine that there is objective evidence of impairment are disclosed on page 140. All loans, where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

Risk Management Report

Full analysis of risk classes

Loans and advances which are neither past due nor impaired

Loans which were neither past due nor impaired have increased by £3.9 billion in the year to 31 December 2017 and represent 99.0% of total secured loans. The proportion of secured loans and advances classified as low risk has increased over the period from 90.9% to 99.2%. Model development work undertaken during the year, to better align the Group's internal rating systems with portfolio performance, has led to improvements in credit quality measurements across the portfolio. In addition, third party process improvements in relation to data matching have improved the accuracy of certain customers' risk classifications, increasing the proportion of loans classified as low risk. Additionally, new lending during the period, although having a diluting effect, showed strong arrears performance.

The segmentation for low, medium and higher risk categories for the unsecured portfolio can be found on page 137.

The tables below show the details of the credit quality for neither past due nor impaired loans.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2017 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**
PD by internal ratings						
Low risk	**26,770.5**	**99.1**	**6,322.5**	**99.8**	**33,093.0**	**99.2**
Medium risk	**220.0**	**0.8**	**11.7**	**0.2**	**231.7**	**0.7**
Higher risk	**35.7**	**0.1**	**2.3**	**–**	**38.0**	**0.1**
Total neither past due nor impaired	**27,026.2**	**100.0**	**6,336.5**	**100.0**	**33,362.7**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2016 (audited)	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	21,565.5	89.7	5,256.8	96.6	26,822.3	90.9
Medium risk	1,699.5	7.1	172.1	3.2	1,871.6	6.3
Higher risk	782.8	3.2	12.9	0.2	795.7	2.8
Total neither past due nor impaired	**24,047.8**	**100.0**	**5,441.8**	**100.0**	**29,489.6**	**100.0**

Loans and advances which are past due and not impaired

The balance of mortgages which were past due and not impaired totalled £186.9 million at 31 December 2017. These assets represented 0.6% of secured loans at 31 December 2017 (31 December 2016: 0.6%). All unsecured assets which are past due are treated as impaired. All loans and advances which are past due and not impaired are classified as higher risk. The tables below show loans and advances which are past due and not impaired by overdue term.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2017 (audited)	£m	%	£m	%	£m	%
Up to one month	**70.1**	**41.7**	**6.4**	**34.3**	**76.5**	**40.8**
One to three months	**74.3**	**44.2**	**9.9**	**52.9**	**84.2**	**45.1**
Three to six months	**16.5**	**9.8**	**2.1**	**11.2**	**18.6**	**10.0**
Over six months	**7.3**	**4.3**	**0.3**	**1.6**	**7.6**	**4.1**
Total past due and not impaired	**168.2**	**100.0**	**18.7**	**100.0**	**186.9**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2016 (audited)	£m	%	£m	%	£m	%
Up to one month	57.1	37.8	4.3	24.4	61.4	36.4
One to three months	63.9	42.2	10.8	61.4	74.7	44.2
Three to six months	21.4	14.1	2.1	11.9	23.5	13.9
Over six months	8.9	5.9	0.4	2.3	9.3	5.5
Total past due and not impaired	**151.3**	**100.0**	**17.6**	**100.0**	**168.9**	**100.0**

Impaired assets

Total impaired assets as a proportion of total assets has remained stable at 0.4% (2016: 0.4%). The Group's definition of impaired assets includes accounts that are in arrears and accounts that may not be in arrears but are showing non-delinquency impairment indicators such as expired contractual terms or fraud. Balances with these indicators are categorised as impaired irrespective of arrears status or expected recoverable amount.

As at 31 December 2017, the balance of impaired assets in arrears was £89.0 million[1] (2016: £74.6 million)[1]. The remainder of the impaired assets balance relates to:

> interest only expired term loans which have an average LTV of 25.8% and do not attract significant impairment provisions; and

> fraud balances, which have an average LTV of 57.2%. These balances account for less than 0.1% of the portfolio, are managed at account level, and provisioning reflects the estimated credit loss associated with the individual account.

The balances not in arrears but showing non-delinquency impairment indicators, by their nature, typically give rise to lower levels of loss and, as a result, attract lower levels of impairment provision.

Unsecured impaired assets increased by 31.5% to £42.6 million, representing 1.4% of total unsecured loans. This is driven both by an increase in arrears balances, consistent with book growth, and by the expected seasoning of older assets on the portfolio. The performance of more recent cohorts is in line with or better than vintage cohorts at a similar stage of maturity. Arrears emergence on all cohorts remains in line with performance expectations.

1 Includes assets where the borrower's property was in possession.

Risk Management Report

Full analysis of risk classes

The tables below show the movement of impaired loan balances during 2017 and 2016.

	Secured		Unsecured		Wholesale		
2017 (audited)	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Credit cards £m**	**Overdrafts £m**	**Treasury assets £m**	**Derivative exposures £m**	**Total £m**
As at 1 January 2017	**83.9**	**9.0**	**32.4**	**–**	**–**	**–**	**125.3**
Classified as impaired during the year	**229.9**	**26.4**	**95.6**	**–**	**–**	**–**	**351.9**
Transferred from impaired to unimpaired	**(141.9)**	**(20.4)**	**(34.9)**	**–**	**–**	**–**	**(197.2)**
Amounts written off	**(0.6)**	**(0.1)**	**(43.4)**	**–**	**–**	**–**	**(44.1)**
Repayments	**(48.5)**	**(2.8)**	**(7.1)**	**–**	**–**	**–**	**(58.4)**
As at 31 December 2017	**122.8**	**12.1**	**42.6**	**–**	**–**	**–**	**177.5**

	Secured		Unsecured		Wholesale		
2016 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Credit cards £m	Overdrafts £m	Treasury assets £m	Derivative exposures £m	Total £m
As at 1 January 2016	77.6	7.0	27.4	–	–	–	112.0
Classified as impaired during the year	132.3	20.4	85.0	–	–	–	237.7
Transferred from impaired to unimpaired	(112.9)	(17.7)	(38.3)	–	–	–	(168.9)
Amounts written off	(0.6)	(0.2)	(32.3)	–	–	–	(33.1)
Repayments	(12.5)	(0.5)	(9.4)	–	–	–	(22.4)
As at 31 December 2016	**83.9**	**9.0**	**32.4**	**–**	**–**	**–**	**125.3**

An analysis of impaired assets by overdue term and assets where the borrower's property was in possession is provided in the tables below. All impaired loans and advances are classified as higher risk.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
2017 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to date	**80.3**	**65.5**	**7.9**	**65.3**	**0.3**	**0.7**	**–**	**–**	**88.5**	**49.8**
Up to one month	**17.6**	**14.3**	**0.8**	**6.6**	**15.5**	**36.3**	**–**	**–**	**33.9**	**19.1**
One to three months	**20.4**	**16.6**	**2.7**	**22.3**	**13.4**	**31.5**	**–**	**–**	**36.5**	**20.6**
Three to six months	**2.5**	**2.0**	**0.3**	**2.5**	**13.1**	**30.8**	**–**	**–**	**15.9**	**9.0**
Over six months	**1.5**	**1.2**	**0.3**	**2.5**	**0.3**	**0.7**	**–**	**–**	**2.1**	**1.2**
Possession	**0.5**	**0.4**	**0.1**	**0.8**	**–**	**–**	**–**	**–**	**0.6**	**0.3**
Total impaired assets	**122.8**	**100.0**	**12.1**	**100.0**	**42.6**	**100.0**	**–**	**–**	**177.5**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
2016 (audited)	£m	%	£m	%	£m	%	£m	%	£m	%
Up to date	45.7	54.5	4.9	54.5	0.1	0.3	–	–	50.7	40.4
Up to one month	10.0	11.9	1.3	14.5	13.1	40.5	–	–	24.4	19.5
One to three months	19.9	23.7	2.2	24.4	9.3	28.7	–	–	31.4	25.1
Three to six months	4.1	4.9	0.3	3.3	9.6	29.6	–	–	14.0	11.2
Over six months	3.9	4.6	0.2	2.2	0.3	0.9	–	–	4.4	3.5
Possession	0.3	0.4	0.1	1.1	–	–	–	–	0.4	0.3
Total impaired assets	**83.9**	**100.0**	**9.0**	**100.0**	**32.4**	**100.0**	**–**	**–**	**125.3**	**100.0**

Risk Management Report

Full analysis of risk classes

Impairment provisions

Secured impairment provisions have increased by £1.5 million, in line with book growth, representing 0.04% as a proportion of gross balances as at 31 December 2017 and 31 December 2016. Secured impairment coverage has fallen from 11.4% at 31 December 2016, to 9.0% as at 31 December 2017 due to the impact of expired term and fraud loan balances.

Unsecured impairment provisions increased by £7.8 million during the period and have reduced as a percentage of gross balances from 1.59% at 31 December 2016 to 1.54% at 31 December 2017. Impairment provisions as a proportion of impaired balances decreased, from 121.9% to 111.0% during the year. The reduction in impairment provision coverage is a result of improved debt recovery rates, which reduces the estimated credit loss attributable to these assets.

The tables below show impaired assets and impairment provisions.

2017 (audited)	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
Residential mortgage loans	27,317.2	122.8	0.4	10.8	8.8
Residential buy-to-let mortgage loans	6,367.3	12.1	0.2	1.3	10.7
Total secured	33,684.5	134.9	0.4	12.1	9.0
Credit cards	3,071.3	42.6	1.4	47.2	110.8
Overdrafts	0.1	–	–	0.1	–
Total unsecured	3,071.4	42.6	1.4	47.3	111.0
Wholesale treasury assets	3,990.5	–	–	–	–
Wholesale derivative exposures	78.8	–	–	–	–
Total wholesale	4,069.3	–	–	–	–
Total	40,825.2	177.5	0.4	59.4	33.5

2016 (audited)	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
Residential mortgage loans	24,283.0	83.9	0.3	9.4	11.2
Residential buy-to-let mortgage loans	5,468.4	9.0	0.2	1.2	13.3
Total secured	29,751.4	92.9	0.3	10.6	11.4
Credit cards	2,486.5	32.4	1.3	39.4	121.6
Overdrafts	0.1	–	–	0.1	–
Total unsecured	2,486.6	32.4	1.3	39.5	121.9
Wholesale treasury assets	2,281.4	–	–	–	–
Wholesale derivative exposures	104.2	–	–	–	–
Total wholesale	2,385.6	–	–	–	–
Total	34,623.6	125.3	0.4	50.1	40.0

The table below shows the movement of impairment provisions during the year.

	Secured		Unsecured		Wholesale		
	On advances secured on residential property £m	On advances secured on residential buy-to-let property £m	Credit cards £m	Overdrafts £m	Treasury assets £m	Derivative exposures £m	Total £m
As at 1 January 2016	7.7	1.0	31.1	0.1	–	–	39.9
Advances written off	(0.6)	(0.2)	(26.6)	–	–	–	(27.4)
Gross charge to the income statements	2.3	0.4	34.9	–	–	–	37.6
As at 1 January 2017	**9.4**	**1.2**	**39.4**	**0.1**	**–**	**–**	**50.1**
Advances written off	**(0.6)**	**(0.1)**	**(34.2)**	**–**	**–**	**–**	**(34.9)**
Gross charge to the income statement	**2.0**	**0.2**	**42.0**	**–**	**–**	**–**	**44.2**
As at 31 December 2017	**10.8**	**1.3**	**47.2**	**0.1**	**–**	**–**	**59.4**

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

Collateral held as security for loans and receivables to customers

A general description of collateral held as security in respect of financial instruments is provided on page 136. The Group holds collateral against loans and receivables in the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral on page 149.

The Group holds collateral in respect of loans and advances to customers as set out on page 136. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables. The tables overleaf show the distribution of retail secured loans by LTV banding.

Risk Management Report

Full analysis of risk classes

2017 (audited)	**Residential mortgage loans** £m	**Residential mortgage loans** %	**Residential buy-to-let mortgage loans** £m	**Residential buy-to-let mortgage loans** %	**Total** £m	**Total** %
<50%	10,249.6	37.6	2,293.5	36.1	12,543.1	37.2
50%-<60%	5,362.9	19.6	1,851.5	29.1	7,214.4	21.4
60%-<70%	4,508.4	16.5	1,441.4	22.6	5,949.8	17.7
70%-<80%	4,022.9	14.7	778.1	12.2	4,801.0	14.3
80%-<90%	2,725.7	10.0	1.9	–	2,727.6	8.1
90%-<100%	444.6	1.6	0.6	–	445.2	1.3
>100%	3.1	–	0.3	–	3.4	–
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**33,684.5**	**100.0**
Average LTV[1] of stock – indexed		56.1%		54.1%		55.8%
Average LTV of new business		70.0%		59.7%		68.1%

1 The average LTV of stock and new business is balance weighted.

2016 (audited)	Residential mortgage loans £m	Residential mortgage loans %	Residential buy-to-let mortgage loans £m	Residential buy-to-let mortgage loans %	Total £m	Total %
<50%	9,476.6	39.1	1,922.8	35.2	11,399.4	38.3
50%-<60%	4,958.1	20.4	1,454.8	26.6	6,412.9	21.6
60%-<70%	3,918.9	16.1	1,271.8	23.3	5,190.7	17.4
70%-<80%	3,162.8	13.0	796.4	14.6	3,959.2	13.3
80%-<90%	2,307.7	9.5	19.0	0.3	2,326.7	7.8
90%-<100%	445.1	1.8	2.2	–	447.3	1.5
>100%	13.8	0.1	1.4	–	15.2	0.1
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**
Average LTV[1] of stock – indexed		55.6%		54.8%		55.4%
Average LTV of new business		69.8%		60.5%		68.0%

1 The average LTV of stock and new business is balance weighted.

The average indexed LTV of the overall mortgage portfolio increased by 0.4 percentage points as at 31 December 2017. This is well within the current Group portfolio risk appetite limit of 70%. The average LTV for new business remained broadly flat at 68.1% as at 31 December 2017.

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the tables below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

	Collateral value of residential mortgage loans		Collateral value of residential buy-to-let mortgage loans		Total collateral value	
2017[1] (audited)	£m	%	£m	%	£m	%
Neither past due nor impaired	**27,025.9**	**100.0**	**6,336.5**	**100.0**	**33,362.4**	**100.0**
> of which in receipt of forbearance	*133.8*	*100.0*	*15.8*	*100.0*	*149.6*	*100.0*
Past due and not impaired	**168.2**	**100.0**	**18.7**	**100.0**	**186.9**	**100.0**
Impaired	**122.8**	**100.0**	**12.1**	**100.0**	**134.9**	**100.0**
> of which in possession	*0.5*	*100.0*	*0.1*	*100.0*	*0.6*	*100.0*
Total	**27,316.9**	**100.0**	**6,367.3**	**100.0**	**33,684.2**	**100.0**

1 Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

	Collateral value of residential mortgage loans		Collateral value of residential buy-to-let mortgage loans		Total collateral value	
2016[1] (audited)	£m	%	£m	%	£m	%
Neither past due nor impaired	24,046.6	100.0	5,441.7	100.0	29,488.3	100.0
> of which in receipt of forbearance[2]	*108.6*	*100.0*	*12.2*	*100.0*	*120.8*	*100.0*
Past due and not impaired	151.3	100.0	17.6	100.0	168.9	100.0
Impaired	83.7	99.8	9.0	100.0	92.7	99.8
> of which in possession	*0.3*	*100.0*	*0.1*	*100.0*	*0.4*	*100.0*
Total	**24,281.6**	**100.0**	**5,468.3**	**100.0**	**29,749.9**	**100.0**

1 Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

2 Forbearance disclosures have been restated to exclude term extensions captured as part of the mortgage review process. Further details can be found on page 151.

As at 31 December 2017, there was £0.3 million (2016: £1.4 million) excess between the balance of residential mortgage loans with a LTV of greater than 100% and the collateral held against them. All these mortgage balances were classified as neither past due nor impaired (2016: £1.2 million). The recoverable amount used for impairment provision purposes reflects this level of collateral.

Repossessions

The Group works with customers who have difficulty paying their mortgages, and will repossess a property only when all other possibilities have been exhausted. Where properties have been repossessed, the Group will obtain the best price, taking into account factors such as property and market conditions.

The Group uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

The Group held ten repossessed properties as at 31 December 2017 compared to six as at 31 December 2016. The total number of properties taken into possession during the year reduced to 12, from 36 in 2016.

Risk Management Report

Full analysis of risk classes

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments made by the customer comprise interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term.

The tables below provide details of balances which are on an interest only basis, analysed by maturity. This includes the interest only balances for loans that provide the customer with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only (part-and-part loans).

The Group's interest only exposure for customers on both interest only and part-and-part for the year to 31 December 2017 reduced to 27.6% of total secured balances, from 29.9% at 31 December 2016.

2017 (audited)	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Total £m**
Term expired (still open)	**46.0**	**3.5**	**49.5**
Due within 2 years	**156.2**	**16.3**	**172.5**
Due after 2 years and before 5 years	**432.0**	**112.4**	**544.4**
Due after 5 years and before 10 years	**1,047.5**	**677.4**	**1,724.9**
Due after more than 10 years	**2,296.9**	**4,499.4**	**6,796.3**
Total	**3,978.6**	**5,309.0**	**9,287.6**
> *of which are impaired*	**11.1**	**61.4**	**72.5**
% of total secured loans and advances to customers	**14.6**	**83.4**	**27.6**
Average LTV (%)	**40.6**	**55.2**	**49.5**

2016 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Total £m
Term expired (still open)	30.1	1.9	32.0
Due within 2 years	167.5	16.4	183.9
Due after 2 years and before 5 years	405.2	77.8	483.0
Due after 5 years and before 10 years	1,012.9	591.8	1,604.7
Due after more than 10 years	2,726.0	3,852.6	6,578.6
Total	**4,341.7**	**4,540.5**	**8,882.2**
> *of which are impaired*	8.6	47.8	56.4
% of total secured loans and advances to customers	**17.9**	**83.0**	**29.9**
Average LTV (%)	**42.1**	**55.8**	**49.6**

The Group contacts customers who have an interest only mortgage scheduled to mature within the next ten years, to confirm that their strategy to repay the mortgage loan in full at the end of the agreed term remains on track. If not, the Group will discuss a range of options, including a mortgage review, to ensure the customers' individual needs continue to be met.

Interest only balances due to mature in the next two years represent 1.9% of total interest only balances, totalling £172.5 million at 31 December 2017. The increase in interest only expired term loans of £17.5 million is in line with expectations. Strategies exist to help customers who may not be able to repay the full amount of principal balance at maturity.

All expired term balances are categorised as impaired loans, regardless of estimated credit loss. Less than 0.2% of the secured portfolio relates to expired term loan balances. The average balance of expired term loans which are more than six months past their maturity date is £87,573 with an average LTV of 25.8%.

The Group offers interest only loans to applicants who have credible means to repay the mortgage loan at maturity other than sale of main residence. The flow of new interest only residential balances has remained low during 2017, representing 2.2% of residential completions. As a result, the proportion of residential interest only mortgages (excluding part-and-part) in the portfolio continues to reduce, moving from 15.0% to 12.3% during 2017.

The Group regularly reviews the effectiveness of its interest only policy and contact strategies.

Forbearance

The Group operates a number of treatments to assist borrowers who are experiencing financial distress. In defining these treatments, the Group distinguishes between the following categories for secured assets:

- payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example, short-term arrangements to pay less than the contractual payment;
- transfers to interest only: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears of capital repayment existing at the commencement of the arrangement remain outstanding;
- term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and
- discretionary payment holidays: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment.

Loans which are subject to forbearance are grouped with other assets with similar risk characteristics and assessed collectively for impairment. Loans are not considered as impaired loans unless they meet the Group's definition of an impaired asset.

Risk Management Report

Full analysis of risk classes

The value of forbearance stock totalled £176.4 million at 31 December 2017 (2016: £141.3 million). £161.2 million (31 December 2016: £128.6 million) of retail secured loans and advances were subject to forbearance, representing 0.48% of total secured loans and advances (2016: 0.43%). This increase in forbearance is consistent with portfolio growth and reflects the Group's focus on proactive debt management due to the low level of arrears emergence.

During 2017, the Group amended its secured forbearance capture to exclude routine term extensions processed as part of the mortgage review process, where there is no forbearance. Such cases had been captured prudently as forborne in prior reporting periods. The 2016 comparative has been restated to reflect this change.

The tables below show analysis by forbearance category.

	Neither past due nor impaired		Past due not impaired		Impaired		Total	
2017 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Secured								
Payment arrangement	**0.6**	**0.5**	**1.4**	**15.7**	**–**	**–**	**2.0**	**1.2**
Transfer to interest only	**29.2**	**19.5**	**1.4**	**15.7**	**0.3**	**11.1**	**30.9**	**19.2**
Term extension	**59.0**	**39.4**	**3.2**	**36.0**	**2.1**	**77.8**	**64.3**	**39.9**
Payment holiday	**60.8**	**40.6**	**2.9**	**32.6**	**0.3**	**11.1**	**64.0**	**39.7**
Total secured forbearance	**149.6**	**100.0**	**8.9**	**100.0**	**2.7**	**100.0**	**161.2**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	**3.5**	**100.0**	**–**	**–**	**11.7**	**100.0**	**15.2**	**100.0**
Total forbearance	**153.1**	**100.0**	**8.9**	**100.0**	**14.4**	**100.0**	**176.4**	**100.0**

	Neither past due nor impaired		Past due not impaired		Impaired		Total	
2016 (audited)	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	0.1	0.1	0.6	11.0	0.2	8.7	0.9	0.7
Transfer to interest only	21.8	18.0	1.8	32.7	0.6	26.1	24.2	18.8
Term extension	44.5	36.9	1.9	34.5	0.8	34.8	47.2	36.8
Payment holiday	54.4	45.0	1.2	21.8	0.7	30.4	56.3	43.8
Total secured forbearance	**120.8**	**100.0**	**5.5**	**100.0**	**2.3**	**100.0**	**128.6**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	–	–	9.8	100.0	12.7	100.0
Total forbearance	**123.7**	**100.0**	**5.5**	**100.0**	**12.1**	**100.0**	**141.3**	**100.0**

Wholesale credit risk

Wholesale credit risk exposures increased by £1.7 billion during the year to £4.1 billion at 31 December 2017. This partly reflects the replacement of off-balance sheet liquidity from the Bank of England's Funding for Lending Scheme (FLS) with on-balance sheet liquidity. The table below shows the wholesale credit risk exposures of the Group. Reserves placed with the Bank of England are included as wholesale credit exposures within the table.

(audited)	2017 £m	2016 £m
Loans and advances to banks excluding Bank of England	**359.4**	635.6
Bank of England	**2,579.0**	786.3
Debt securities classified as loans and receivables	**0.3**	0.7
Debt securities classified as available-for-sale financial assets	**1,048.7**	850.9
Gross positive fair value of derivative contracts	**78.8**	104.2
Total	**4,066.2**	2,377.7

The Group has increased its holdings of high-quality available-for-sale wholesale assets during the year including gilts, supranational, covered bonds and RMBS investments. Wholesale credit risk exposures are assessed by reference to credit rating. All of the Group's wholesale exposures were investment grade and classified as low risk at 31 December 2017. Full disclosure of the Group's portfolio of liquid assets can be found on page 176.

At 31 December 2017, the single largest exposure to any single counterparty, which is not a sovereign or a supranational, was £108.4 million (2016: £115.9 million). The table below shows the credit ratings of loans and advances to banks excluding the Bank of England, which has a credit rating of AA (2016: AA).

(audited)	2017 £m	2016 £m
AA+	**–**	56.8
AA-	**100.3**	115.9
A+	**145.5**	208.4
A	**79.4**	187.4
A-	**14.8**	35.2
BBB+	**19.4**	31.9
Total	**359.4**	635.6

Risk Management Report

Full analysis of risk classes

The table below shows debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	2017 Debt securities classified as loans and receivables £m	2017 Debt securities classified as available-for-sale financial assets £m	2016 Debt securities classified as loans and receivables £m	2016 Debt securities classified as available-for-sale financial assets £m
UK sovereign exposures	**–**	**356.7**	–	317.3
Supranational	**–**	**234.1**	–	129.3
Residential mortgage-backed securities	**0.3**	**61.4**	0.7	52.2
Covered bonds	**–**	**396.5**	–	327.1
Debt securities issued by banks	**–**	**–**	–	25.0
Total	**0.3**	**1,048.7**	0.7	850.9

The table below shows the credit rating of debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	2017 £m	2016 £m
AAA	**692.0**	508.6
AA+	**–**	–
AA	**356.7**	317.3
AA-	**–**	25.0
A+	**–**	–
A	**0.3**	0.7
Total	**1,049.0**	851.6

The credit rating of the debt securities remains high, with 100.0% rated AA or higher at 31 December 2017 (2016: 97.0%).

Derivative financial instruments

The Group reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions, as detailed in notes 13 and 33 to the financial statements. For derivatives not eligible for central clearing, exposure is reduced by the use of master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £78.8 million (2016: £104.2 million), collateral of £84.4 million (2016: £86.4 million) was held.

The Group measures exposure in derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, they are represented on the balance sheet on a gross basis unless the IAS 32 offsetting rules are met. Derivative contracts which do not meet the IAS 32 offsetting rules, and have positive fair values, are disclosed as assets in the balance sheet. Those with negative fair values are disclosed as liabilities.

Cash collateral received is classified as deposits from banks, and cash collateral posted is classified as loans and advances to banks. The notes to the financial statements provide further information on collateral.

The table below details derivative exposures, excluding those that are centrally cleared.

(audited)	**2017 £m**	2016 £m
Gross positive fair value of derivative contracts	**78.8**	104.2
Netting with gross negative fair value of derivative contracts[1]	**(11.5)**	(25.4)
Potential future incremental exposure	**47.3**	61.2
Collateral received (deposits from banks)	**(84.4)**	(86.4)
Net derivative exposures	**30.2**	53.6

1 The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The table below provides a summary of net derivative liabilities, excluding those that are centrally cleared.

(audited)	**2017 £m**	2016 £m
Gross negative fair value of derivative contracts	**(84.3)**	(222.3)
Netting with gross positive fair value of derivative contracts[1]	**11.5**	25.4
Collateral pledged (loans and advances to banks)	**74.6**	168.1
Net derivative liability	**1.8**	(28.8)

1 The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The only netting agreements in place are in relation to derivative financial instruments and repurchase transactions. In respect of repurchase transactions, only the difference between the asset pledged and deposit received is classed as an exposure given the balance sheet maintains the exposure to the underlying obligor.

Risk Management Report

Full analysis of risk classes

The table below provides credit quality analysis of the gross derivative exposures, excluding those that are centrally cleared, by credit rating of the counterparties.

	2017		2016	
(audited)	£m	%	£m	%
AA-	**1.7**	**2.2**	5.6	5.4
A+	**6.5**	**8.2**	0.6	0.6
A	**67.0**	**85.0**	84.5	81.1
A-	**0.3**	**0.4**	12.7	12.2
BBB+	**0.2**	**0.3**	0.8	0.7
NR	**3.1**	**3.9**	–	–
Total	**78.8**	**100.0**	104.2	100.0

Market risk

Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets and transacts foreign exchange for limited operational purposes only. As a result, interest rate risk is the only material market risk for the Group.

Risk appetite

The Group has limited risk appetite for exposures to interest rate risk in the banking book (IRRBB), in terms of both potential changes to economic value, and changes to expected net interest income or earnings. Risk appetite limits and metrics are set with reference to stress scenarios using measures described in this section.

Exposures

The Group's banking activities expose it to the risk of adverse movements in interest rates and exchange rates.

Term mismatch risk in the Group's portfolio arises from the different re-pricing characteristics of the Group's assets, liabilities and off-balance sheet exposures. Term mismatch risk arises predominantly from the mismatch between assets and liabilities either maturing or the amount resetting in any given time period, and the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The Group is exposed to Bank Base Rate and LIBOR. If the spread between these rates moves adversely, the Group may experience a reduction in income on unhedged exposures.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates unfavourable to those that were expected. Variations in business volume outturn to forecast arise from changes in customer behaviour and relative product competitiveness.

Product optionality risk arises when customer balances reduce more quickly or slowly than anticipated due to economic conditions or customers' responses to changes in interest rates or other economic conditions differing from expectations.

Swap spread risk arises through the hedging of the repricing risk of fixed rate securities (e.g. gilt securities) with derivatives. The yields in securities and swap markets for a given tenor may not change by the same amount as each other. Such differences cause spread risk to arise.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. The Group has minimal exposure to foreign currency risk.

Measurement

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

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

Interest rate risk exposure is measured as follows:

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

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

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

Risk Management Report

Full analysis of risk classes

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

Mitigation

The Group uses derivative financial instruments to bring its residual net exposure within risk appetite. The residual net exposure takes account of natural offsets between assets and liabilities.

As defined within the scope of the Group's IRRBB Policy, the Interest Rate Risk Transfer Pricing framework is used for interest rate risk arising from commercial product lines that can be hedged. Treasury is responsible for managing risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board-approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour.

Where possible, the Group mitigates basis risk by creating natural offsets. When required, the Group uses basis derivatives to maintain the residual exposure within risk appetite.

The Group is exposed to fair value interest rate risk on fixed rate customer loans and deposits and to cash flow interest rate risk on variable rate loans and deposits. Accounting methodology for derivative financial instruments and hedge accounting is captured within the notes to the consolidated financial statements.

Monitoring

Interest rate risk is monitored centrally on a day-to-day basis using the measures described above and other key risk indicators.

The Asset and Liability Committee and the Risk Management Committee regularly review market risk exposure as part of the wider risk management framework. The Asset and Liability Committee reviews and approves strategies to manage IRRBB.

Capital at Risk

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

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

	2017		2016	
	Positive 2% rate shock £m	**Negative 2% rate shock £m**	Positive 2% rate shock £m	Negative 2% rate shock £m
Interest rate mismatch risk	**(6.3)**	**0.4**	1.6	0.7
Basis Risk	**(1.4)**	**(1.4)**	–	–
Pipeline risk	**(4.7)**	**(5.5)**	(5.7)	(7.1)
Optionality risk	**(39.8)**	**(19.0)**	(30.1)	(7.7)
Total interest rate risk – Capital at Risk	**(52.2)**	**(25.5)**	(34.2)	(14.1)

Earnings at Risk

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

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

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

Foreign currency assets and liabilities

Exposures to adverse changes in currency exchange rates have been reduced by using cross-currency swaps, resulting in a minimal net exposure. The table below shows assets and liabilities in foreign currency at Sterling carrying values.

	2017		2016	
(audited)	US$ in £m	€ in £m	US$ in £m	€ in £m
Assets				
Loans and advances to banks	0.7	0.9	0.7	0.9
Available-for-sale financial assets	1.4	54.0	1.5	–
Intangible assets	0.1	0.1	0.1	0.1
Other assets	–	0.6	–	0.4
Total assets	2.2	55.6	2.3	1.4
Liabilities				
Debt securities in issue	377.0	387.0	175.7	412.4
Other liabilities	0.7	0.5	0.4	0.5
Total liabilities	377.7	387.5	176.1	412.9
Notional value of derivatives affecting currency exposures	(375.4)	(332.9)	(174.1)	(412.4)
Net position	(0.1)	1.0	0.3	0.9

Risk Management Report

Full analysis of risk classes

Interest rate re-pricing of assets and liabilities

The following tables provide an analysis of the contractual re-pricing periods of assets and liabilities on the balance sheet. Mismatches in the re-pricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in CaR and EaR.

2017[1] (audited)	Within 3 months £m	After 3 months and within 6 months £m	After 6 months and within 1 year £m	After 1 year and within 5 years £m	After 5 years £m	Non-interest bearing instruments £m	Total £m
Assets							
Cash and balances at central banks	2,521.3	–	–	–	–	57.7	2,579.0
Loans and receivables:							
Loans and advances to banks	352.0	–	–	–	–	7.4	359.4
Loans and advances to customers	7,281.3	2,137.5	4,843.8	21,650.2	532.8	294.6	36,740.2
Debt securities	0.3	–	–	–	–	–	0.3
Available-for-sale financial assets	406.8	13.1	5.0	122.8	444.8	59.3	1,051.8
Other assets	(32.5)	–	–	–	–	409.6	377.1
Total assets	**10,529.2**	**2,150.6**	**4,848.8**	**21,773.0**	**977.6**	**828.6**	**41,107.8**
Liabilities							
Deposits from banks	5,379.0	–	–	–	–	–	5,379.0
Customer deposits	17,022.0	2,256.0	5,275.7	6,245.5	0.6	8.6	30,808.4
Debt securities in issue	2,439.3	–	–	300.0	–	(2.4)	2,736.9
Other liabilities	–	–	–	–	–	358.6	358.6
Equity	–	–	–	390.0	–	1,434.9	1,824.9
Total liabilities and equity	**24,840.3**	**2,256.0**	**5,275.7**	**6,935.5**	**0.6**	**1,799.7**	**41,107.8**
Notional values of derivatives affecting interest rate sensitivity	12,799.6	676.0	674.8	(12,749.6)	(1,343.6)	(57.2)	–
Total interest rate sensitivity gap	**(1,511.5)**	**570.6**	**247.9**	**2,087.9**	**(366.6)**	**(1,028.3)**	**–**
Cumulative interest rate sensitivity gap	(1,511.5)	(940.9)	(693.0)	1,394.9	1,028.3	–	–

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

2016[1] (audited)	Within 3 months £m	After 3 months and within 6 months £m	After 6 months and within 1 year £m	After 1 year and within 5 years £m	After 5 years £m	Non-interest bearing instruments £m	Total £m
Assets							
Cash and balances at central banks	732.0	–	–	–	–	54.3	786.3
Loans and receivables:							
Loans and advances to banks	630.1	–	–	–	–	5.5	635.6
Loans and advances to customers	8,074.2	1,871.1	3,425.2	18,365.1	298.5	333.0	32,367.1
Debt securities	0.7	–	–	–	–	–	0.7
Available-for-sale financial assets	212.9	–	–	154.5	426.0	65.4	858.8
Other assets	54.0	–	–	–	–	353.1	407.1
Total assets	**9,703.9**	**1,871.1**	**3,425.2**	**18,519.6**	**724.5**	**811.3**	**35,055.6**
Liabilities							
Deposits from banks	2,132.5	–	–	–	–	–	2,132.5
Customer deposits	18,027.5	1,157.1	4,081.4	4,810.2	–	30.1	28,106.3
Debt securities in issue	2,299.9	–	–	300.0	–	0.1	2,600.0
Other liabilities	–	–	–	–	–	546.3	546.3
Equity	–	–	–	390.0	–	1,280.5	1,670.5
Total liabilities and equity	**22,459.9**	**1,157.1**	**4,081.4**	**5,500.2**	**–**	**1,857.0**	**35,055.6**
Notional values of derivatives affecting interest rate sensitivity	10,864.0	(548.2)	1,388.0	(10,395.4)	(1,240.7)	(67.7)	–
Total interest rate sensitivity gap	**(1,892.0)**	**165.8**	**731.8**	**2,624.0**	**(516.2)**	**(1,113.4)**	**–**
Cumulative interest rate sensitivity gap	(1,892.0)	(1,726.2)	(994.4)	1,629.6	1,113.4	–	–

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

The interest rate re-pricing tables shown above reflect the re-pricing of assets and liabilities without adjustments to the re-pricing profile that reflect future pricing assumptions. Expected future business that the Group hedges ahead of entering into a customer contract is not taken into account. The Group manages interest rate risk on this basis. Therefore, the gap profile shown above does not directly translate to the CaR and EaR term mismatch quantification.

Risk Management Report

Full analysis of risk classes

Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes legal risk.

Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;
- external fraud arising from an act of deception or omission;
- cyber-crime arising from malicious attacks on the Group via technology, networks and systems;
- service disruption;
- failure of a third party corporate partner or strategic supplier; and
- normal business operational risk including transaction processing, information capture and implementation of change.

Measurement

A variety of measures are used to monitor operational risk, such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root cause of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

Mitigation

The Group's control environment is regularly reviewed and reporting on material risks is discussed monthly by Senior Management. Risks are managed through a range of strategies such as mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

- investment in IT infrastructure to ensure continued availability, security and resilience;
- investment in information security capability to protect customers and the Group;
- investment in the protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the financial crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. The Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and
- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive Committees. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and considered by Executive management.

Key operational risks are appropriately insured, where possible. The insurance programme is monitored and reviewed regularly, with recommendations made to Executive management prior to each renewal.

Conduct risk and compliance

Definition

Conduct risk and compliance is defined as the risk that the Group's operating model, culture or actions result in unfair outcomes for customers, and the risk of regulatory sanction, material financial loss or reputational damage if the Group fails to design and implement effective operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Risk appetite

The Group has no appetite for failure to remediate regulatory breaches and no tolerance for failing to deliver fair customer outcomes, whether through product design, sales or after sales processes.

Exposures

The Group manages conduct risk in relation to products and services, sales processes and complaint handling.

A series of change programmes drives new legislation and regulation into day-to-day operational and business practices across the Group.

The Group is unburdened with legacy conduct risk issues such as PPI, investments or derivatives mis-selling, LIBOR manipulation and distressed asset portfolios.

Measurement

Risk assessments are regularly reviewed and include assessments of control and material regulatory rule breaches, complaints and whistleblowing.

Mitigation

The Group takes a range of mitigating actions with respect to conduct risk and compliance. They include:

> promoting a culture throughout the business that places the customer at the heart of decision-making, business planning and culture;

> policies, processes and standards which provide a framework for the business to operate in accordance with the relevant laws and regulations;

> using a risk assessment framework that ensures product design and sales processes offer customers value for money, meet the needs of the target market, and deliver fair outcomes to customers, including vulnerable customers;

> focusing on recruitment and training and how the Group manages colleagues' performance in relation to fair customer outcomes;

> regulatory horizon scanning; and

> using oversight and assurance themed reviews to assess compliance with rules, regulations and policies.

Monitoring

A robust assurance and quality monitoring regime is in place to test the performance of customer critical activities. Customer metrics are proactively used when reviewing business performance and feedback mechanisms have been established to learn from any issues identified.

The Risk function reports on conduct risk and compliance exposure. The report forms the basis of challenge to the business at the monthly Operational Risk, Conduct Risk and Compliance Committee.

Risk Management Report

Full analysis of risk classes

Concentration risk

Definition

Concentration risk is defined as the exposure of the Group to credit concentrations in relation to retail and wholesale portfolios, products and counterparty levels. Concentration risk is the most significant component of financial risk and therefore has been disclosed in detail.

Risk appetite

The Group has limited appetite for concentrated exposures by country, region, loan size and type.

Exposures

The principal source of concentration risk is from loans and advances to customers in relation to:

> geography (see page 165);

> loan size (see page 166); and

> loan type (see page 168).

In addition, concentration risk arises from cash, debt securities and derivatives in relation to individual counterparty and country of exposure.

The Group has no significant concentrations of risk in the credit card portfolio.

Measurement

Credit concentration risk is measured through the application of limits relating to each concentration category.

Mitigation

Credit risk management includes portfolio controls on product lines and risk segments to reflect risk appetite and individual limit guidelines. Credit policy is aligned to the Group's risk appetite, restricts exposure to higher risk sectors and segments and manages overall portfolio concentrations.

Monitoring

Monthly reporting on concentration risk exposures is made to the Board.

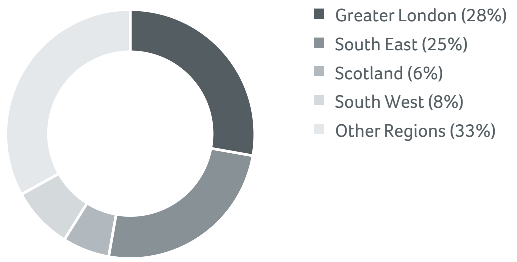
Secured credit

The Group's large exposures are reported in accordance with regulatory reporting requirements. Since the end of 2013 London and the South East have experienced higher levels of house price growth than the rest of the UK. Whilst demand for London property may be influenced by the international market, concerns over an asset bubble forming in these two regions are based on the rate of growth relative to other regions, a potential divergence in supply and demand for property, and customer affordability being stretched. The Group's policy restricts LTV for higher value loans, resulting in the lower average new lending LTVs observed in London (59%) and the South East (65%) compared to other regions (72%). The Group made changes to its lending policy in March 2016 in response to this risk through an income multiple cap.

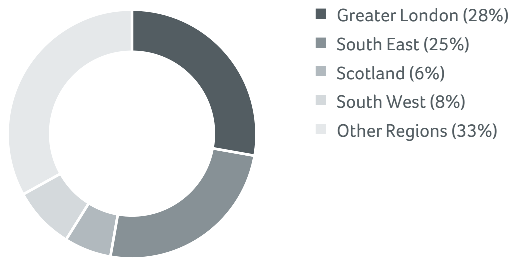
The table below shows the geographical concentration of the mortgage portfolio.

	2017		2016	
(audited)	£m	%	£m	%
East Anglia	**862.4**	**2.6**	726.0	2.6
East Midlands	**1,784.3**	**5.3**	1,556.4	5.2
North	**1,118.2**	**3.3**	1,025.3	3.4
Yorkshire & Humberside	**1,881.5**	**5.6**	1,640.3	5.5
North West	**2,512.2**	**7.5**	2,209.3	7.4
West Midlands	**1,785.5**	**5.3**	1,560.9	5.2
South West	**2,676.6**	**7.9**	2,320.6	7.8
South East	**8,447.1**	**25.1**	7,365.7	24.8
Greater London	**9,297.2**	**27.6**	8,365.9	28.1
Wales	**753.7**	**2.2**	673.9	2.3
Scotland	**2,030.3**	**6.0**	1,828.0	6.1
Northern Ireland	**534.0**	**1.6**	478.3	1.6
Other	**1.5**	**–**	0.8	–
Total	**33,684.5**	**100.0**	29,751.4	100.0

2017



2016



The geographical split of the portfolio remains broadly unchanged.

Risk Management Report

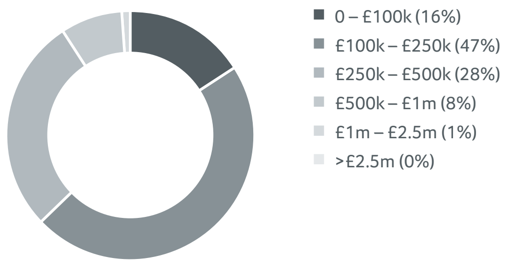
Full analysis of risk classes

The table below shows retail secured credit concentrations by loan size.

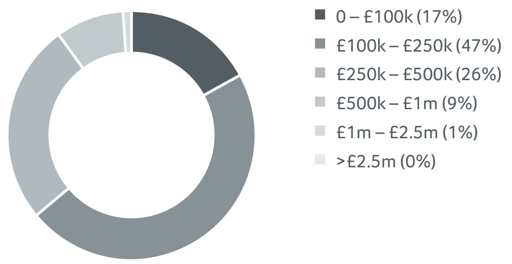
	2017		2016	
(audited)	£m	%	£m	%
0-£100k	**5,324.4**	**15.9**	5,169.9	17.4
£100k-£250k	**16,023.6**	**47.6**	13,989.5	47.1
£250k-£500k	**9,569.0**	**28.4**	7,835.2	26.3
£500k-£1m	**2,542.0**	**7.5**	2,536.2	8.5
£1m-£2.5m	**215.5**	**0.6**	207.4	0.7
>£2.5m	**10.0**	**–**	13.2	–
Total	**33,684.5**	**100.0**	29,751.4	100.0

As at 31 December 2017, 0.7% (2016: 0.7%) of mortgage balances consisted of loans in excess of £1 million.

2017



2016



The value of loans with balances of up to £250,000 increased by £2,188.6 million during 2017. This represents 56% of the total secured loans portfolio growth of £3,933.1 million.

The tables below show retail secured credit average LTV by loan size.

2017 (audited)	**Residential mortgage loans %**	**Residential buy-to-let mortgage loans %**	**Total %**
0-£100k	**42.1**	**56.1**	**47.5**
£100k-£250k	**58.9**	**54.9**	**58.1**
£250k-£500k	**59.1**	**50.3**	**58.2**
£500k-£1m	**50.9**	**43.7**	**50.2**
£1m-£2.5m	**43.1**	**38.7**	**42.3**
>£2.5m	**34.0**	**–**	**34.0**
Total	**56.1**	**54.1**	**55.8**

2016 (audited)	Residential mortgage loans %	Residential buy-to-let mortgage loans %	Total %
0-£100k	42.6	58.2	48.4
£100k-£250k	58.9	55.2	58.2
£250k-£500k	57.9	49.0	57.1
£500k-£1m	51.0	42.7	50.3
£1m-£2.5m	43.7	34.9	42.2
>£2.5m	35.8	–	35.8
Total	**55.6**	**54.8**	**55.4**

The Group's policy restricts LTV for higher value loans. The average LTV for each loan band demonstrates that, excluding loans under £100,000, higher value loans have lower LTVs, primarily due to seasoning of the portfolio and tightened underwriting practices. The average indexed LTV across the loan size bands has reduced in the majority of bands reflecting positive house price index movements throughout 2017.

Risk Management Report

Full analysis of risk classes

Loan type

The residential mortgage loan portfolio comprises three principal loan repayment types:

- capital repayment loans amortise monthly through customer repayments which comprise an interest payment and contribution to the principal loan balance;
- part-and-part loans provide customers with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only, with the interest only element repaid from an acceptable repayment vehicle; and
- interest only loans allow borrowers to pay only the interest on the loan each month, with the capital to be repaid in full at the end of the loan period from an acceptable repayment vehicle.

For residential mortgage customers, the Group continues to apply strict affordability criteria and restricts applicant LTV. For buy-to-let customers, interest only mortgages continue to be the predominant repayment method, with the majority of customers looking to the sale of the mortgaged property as the ultimate loan repayment vehicle. These loans are also subject to stringent lending standards.

The tables below show retail secured credit concentrations by loan type.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2017 (audited)	£m	%	£m	%	£m	%
Capital repayment	**22,963.2**	**84.0**	**1,040.0**	**16.4**	**24,003.2**	**71.3**
Part-and-part	**1,007.1**	**3.7**	**46.8**	**0.7**	**1,053.9**	**3.1**
Interest only	**3,346.9**	**12.3**	**5,280.5**	**82.9**	**8,627.4**	**25.6**
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**33,684.5**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2016 (audited)	£m	%	£m	%	£m	%
Capital repayment	19,521.7	80.4	913.0	16.7	20,434.7	68.7
Part-and-part	1,115.6	4.6	37.3	0.7	1,152.9	3.9
Interest only	3,645.7	15.0	4,518.1	82.6	8,163.8	27.4
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**

Wholesale

Concentration risk is managed for both individual counterparties and for country of exposure. The Group does not set a limit on exposures to the Bank of England and the UK Sovereign.

The table below shows wholesale credit risk exposures by country.

(audited)	**2017 £m**	2016 £m
Australia	**8.5**	19.3
Canada	**170.3**	169.0
France	**83.1**	105.3
UK	**3,532.8**	1,747.5
Netherlands	**–**	102.7
USA	**37.4**	104.6
Supranational	**234.1**	129.3
Total	**4,066.2**	2,377.7

The Group's wholesale credit risk exposure outside the UK remains well-diversified. UK exposures have increased by £1,785.3 million during the year due to further drawings from the TFS.

Risk Management Report

Full analysis of risk classes

Funding and liquidity risk

Definition
Funding risk is defined as the inability to raise and maintain sufficient cost-effective funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

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

Risk appetite
The Group funds before it lends, and has a clear framework for balance sheet structure in order to control funding, refinancing and liquidity risk. The Group operates an investment strategy for wholesale investments which prioritises liquidity and ensures that the Group holds a liquid asset buffer in excess of both regulatory and internally assessed requirements.

Exposures
Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows.

The Group's primary liquidity risk exposure arises through the redemption of retail deposits where customers are permitted to withdraw funds with limited or no notice. Additional exposures exist in relation to pipeline mortgage business, undrawn card balances and wholesale funding.

The Group is exposed to refinancing risk at the point of contractual maturity. The risk arises from both wholesale and retail funding sources.

Measurement
A series of measures are used across the Group to monitor both short and long-term liquidity requirements including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival periods. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

The measurement framework has two other important components:

> the volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Group ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

As the Group is predominantly retail funded, the largest potential source of liquidity stress is the unexpected outflow of retail customer deposits.

The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	Modelling assumption
Retail funding	Severe unexpected withdrawal of retail deposits by customers arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments.
Franchise viability	Lending outflows, over and above contractual obligations, are honoured as the Group preserves ongoing franchise viability.
Liquid assets	The liquidity portfolio value is reduced, reflecting stressed market conditions.

The scenarios and the assumptions are reviewed to ensure that they continue to be relevant to the nature of the business. The Group's liquidity risk appetite is calibrated against a number of stressed metrics. The funding plan is also stressed against a range of macro-economic scenarios; and

- the Group maintains a Liquidity Contingency Plan which is designed to provide an early warning indicator for liquidity concerns and a list of potential actions to address a liquidity shortfall. As a result, mitigating actions can be taken to avoid a more serious situation developing.

Mitigation

The most material component of the Group's funding and liquidity position is the customer deposit base, which is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. Where funding concentrations exist, for example refinancing at maturity, these are managed within the appropriate internal risk appetite, to control the size of the exposure. Refinancing is planned in advance of maturity with liquidity held to mitigate the potential exposure. Longer term funding is used to manage the Group's strategic liquidity profile in line with limits.

The Group operates a Funds Transfer Pricing (FTP) mechanism which supports customer pricing and the overall Group balance sheet strategy.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group. In addition to central bank reserves, the Group holds sizeable balances of high-quality marketable debt securities. Such securities can be sold to provide, or used to secure, additional cash inflows from market counterparties or central bank facilities (Bank of England), should the need arise.

Monitoring

Liquidity is actively monitored by the Group. Reporting is conducted through the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

Funding and liquidity management in 2017

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

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

Risk Management Report

Full analysis of risk classes

Funding sources

The Group is funded predominantly through retail customer deposits. During 2017, the Group maintained a strong presence in the retail savings market. Total customer deposits increased by £2.7 billion in the year and represented 75.6% of the Group's funding at 31 December 2017. The Group's retail funding portfolio demonstrated resilience and stability throughout 2017. The retention performance was in line with plan following repricing activities and the retail product mix moved towards fixed rate products, with overall contractual tenor increasing.

The Group's loan-to-deposit ratio increased to 119.1% as planned during 2017 from 114.5% at 31 December 2016.

The table below shows the Group's funding position.

(audited)	2017 £m	2016 £m
Loans and advances to customers	**36,740.2**	32,367.1
Loans and advances to banks	**359.4**	635.6
Debt securities classified as loans and receivables	**0.3**	0.7
Available-for-sale financial assets (encumbered)	**149.4**	10.6
Cash and balances at central banks (encumbered)	**215.7**	168.1
Funded assets	**37,465.0**	33,182.1
Other assets	**377.1**	407.1
Total assets (excluding liquid assets)	**37,842.1**	33,589.2
On balance sheet primary liquidity assets		
Cash and balances at central banks – primary	**2,363.3**	618.2
Available-for-sale financial assets (unencumbered)	**902.4**	848.2
Total assets	**41,107.8**	35,055.6
Less: Other liabilities	**(371.6)**	(560.8)
Funding requirement	**40,736.2**	34,494.8
Funded by		
Customer deposits	**30,808.4**	28,106.3
Wholesale funding	**8,102.9**	4,718.0
Total equity	**1,824.9**	1,670.5
Total funding	**40,736.2**	34,494.8

The table below shows the sources of wholesale funding.

(audited)	2017 £m	2016 £m
Debt securities in issue	**2,736.9**	2,600.0
Liabilities in respect of securities sold under repurchase agreements	**1,130.0**	850.0
Secured loans	**4,236.0**	1,268.0
Total on-balance sheet sources of funds	**8,102.9**	4,718.0
Treasury bills raised through FLS	**2,033.5**	2,683.7
Total	**10,136.4**	7,401.7

Secured loans relate to the Group's drawings from the Bank of England's TFS. The increase is due to further TFS drawings that were made during the year.

The tables below show residual maturity of the wholesale funding book.

2017 (audited)	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Debt securities in issue	**–**	**–**	**302.8**	**2,434.1**	**2,736.9**
Liabilities in respect of securities sold under repurchase agreements	**5.0**	**850.0**	**275.0**	**–**	**1,130.0**
Secured loans	**–**	**–**	**4,236.0**	**–**	**4,236.0**
Total on-balance sheet sources of funds	**5.0**	**850.0**	**4,813.8**	**2,434.1**	**8,102.9**
Treasury bills raised through FLS	**–**	**1,098.5**	**935.0**	**–**	**2,033.5**
Total	**5.0**	**1,948.5**	**5,748.8**	**2,434.1**	**10,136.4**

2016 (audited)	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Debt securities in issue	–	–	305.8	2,294.2	2,600.0
Liabilities in respect of securities sold under repurchase agreements	500.0	75.0	275.0	–	850.0
Secured loans	–	–	1,268.0	–	1,268.0
Total on-balance sheet sources of funds	500.0	75.0	1,848.8	2,294.2	4,718.0
Treasury bills raised through FLS	–	649.2	2,034.5	–	2,683.7
Total	**500.0**	**724.2**	**3,883.3**	**2,294.2**	**7,401.7**

An increase in average tenor of wholesale funding during 2017 is driven by the drawings of TFS, which are categorised as 1-5 years maturity.

Risk Management Report

Full analysis of risk classes

Encumbered assets

The Group's assets can be used to support funding collateral requirements for central bank operations or third party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes.

The tables below show the total asset encumbrance position of the Group for 2017 and 2016.

2017 (audited)	Encumbered assets		Unencumbered assets		
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total £m
Cash and balances at central banks	–	215.7	–	2,363.3	2,579.0
Debt securities classified as loans and receivables	–	–	0.3	–	0.3
Available-for-sale financial assets	–	149.4	899.3	3.1	1,051.8
Derivative financial assets	–	–	–	78.8	78.8
Loans and advances to banks	93.0	201.1	–	65.3	359.4
Loans and advances to customers	13,109.4	–	4,670.3	18,960.5	36,740.2
Other assets	8.5	–	–	289.8	298.3
Total assets	**13,210.9**	**566.2**	**5,569.9**	**21,760.8**	**41,107.8**
Treasury bills raised through FLS held off balance sheet[5]	182.9	–	1,850.6	–	2,033.5
Total assets plus off-balance sheet Treasury bills raised through FLS	**13,393.8**	**566.2**	**7,420.5**	**21,760.8**	**43,141.3**

2016 (audited)	Encumbered assets		Unencumbered assets		
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total £m
Cash and balances at central banks	–	168.1	–	618.2	786.3
Debt securities classified as loans and receivables	–	–	0.7	–	0.7
Available-for-sale financial assets	10.6	–	840.3	7.9	858.8
Derivative financial assets	–	–	–	104.2	104.2
Loans and advances to banks	181.1	354.4	–	100.1	635.6
Loans and advances to customers	9,425.6	–	2,932.9	20,008.6	32,367.1
Other assets	53.9	–	–	249.0	302.9
Total assets	**9,671.2**	**522.5**	**3,773.9**	**21,088.0**	**35,055.6**
Treasury bills raised through FLS held off balance sheet[5]	–	–	2,683.7	–	2,683.7
Total assets plus off-balance sheet Treasury bills raised through FLS	**9,671.2**	**522.5**	**6,457.6**	**21,088.0**	**37,739.3**

1 Encumbered assets pledged as collateral include amounts to derivative counterparties of £93.0 million (2016: £181.1 million) and amounts in respect of centrally cleared derivatives of £8.5 million (2016: £53.9 million). Encumbered loans and advances to customers of £13,109.4 million (2016: £9,425.6 million) consist of securitised mortgages and other loan pools positioned with the Bank of England that have been pledged as collateral for funding and liquidity transactions. As at 31 December 2017, £6,219.8 million (2016: £2,302.3 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements.

2 Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These comprise the mandatory reserve and the minimum requirement for the BACS payment system of £215.7 million (2016: £168.1 million) and cash reserves supporting secured funding structures of £201.1 million (2016: £354.4 million).

3 Unencumbered asserts which are classified as 'Available for collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'Available for collateral' only if they are already in such a form that they can be used immediately to raise funding.

4 Other unencumbered assets are assets which are not subject to any restrictions but are not readily available for use.

5 These amounts represent Treasury Bills received by the Group through FLS, which are not recognised on the balance sheet. The Group is permitted to re-pledge these securities to generate on-balance sheet financial assets, such as cash, or to fund lending. These items are classified as encumbered where the Group has used them in repurchase transactions or unencumbered where it has not.

The Group's total level of asset encumbrance increased by £3.8 billion to 32.4% at 31 December 2017. This was primarily due to using the TFS to support increased lending, which took total drawings to date to £4.2 billion. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Risk Management Report

Full analysis of risk classes

Liquid asset portfolio

The Group maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or supranational institutions and deposits with the Bank of England. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to cover more extreme stress events and provide flexibility for liquidity management.

The table below shows the composition of the liquidity portfolio.

Level 1	2017 £m	2017 Average £m	2016 £m	2016 Average £m
Cash and balances at central banks	**2,525.9**	**1,923.0**	737.2	819.6
UK Government securities	**207.3**	**221.8**	306.7	339.3
Other HQLA level 1 eligible	**–**	**–**	–	33.8
Supranational securities	**234.1**	**178.0**	129.3	222.0
Treasury bills raised through FLS	**1,850.6**	**2,219.7**	2,683.7	2,528.2
Covered bonds (Level 1 eligible)	**374.7**	**378.8**	304.9	434.4
Total level 1	**5,192.6**	**4,921.3**	4,161.8	4,377.3
Level 2a				
Covered bonds (Level 2a eligible)	**21.7**	**22.2**	22.2	22.4
Total level 2a	**21.7**	**22.2**	22.2	22.4
Level 2b				
Eligible RMBS	**50.1**	**52.6**	38.6	49.1
Total level 2b	**50.1**	**52.6**	38.6	49.1
High quality liquid assets (Level 1 + 2a + 2b)	**5,264.4**	**4,996.1**	4,222.6	4,448.8
Other liquidity resources				
Covered bonds	**–**	**–**	–	1.2
Non-eligible RMBS	**11.4**	**8.6**	13.6	11.6
Certificates of deposit	**–**	**40.8**	–	44.5
Floating rate notes	**–**	**6.3**	25.0	9.6
Money market loans	**13.8**	**13.3**	26.0	38.8
Total other liquidity resources	**25.2**	**69.0**	64.6	105.7
Self-issued RMBS	**601.7**	**958.2**	1,306.4	550.8
Total liquidity	**5,891.3**	**6,023.3**	5,593.6	5,105.3

The Group holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

The following tables analyse assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms.

In particular, the majority of customer deposits are contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity. Amounts in respect of RMBS in issue have a maximum contractual maturity consistent with underlying mortgage assets (in excess of five years); the cash flow profile below reflects that securitisation documents will require repayment of the securities in line with repayments of the underlying mortgages, which may be in advance of the legal maturity date.

2017 (audited) **Assets**	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Cash and balances at central banks	2,526.0	–	–	53.0	2,579.0
Derivative financial instruments	0.5	1.4	76.8	0.1	78.8
Loans and receivables:					
Loans and advances to banks	359.4	–	–	–	359.4
Loans and advances to customers	3,328.0	794.2	4,429.1	28,188.9	36,740.2
Debt securities	–	–	–	0.3	0.3
Available-for-sale financial assets	159.4	18.9	314.9	558.6	1,051.8
Other assets	75.7	7.3	60.3	155.0	298.3
Total assets	6,449.0	821.8	4,881.1	28,955.9	41,107.8
Liabilities					
Deposits from banks	18.0	850.0	4,511.0	–	5,379.0
Customer deposits	27,268.6	2,144.2	1,395.0	0.6	30,808.4
Derivative financial instruments	9.4	4.4	64.3	15.4	93.5
Debt securities in issue	–	–	302.8	2,434.1	2,736.9
Other liabilities	185.8	70.2	5.7	3.4	265.1
Total liabilities	27,481.8	3,068.8	6,278.8	2,453.5	39,282.9
Net liquidity (gap) / surplus	(21,032.8)	(2,247.0)	(1,397.7)	26,502.4	1,824.9

Risk Management Report

Full analysis of risk classes

2016 (audited) Assets	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Cash and balances at central banks	737.2	–	–	49.1	786.3
Derivative financial instruments	1.4	1.5	99.8	1.5	104.2
Loans and receivables:					
Loans and advances to banks	635.6	–	–	–	635.6
Loans and advances to customers	2,700.3	720.1	3,910.6	25,036.1	32,367.1
Debt securities	–	–	–	0.7	0.7
Available-for-sale financial assets	–	25.0	283.2	550.6	858.8
Other assets	99.2	25.3	10.8	167.6	302.9
Total assets	**4,173.7**	**771.9**	**4,304.4**	**25,805.6**	**35,055.6**
Liabilities					
Deposits from banks	514.5	75.0	1,543.0	–	2,132.5
Customer deposits	24,540.2	1,883.6	1,682.5	–	28,106.3
Derivative financial instruments	8.2	8.6	185.6	27.3	229.7
Debt securities in issue	–	–	305.8	2,294.2	2,600.0
Other liabilities	240.7	67.0	5.0	3.9	316.6
Total liabilities	**25,303.6**	**2,034.2**	**3,721.9**	**2,325.4**	**33,385.1**
Net liquidity (gap) / surplus	(21,129.9)	(1,262.3)	582.5	23,480.2	1,670.5

Cash flow profile

The tables below allocate the Group's non-derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

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

2016 (audited)	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	514.1	76.7	3.1	1,556.8	–	2,150.7
Customer deposits	24,628.0	680.8	1,371.3	1,835.9	–	28,516.0
Debt securities in issue	158.7	161.2	297.3	2,056.5	–	2,673.7
Total	**25,300.8**	**918.7**	**1,671.7**	**5,449.2**	**–**	**33,340.4**

Risk Management Report

Full analysis of risk classes

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

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

2016 (audited)	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(1.8)	(0.5)	(4.5)	(12.2)	(0.3)	(19.3)
Derivatives in accounting hedge relationships	(26.1)	(21.2)	(37.6)	(110.0)	(6.2)	(201.1)
	(27.9)	(21.7)	(42.1)	(122.2)	(6.5)	(220.4)
Settled on a gross basis						
Outflows	1.4	2.6	2.5	23.3	–	29.8
Inflows	(1.5)	(3.0)	(2.8)	(26.6)	–	(33.9)
Total	**(28.0)**	**(22.1)**	**(42.4)**	**(125.5)**	**(6.5)**	**(224.5)**

External credit ratings

Virgin Money Holdings (UK) plc does not have an external credit rating. Disclosures below relate to its subsidiary, Virgin Money plc. Virgin Money plc's short and long-term credit ratings as at 31 December 2017 are as follows.

	Long term	Short term	Outlook	Date of last rating action	Rating action type
Fitch	BBB+	F2	Stable	7 September 2017	Affirmed
Moody's	Baa2	P2	Stable	26 June 2017	Assigned

In September 2017, the rating agency Fitch maintained Virgin Money plc's outlook as Stable and affirmed its long-term rating at BBB+. On 26 June 2017, the rating agency Moody's assigned Virgin Money plc's outlook as Stable and its long-term rating as Baa2.

The table below sets out the amount of additional collateral the Company would need to provide in the event of a one and two notch downgrade by external credit ratings agencies.

	Cumulative adjustment for a one-notch downgrade £m	Cumulative adjustment for a two-notch downgrade £m
2017	**–**	**–**
2016	–	10.0

In addition, the Group could be required to post further collateral for payment systems, clearing houses and to support secured funding transactions. These requirements can be directly linked to the Group's external credit rating or driven by other factors. The Group monitors the related collateral requirements and includes these in liquidity stress requirements.

Risk Management Report

Full analysis of risk classes

Capital

Definition

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

Risk appetite

The Group maintains a high-quality capital base, targeting capital ratios which support business development and the risks inherent in the strategic plan.

The Group's capital planning approach is focused on maintaining capital in excess of regulatory requirements at all times.

Measurement

The Group calculates capital resources and requirements using the CRD IV CRR regulatory framework as implemented by the PRA. Pillar 1 capital requirements are calculated in respect of credit risk, operational risk, market risk and credit valuation adjustments. The capital requirement for residential mortgages is measured using an Advanced Internal Ratings Based (AIRB) approach approved by the PRA, and all other requirements are calculated using the Standardised Approach.

The Group uses AIRB models in measuring the credit risk of secured loans and advances to customers as described on page 134. In contrast, impairment allowances are recognised for financial reporting purposes only for loss events that have occurred at the balance sheet date, based on objective evidence of impairment.

Due to the different methodologies applied, the amount of incurred credit loss provisions in the financial statements differs from the amount determined from expected loss models used for internal operational management, capital requirement and other banking regulation purposes. Pages 209 to 210 provide details of the Group's approach to the impairment of financial assets.

The PRA supplements the Group's minimum total capital requirement by setting additional Pillar 2 requirements issued within the Group's Individual Capital Guidance (ICG). The PRA provided the Group's revised ICG in 2016 which included a Pillar 2A component of 3.87% of risk-weighted assets. The Group's ICG is the higher of Pillar 1 and 2A combined or the Basel I floor. The Basel I floor is a transitional capital minimum requirement based on the Basel I framework. As at 31 December 2017, as per the Group's ICG, the Basel I floor was the Group's binding constraint and was equivalent to a Pillar 2A capital add-on of 5.71%.

As part of the capital planning process, capital positions are subjected to stress testing and sensitivity analysis to determine the adequacy of capital resources against minimum requirements, including ICG, over the forecast period. This stress testing generates an additional capital requirement issued by the PRA, known as the PRA buffer, which is a matter between the PRA and the Group. The PRA buffer also takes account of the capital conservation buffer.

From 1 January 2018, the Group will transition to the new accounting requirements of IFRS 9.

Mitigation

The Group has capital management procedures that are designed to ensure compliance with risk appetite and regulatory requirements and are positioned to meet anticipated future changes to capital requirements.

The Group is able to accumulate additional capital through profit retention, by raising equity through, for example, a rights issue or debt exchange and by raising Tier 1 and Tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting lending strategy, risk hedging strategies and through business disposals. If necessary, this could include limiting business growth.

Monitoring

Capital is actively managed with regulatory ratios being a key factor in the Group's planning processes and stress analysis. A minimum of a three year forecast of the Group's capital position, based upon the strategic plan, is produced at least annually to inform the capital strategy. Shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan.

Regular reporting of actual and projected ratios is undertaken, including submissions to the Asset and Liability Committee, the Risk Management Committee and the Board.

Capital developments

CRD IV introduced new capital limits and buffers for banks, and includes a requirement to hold Common Equity Tier 1 capital to account for capital conservation, countercyclical and systemic risk buffers. These new buffers will influence the type of capital instruments that best meet the requirements likely to be expected of the Group.

A capital conservation buffer of 2.5% was introduced on 1 January 2016. This is being introduced through a transitionary period of four years with the buffer increasing by 0.625% per annum from 1 January 2016. The Bank of England announced in June that they would increase the countercyclical capital buffer from 0% to 0.5% from 27 June 2018. In November 2017, the Bank of England announced a further increase to 1.0%, with binding effect from 28 November 2018. The Group expects to be able to accommodate these stepped increases as and when implemented within existing management buffers.

CRD IV also introduced a new leverage ratio measure. The leverage ratio is a non-risk based measure that is designed to act as a supplement to risk based capital requirements. It is intended as a back stop measure. The leverage calculation determines a ratio based on the relationship between total Tier 1 capital and total consolidated exposures (total exposure is the sum of on-balance sheet exposures, derivative exposures, securities financing transaction exposures and off-balance sheet items). The Group is not subject to the PRA Leverage Framework until core deposits exceed £50 billion. To avoid capital cliffs the Group maintains a prudent risk appetite for leverage.

The leverage ratio for the Group (based on the Basel III definition of January 2014, and the revised CRD IV definition of October 2014) is 3.9% as at 31 December 2017 (2016: 4.4%).

The Financial Services (Banking Reform) Act 2013 introduces a ring-fence for UK retail banks, with the aim of separating core banking services critical to individuals and small and medium-sized enterprises from wholesale and investment banking services. The Group anticipates being a fully ring-fenced bank by 1 January 2019 implementation date and is preparing for this change.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL) were applicable from 1 January 2016 on a transitional basis with full implementation required by 1 January 2022. The Bank of England provided the Group's MREL guidance and transitional arrangements during 2016.

From 1 January 2020 until 31 December 2021 the Group will be required to hold 18% of risk-weighted assets. The Group is working towards implementation of these requirements and has reflected requirements in strategic plans. The Group expect to issue further senior debt over the next four year period to ensure compliance with MREL obligations.

Risk Management Report

Full analysis of risk classes

The table below shows the Group's capital resources.

	2017 £m	2016 £m
Share capital and share premium account	**654.6**	654.6
Other equity instruments	**384.1**	384.1
Other reserves	**(18.1)**	(27.4)
Retained earnings	**804.3**	659.2
Total equity per balance sheet (audited)	**1,824.9**	1,670.5
Regulatory capital adjustments		
Deconsolidation of non-regulated companies	**(0.3)**	5.4
Foreseeable distribution on Additional Tier 1 securities	**(3.8)**	(4.9)
Foreseeable distribution on ordinary shares	**(18.1)**	(15.5)
Other equity instruments	**(384.1)**	(384.1)
Cash flow hedge reserve	**22.7**	31.5
Additional valuation adjustment	**(1.2)**	(1.2)
Intangible assets	**(128.4)**	(80.6)
Excess of expected loss over impairment	**(46.9)**	(41.1)
Deferred tax on tax losses carried forward	**(0.6)**	(7.3)
Total regulatory capital adjustments	**(560.7)**	(497.8)
Common Equity Tier 1 capital	**1,264.2**	1,172.7
Additional Tier 1 securities	**384.1**	384.1
Total Tier 1 capital	**1,648.3**	1,556.8
Tier 2 capital		
General credit risk adjustments	**14.3**	11.9
Total Tier 2 capital	**14.3**	11.9
Total own funds	**1,662.6**	1,568.7
Common Equity Tier 1 ratio	**13.8%**	15.2%
Tier 1 ratio	**18.0%**	20.2%
Total capital ratio	**18.1%**	20.4%

As required by Article 26(2) of the Capital Requirements Regulation, a deduction has been made for foreseeable dividends on 2017 profits.

The table below shows movements in Common Equity Tier 1 capital.

	2017 £m	2016 £m
At 1 January	**1,172.7**	1,070.0
Movement in retained earnings	**145.1**	114.4
Additional valuation adjustment	**0.0**	(1.2)
Movement in available-for-sale reserve	**0.5**	4.4
Distributions on ordinary shares paid during the year	**23.9**	20.8
Distributions on ordinary shares accrued during the year	**(26.5)**	(22.6)
AT1 coupons accrued at previous year end	**4.9**	2.1
AT1 coupons accrued at this year end	**(3.8)**	(4.9)
Movement in reserves of non-regulated companies	**(5.7)**	0.9
Movement in intangible assets	**(47.8)**	(16.2)
Movement in excess of expected loss over impairment	**(5.8)**	(5.7)
Movement in deferred tax on tax losses carried forward	**6.7**	10.7
At 31 December	**1,264.2**	1,172.7

The main drivers for the increase in capital resources are the increase in retained earnings and the reduction in deferred tax asset on tax losses, offset by increased intangible assets, and other items as set out in the table above.

Risk Management Report

Full analysis of risk classes

The table below shows total risk-weighted assets.

	2017 £m	2016 £m
Retail mortgages	**5,790.5**	4,764.5
Retail unsecured lending	**2,282.9**	1,847.4
Treasury	**134.8**	178.6
Other assets	**204.3**	226.4
Credit valuation adjustments	**10.4**	22.6
Operational risk	**755.7**	655.3
Total risk-weighted assets	**9,178.6**	7,694.8

The table below shows Pillar 1 risk-weighted assets and capital requirements by business line.

	2017 Risk-weighted assets £m	**2017 Pillar 1 Capital requirement £m**	2016 Risk-weighted assets £m	2016 Pillar 1 Capital requirement £m
Mortgages and savings	**6,308.1**	**504.6**	5,204.5	416.4
Credit cards	**2,467.6**	**197.4**	2,012.3	161.0
Financial services	**53.4**	**4.3**	50.4	4.0
Central functions	**349.5**	**28.0**	427.6	34.2
Total	**9,178.6**	**734.3**	7,694.8	615.6

Movement in risk-weighted assets

The table below shows the movement in risk-weighted assets during the year to 31 December 2017. Lending growth in the year resulted in a 19.3% increase in total risk-weighted assets. For mortgages, growth in risk-weighted assets was higher than growth in customer balances as the average mortgage risk-weight density increased to 17.2% from 16.0% in 2016. This was in line with the Group's expectations as the advanced ratings models result in higher risk-weights for new lending than for maturing loans. For credit cards, growth in risk-weighted assets was in line with growth in customer balances as unsecured risk-weighted assets are calculated on the standardised approach.

There was an additional increase in operational risk-weighted assets of £100.4 million. This increase was in line with the standardised approach for the calculation of operational risk, where the growth in average income over the past three years is recognised in a higher level of operational risk-weighted asset. This was largely offset by a reduction in exposure to higher risk-weighted instruments and counterparties in the Group's liquid asset portfolio.

	IRB mortgage £m	Standardised lending £m	Other standardised assets £m	Credit valuation adjustment £m	Operational risks £m	Total £m
RWAs at 1 January 2017	4,764.5	1,847.4	405.0	22.6	655.3	7,694.8
Book size	1,179.7	435.6	–	–	–	1,615.3
Other movements	(153.7)	(0.1)	(65.9)	(12.2)	100.4	(131.5)
RWAs at 31 December 2017	**5,790.5**	**2,282.9**	**339.1**	**10.4**	**755.7**	**9,178.6**

Leverage ratio

CRD IV introduced a new balance sheet metric, the leverage ratio, from 1 January 2014. The leverage ratio is risk insensitive, requiring capital to be held against total on and off-balance sheet exposures including undrawn credit facilities.

The Basel Committee is testing this ratio at a minimum threshold of 3.0% until 2017. The Group's leverage ratio as at 31 December 2017 was 3.9% (December 2016: 4.4%) as disclosed below.

Exposure values associated with derivatives and securities financing transactions have been reported in compliance with CRD IV rules. For the purposes of the leverage ratio, the derivative measure has been adjusted for regulatory netting rules, potential future exposures and cash collateral.

Off-balance sheet items are made up of undrawn credit facilities. Credit conversion factors have been applied to these items to convert them to an on-balance sheet equivalent in compliance with the CRD IV rules.

Other regulatory adjustments consist of adjustments that have been applied to Tier 1 capital which are also applied to the leverage ratio exposure measure. This ensures consistency between Tier 1 capital and the total exposures of the ratio.

Risk Management Report

Full analysis of risk classes

	2017 £m	2016 £m
Total tier 1 capital for leverage ratio		
Common equity tier 1 capital	**1,264.2**	1,172.7
Additional tier 1 capital	**384.1**	384.1
Total tier 1 capital	**1,648.3**	1,556.8
Exposure measure		
Statutory balance sheet assets		
Derivative financial instruments	**78.8**	104.2
Loans and advances and other assets	**41,029.0**	34,951.4
Total assets	**41,107.8**	35,055.6
Deconsolidation adjustments		
Loans and advances and other assets	**(0.4)**	5.3
Total deconsolidation adjustments	**(0.4)**	5.3
Derivative adjustments		
Adjustments for regulatory netting	**(11.5)**	(25.4)
Adjustments for cash collateral	**(142.5)**	(195.0)
Net written credit protection	**36.8**	–
Regulatory potential future exposure	**131.3**	86.8
Total derivative adjustments	**14.1**	(133.6)
Securities financing transactions adjustments	**364.3**	222.4
Off-balance sheet items	**776.8**	714.5
Regulatory deductions and other adjustments	**(154.4)**	(98.7)
Total exposures	**42,108.2**	35,765.5
Leverage ratio	**3.9%**	4.4%

Financial statements

Virgin Money Lounge, Manchester

Financial statements

Independent auditors’ report to the members of Virgin Money Holdings (UK) plc

Report on the audit of the financial statements

Opinion

In our opinion, Virgin Money Holdings (UK) plc’s Group financial statements and Parent Company financial statements (the ‘financial statements’):

> give a true and fair view of the state of the Group’s and of the Parent Company’s affairs as at 31 December 2017 and of the Group’s profit and the Group’s and the Parent Company’s cash flows for the year then ended;

> have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards the Parent Company’s financial statements, as applied in accordance with the provisions of the Companies Act 2006; and

> have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the ‘Annual Report’), which comprise: the Group and Parent Company balance sheets as at 31 December 2017; the Group income statement, the Group statement of comprehensive income, the Group and Parent Company statements of cash flows, and the Group and Parent Company statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors’ responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

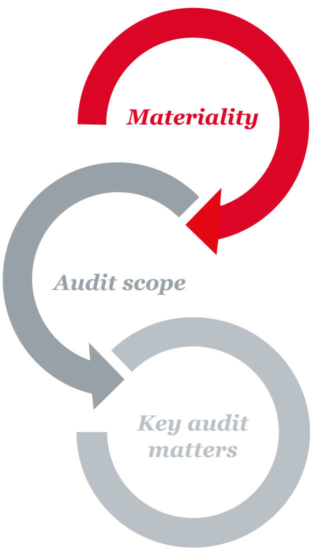
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC’s Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC’s Ethical Standard were not provided to the Group or the Parent Company.

Other than those disclosed in note 6 to the financial statements, we have provided no non-audit services to the Group or the Parent Company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview



> Overall Group materiality: £13.4 million (2016: £9.8 million), based on 5% of adjusted profit before tax, adjusted for £6.5 million of strategic items (as detailed in note 2), as these are not considered to be recurring. This adjusted measure of profit is deemed as the most appropriate benchmark upon which to base our materiality.

> We performed a full scope audit over the Group’s five 100% owned subsidiaries and certain Special Purpose Vehicle (SPV) balances were scoped in on a line by line basis based on their proportion of the consolidated financial statement line item. 98% of interest income, 98% of profit before tax (98% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of total assets were subject to audit.

Key audit matters included:

> Revenue recognition – Effective Interest Rate (EIR) accounting.

> Impairment of loans and advances to customers.

> Recognition of intangible assets.

> Disclosure of impact of adoption of IFRS 9.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Report on the audit of the financial statements

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group financial statements, including but not limited to, the Companies Act 2006, the Listing Rules, and UK tax legislation.

Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Each of the key audit matters below related to our audit of Group financial statements.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Key audit matter	How our audit addressed the key audit matter
Revenue recognition – Effective Interest Rate (EIR) accounting See note 1 of the financial statements for the disclosure of the related accounting policies and critical estimates and judgements, and page 88 for the Audit Committee's consideration of key financial issues and judgements. The Group's total loans and advances to customers balance of £36.7 billion and net interest income of £594.6 million include certain EIR adjustments as per the requirements of IAS 39. The vast majority of the income recognised by the Group is system generated and requires minimal judgement, therefore we focused our work in relation to revenue recognition on EIR accounting due to the inherent subjectivity and complexity involved in forecasting future customer behaviour on which the EIR adjustment calculation is based. Changes in assumptions used in the forecasting model could have a material impact on EIR adjustments and hence the revenue recognised in any one accounting period. The most significant assumption for secured lending EIR is the estimation of the expected life of the product over which fees are spread. For unsecured lending, significant judgement is applied in calculating the EIR adjustment including setting assumptions relating to movements in customer balances over the expected life and the related future revenue associated with these balances in the context of the Group's historic experience. Key assumptions include retail spending levels and repayment rates.	Across both the secured and unsecured lending EIR calculation models, we tested controls over data input and checked the accuracy of model calculations. We also assessed controls over the setting and approving of key assumptions. We tested the impact of any changes in assumptions on the financial statements, ensuring these were calculated in accordance with IAS 39. In relation to secured lending EIR, we: > Substantively tested a sample of fees incorporated within the calculation to underlying secured lending agreements and considered the appropriateness of the inclusion of fees in the EIR calculation; and > Assessed the estimate of the expected life applied and forecast cash flows during this life by comparing to recent Group experience and expectations of future patterns. We concluded that, whilst there is significant judgement inherent in the secured EIR adjustment, the assumptions applied were within a reasonable range based on past experience and future assumptions. In relation to unsecured lending EIR, we: > Tested controls over the ongoing monitoring of actual credit card cash flows as compared with the forecast assumptions and compared 2017 experience with expected experience for that period on a sample basis; > Assessed the key forecast assumptions, including expected life, balance, repayment rate, volume of retail spend and interest income earned by comparing to recent experience; > Performed sensitivity analyses of key judgements to understand the materiality of the impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset; and > Assessed the sufficiency of the disclosures in the financial statements relating to significant estimates made in the EIR calculation, including disclosure of sensitivities. We concluded that, whilst there is significant judgement inherent in the unsecured EIR adjustment, the assumptions applied were within a reasonable range based on past experience and future assumptions. We concluded that the disclosures in note 1 of the financial statements provide appropriate details of the degree and nature of estimation uncertainty and the impact on the financial statements of actual future customer experience differing from the assumptions made.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Report on the audit of the financial statements

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers See note 1 of the financial statements for the disclosure of the related accounting policies and critical estimates and judgements, and page 88 for the Audit Committee's consideration of key financial issues and judgements. The impairment provision of £59.4 million consists of provisions of £12.1 million in relation to secured lending and £47.3 million in relation to unsecured lending. Total loans and advances as at 31 December 2017 relating to secured lending was £33.7 billion and £3.1 billion for unsecured lending. We focused on this area because Management make subjective judgements over both the timing of recognition and the size of provisions for impairment of loans and advances. This judgement includes considering the completeness of the provisions and whether any specific judgemental overlays are appropriate to recognise the impact of emerging trends not captured in the impairment models. The Group has developed historic data based models that derive key assumptions used within the provision calculation such as probability of default (PD) and loss given default (LGD). The output of these models is then applied to the provision calculation with other information including the selection of an appropriate loss emergence period (LEP) and the exposure at default (EAD).	We assessed and tested the design and operating effectiveness of the controls over data flows, model governance and setting and approval of key assumptions used in the provisioning process. As part of our detailed work, we: > Assessed the provision calculation methodology applied in the context of industry practice and the requirements of accounting standards; > Tested key assumptions used within the models to internal and external information where appropriate; > Tested that the model calculations were consistent with our understanding of the Group's methodology and the requirements of accounting standards; and > Examined the basis for the judgemental overlays made to the results produced by models and assessing the rationale for the adjustments, as well as considering the completeness of the overlays. We found the approach taken in relation to the Group's impairment provisions to be consistent with the requirements of IAS 39 and judgements made were reasonable.
Recognition of intangible assets See note 1 of the financial statements for the disclosure of the related accounting policies and also page 88 for the Audit Committee's consideration of key financial issues and judgements. During 2017 certain technology project costs incurred by the Group were capitalised. These projects require cash and non-cash resources during development and management applies judgement in considering whether or not costs should be capitalised in the context of IAS 38. As technology and customer expectations continue to change there is a risk that certain technology assets may not generate the return that the Group had initially anticipated and therefore may be subject to impairment. The Group's total net book value of intangible assets was £128.4 million as at 31 December 2017.	We assessed the Group's capitalisation policy to check that it met the requirements of IAS 38. We tested the design and operating effectiveness of the control environment in relation to the recording and approval of project costs which form the basis of capitalisation accounting entries. We selected a sample of intangible assets and undertook the following procedures: > Substantively tested a selection of costs including those related to new projects to check that these meet the criteria of IAS 38 for capitalisation as intangible assets; > Discussed material capitalised assets with management to identify any that may be at higher risk of potential impairment; and > Where higher risk items were noted, we discussed the asset and related forecast economic benefits with management to inform our independent consideration as to whether any possible impairment triggers existed. One item was noted by management as requiring impairment resulting in a charge of £4.8 million to the income statement. This is disclosed in note 19. We found the accounting treatment applied in recognising capitalised costs was consistent with the requirements of IAS 38 and we did not identify any material matters which we considered necessary to report to the Audit Committee.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Key audit matter	How our audit addressed the key audit matter
Disclosure of impact of adoption of IFRS 9 IFRS 9 became effective on 1 January 2018 and therefore does not affect the Balance Sheet and Income Statement of the Group as at 31 December 2017. However, under the requirements of IAS 8, the Group is required to disclose the estimated impact that new accounting standards will have on initial adoption. The Group has presented a transition disclosure in note 37. Management estimate that the transition to IFRS 9 will reduce shareholders' equity by approximately £35 million after deferred tax as at 1 January 2018. The most significant impact of adopting IFRS 9 to the Group relates to a change in the way that credit losses are recognised, moving from an incurred loss to an expected loss basis for financial instruments held at amortised cost. The estimation of expected credit losses (ECL) for the disclosure required in these 2017 financial statements has required significant judgement to be applied in the development of lifetime PD, LGD and EAD. This has required a more complex provision calculation methodology based on the application of differing levels of forecasting of losses. This is dependent on whether a significant increase in credit risk has occurred, as well as an adjustment applied for the impact of multiple economic scenarios in the future.	We read the disclosure as set out in note 37 to assess its compliance with the requirements of IAS 8. We also tested the completeness and accuracy of data inputs for the Group's material IFRS 9 models to identify any material inconsistencies with source system data. Our detailed work in auditing the estimated 2018 opening impairment provisions included: > Reading model documentation papers and assessing the Group's methodology and modelling approach in the context of our understanding of IFRS 9; > Independently estimating model outputs based on the Group's methodology and data for material IFRS 9 models and comparing our outcomes with those of management; and > Comparing macroeconomic forecasts used by the Group for IFRS 9 purposes with third party market information. We found the disclosure in respect of the transition to IFRS 9 and the estimated impact this has on shareholders' equity to be consistent with the requirements of accounting standards.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

We updated our understanding of processes within the business in order to understand and evaluate the key financial processes and controls across the Group. Our audit plan was presented to the Audit Committee. Following our procedures, we were able to obtain sufficient appropriate audit evidence to form a basis for our audit opinion.

The consolidated financial statements include the Group's five 100% owned subsidiaries as well as a number of securitisation related SPVs. As the statutory audit of subsidiaries is undertaken concurrently with the Group audit, all five subsidiaries were designated as in-scope components for Group audit purposes. Additionally, certain SPV balances were scoped in for audit on a line by line basis based on their proportion of the consolidated financial statement line item to ensure adequate overall audit coverage for each line item. 98% of interest income, 98% of profit before tax (98% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of Total Assets were subject to audit.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed over the components. All of the audit work was completed by the Group engagement team.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Report on the audit of the financial statements

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Overall materiality	£13.4 million (2016: £9.8 million).	£13.4 million (2016: £2.8 million).
How we determined it	5% of adjusted profit before tax adjusted for £6.5 million of strategic items (as detailed in note 2), as these are not considered to be recurring.	1% of total assets, capped to Group overall materiality of £13.4 million
Rationale for benchmark applied	This adjusted measure of profit is deemed as the most appropriate measure of underlying business performance and hence an appropriate benchmark upon which to base our materiality.	As the Company is not profit orientated on a solo-entity basis, we have used 1% of total assets, but cap this to the lower materiality of the Group.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £0.02 million and £13.0 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above

£0.67 million (Group audit) (2016: £0.49 million) and £0.67 million (Parent Company audit) (2016: £0.14 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the Group's and the Parent Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements. We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Parent Company's ability to continue as a going concern.

We are also required to report if the Directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit. We have nothing to report.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report, Directors' Report and Corporate Governance Statement, we also considered whether the disclosures required by the Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

Corporate Governance Statement

In our opinion, based on the work undertaken in the course of the audit, the information on pages 81, 89 and 126 to 188 of the Annual Report about internal controls and risk management systems in relation to financial reporting processes, and in note 27 to the financial statements about share capital structures in compliance with rules 7.2.5 and 7.2.6 of the Disclosure Guidance and Transparency Rules sourcebook of the FCA (DTR) is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit, we did not identify any material misstatements in this information. (CA06)

In our opinion, based on the work undertaken in the course of the audit, the information given on pages 71 to 94 of the Annual Report with respect to the Parent Company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the DTR. (CA06)

We have nothing to report arising from our responsibility to report if a corporate governance statement has not been prepared by the Parent Company. (CA06)

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

> The Directors' confirmation on page 132 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;

> The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; and

> The Directors' explanation on page 120 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the Code); and considering whether the statements are consistent with the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit. (Listing Rules)

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Reporting on other information

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the Directors, on page 125, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company obtained in the course of performing our audit;
- The section of the Annual Report on pages 88 and 89 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; and
- The Directors' statement relating to the Parent Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on page 124, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Independent auditors' report to the members of Virgin Money Holdings (UK) plc

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

> we have not received all the information and explanations we require for our audit; or

> adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

> certain disclosures of Directors' remuneration specified by law are not made; or

> the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 4 May 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is two years, covering the years ended 31 December 2016 and 31 December 2017.

Catrin Thomas

Catrin Thomas (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh

26 February 2018

Consolidated income statement

For the year ended 31 December

	Note	2017 £ million	2016 £ million
Interest and similar income		**958.0**	948.1
Interest and similar expense		**(363.4)**	(425.7)
Net interest income	3	**594.6**	522.4
Fee and commission income		**29.6**	28.8
Fee and commission expense		**–**	(1.2)
Net fee and commission income	4	**29.6**	27.6
Other operating income	5	**41.8**	40.3
Fair value losses on financial instruments	13	**(3.3)**	(8.9)
Other income		**68.1**	59.0
Total income		**662.7**	581.4
Operating expenses	6	**(355.9)**	(349.4)
Profit before tax from operating activities		**306.8**	232.0
Impairment	8	**(44.2)**	(37.6)
Profit before tax		**262.6**	194.4
Taxation	9	**(70.5)**	(54.3)
Profit for the year		**192.1**	140.1

Profit attributable to equity owners		**192.1**	140.1
Profit for the year		**192.1**	140.1

Basic earnings per share (pence)	10	**37.8**	29.4
Diluted earnings per share (pence)	10	**37.5**	29.1

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

Consolidated statement of comprehensive income

For the year ended 31 December

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

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

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

Consolidated balance sheet

As at 31 December

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

Consolidated balance sheet (continued)

As at 31 December

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

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

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

Glen Moreno
Chair

Jayne-Anne Gadhia CBE
Chief Executive

Consolidated statement of changes in equity

For the year ended 31 December 2017

Attributable to equity holders

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

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

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

Consolidated statement of changes in equity

For the year ended 31 December 2016

Attributable to equity holders (continued)

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2016	654.6	156.5	(15.6)	544.8	1,340.3
Comprehensive income					
Profit for the year	–	–	–	140.1	140.1
Other comprehensive income/(expense)					
Net movement in revaluation reserve in respect of available-for-sale financial assets	–	–	4.4	–	4.4
Net movement in cash flow hedge reserve	–	–	(16.2)	–	(16.2)
Total other comprehensive expense	–	–	(11.8)	–	(11.8)
Total comprehensive (expense)/income for the year	–	–	(11.8)	140.1	128.3
Transactions with equity holders					
Dividends paid to ordinary shareholders	–	–	–	(20.8)	(20.8)
Distribution to Additional Tier 1 security holders	–	–	–	(12.6)	(12.6)
Tax attributable to Additional Tier 1 securities	–	–	–	2.5	2.5
Purchase of own shares	–	–	–	(7.3)	(7.3)
Issue of Additional Tier 1 securities	–	227.6	–	–	227.6
Share based payments – charge for the year	–	–	–	12.8	12.8
Deferred tax on share based payments	–	–	–	(0.3)	(0.3)
Total transactions with equity holders	–	227.6	–	(25.7)	201.9
Balance at 31 December 2016	654.6	384.1	(27.4)	659.2	1,670.5

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

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

Consolidated cash flow statement

For the year ended 31 December

	Note	2017 £ million	2016 £ million
Profit before taxation		**262.6**	194.4
Adjustments for:			
Changes in operating assets	34(a)	**(4,357.8)**	(5,387.3)
Changes in operating liabilities	34(b)	**5,806.6**	3,957.3
Non-cash and other items	34(c)	**48.2**	60.3
Tax paid		**(45.1)**	(22.1)
Net cash provided by/(used in) operating activities		**1,714.5**	(1,197.4)
Cash flows from investing activities			
Purchase of securities		**(541.5)**	(670.0)
Proceeds from sale and redemption of securities		**497.1**	1,150.0
Purchase and investment in intangible assets		**(74.3)**	(31.6)
Purchase of tangible fixed assets		**(5.8)**	(8.6)
Disposal of tangible fixed assets		**–**	0.7
Net cash (used in)/provided by investing activities		**(124.5)**	440.5
Cash flows from financing activities			
Dividends paid to ordinary shareholders	11	**(23.9)**	(20.8)
Distributions to Additional Tier 1 security holders		**(32.7)**	(12.6)
Other distributions		**(0.2)**	–
Net proceeds from issue of debt securities	25	**746.2**	1,278.9
Repayments of debt securities in issue	25	**(608.3)**	(798.1)
Purchase of own shares		**(8.5)**	(7.3)
Issue of Additional Tier 1 securities (net of costs)		**–**	227.6
Net cash provided by financing activities		**72.6**	667.7
Change in cash and cash equivalents		**1,662.6**	(89.2)
Cash and cash equivalents at beginning of year		**1,372.2**	1,461.4
Cash and cash equivalents at end of year	34(d)	**3,034.8**	1,372.2

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies

1.1 Reporting entity

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

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

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

1.2 Basis of preparation

The Group consolidated financial statements, which should be read in conjunction with the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

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

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

1.3 Changes in accounting policy

New standards, amendments to standards and interpretations adopted

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

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

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

1.4 Presentation of information

Presentation of risk and capital management disclosures

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

1.5 Basis of consolidation

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

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

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

The Virgin Money Foundation is classified as an associate.

1.6 Basis of measurement

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

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

1.7 Client money

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

1.8 Foreign currency translation

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

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

1.9 Accounting policies

The accounting policies of the Group are set out below.

(a) Operating segments

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

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

(b) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

This method calculates the amortised cost of a financial asset or liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or liability. The Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument, loan commitment fees and all other premiums and discounts.

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

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accruals basis in interest receivable or payable. Interest on available-for-sale (AFS) debt securities is recorded in interest receivable using the effective interest rate method.

(c) Fees and commissions

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided.

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

(d) Other operating income

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to the sale and management of stocks and shares ISAs, pensions, authorised unit trusts and other financial services products.

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

Other income includes commission on donations and other sundry income.

(e) Operating expenses

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

Staff costs

The Group accounts for components of employee costs on the following bases:

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

> Short-term employee benefits

Short-term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period that employees are required to provide services.

> Other long-term employee benefits

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

> Retirement benefit obligations

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

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

Leases

If the lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

(f) Share based payments

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

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

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

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

(g) Impairment losses

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

> Loans and receivables at amortised cost

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

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

- there is evidence of the customer or issuer experiencing financial difficulty;
- there is a breach of contract, such as a default or delinquency in repayments;
- the customer is granted a concession that would otherwise not be considered;
- the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; and

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

> observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:

- there are adverse changes in the payment status of borrowers in the portfolio; and
- economic conditions that correlate with defaults on the assets in the portfolio.

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

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

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

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

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

Available-for-sale financial assets

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

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

(h) Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income. Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Group has adopted the Code of Practice on Taxation for Banks issued by HM Revenue & Customs.

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

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

(i) Earnings per share

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

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

(j) Financial instruments

Financial assets

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

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

> loans and receivables;

> available-for-sale;

> held to maturity; or

> financial assets at fair value through profit or loss.

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

> Loans and receivables at amortised cost

The Group's loans and advances to banks and customers, and asset backed securities for which there is no active market, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

> Available-for-sale financial assets

Available-for-sale financial assets are non-derivative assets that are either designated as available-for-sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally, but not exclusively, investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models (refer policy (m)). With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

> Held to maturity financial assets

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

> Financial assets at fair value through profit or loss

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

Financial liabilities

The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (n)). Borrowings, including deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

Offsetting financial instruments

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Derecognition of financial assets and liabilities
Derecognition is the point at which the Group ceases to recognise an asset or liability on its balance sheet. The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Group transfers the financial assets to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, converted to shares, cancelled or has expired or is transferred to a third party. There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

(k) Loans and advances to banks
The Group's loans and advances to banks are classified as loans and receivables.

(l) Loans and advances to customers
The Group's loans and advances to customers are classified as loans and receivables.

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

(n) Derivative financial instruments and hedge accounting
The Group is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

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

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the accounting hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group designates certain derivatives as either:

> Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

> Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

The most frequently used fair value hedges are:

- hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;
- hedging the interest rate risk of a portfolio of non-prepayable fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish micro fair value hedges for fixed rate investments; and
- hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps. This solution is used to establish micro fair value hedges for foreign currency denominated fixed rate investments.

(o) Securitisation transactions

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

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

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

> Debt securities in issue

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

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

Securitisation is a means used by the Group to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their principal value to Special Purpose Vehicles (SPV) and have been funded through the issue of amortising mortgage backed securities to investors.

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

(p) Funding for Lending Scheme

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

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

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

(q) Intangible assets and amortisation

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3 to 10 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 13 'Fair Value Measurement'.

Expenditure incurred in relation to scoping, planning and researching the build of an asset as part of a project is expensed as incurred.

Development expenditure incurred on a project is capitalised only if the following criteria are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

Internally generated intangible assets relate to computer software and core banking platforms.

> Computer software

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

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

> Banking platforms

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

> Impairment of intangible assets

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

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

(r) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50-100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5-30 years
Computer equipment	3-5 years
Office equipment	3-10 years
Motor vehicles	4 years

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

> Impairment of tangible fixed assets

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

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

(s) Other assets

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

(t) Deposits from banks

Deposits from banks are initially measured at fair value, which is normally the proceeds received net of any directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method.

(u) Customer deposits

Customer deposits are initially measured at fair value, which is normally the proceeds received. Subsequent measurement is at amortised cost, using the effective interest rate method.

(v) Provisions

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

(w) Other liabilities

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

Trade creditors and accruals represent amounts the Group is due to pay to third parties in the normal course of business. These include expense accruals, which have been incurred, but not yet billed. Accrued expenses are amounts that the Group is due to pay to third parties in the normal course of business.

(x) Share capital and share premium

> Share capital

The financial instruments issued by the Company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

> they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Group; and

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

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

> Share issue costs

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

> Dividends

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

> Share premium

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

(y) Other equity instruments

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

(z) Other reserves

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

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

> Cash flow hedge reserve

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

(aa) Contingent liabilities

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(ab) Fair value of financial assets and liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Group will not fulfil an obligation), including the Group's own credit risk.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

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

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

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

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

1.10 Critical estimates and judgements

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

(a) Critical assumptions and sources of estimation uncertainty

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

> Effective interest rates

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

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

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

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

In the calculation of EIR, Management uses estimates and assumptions of future customer behaviour. These include the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period. Should Management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured lending cohorts were all reduced by 0.1%, the present value adjustment to interest income, in relation to the revised future cash flows, would be approximately £(10.2) million as at 31 December 2017.

A significant proportion of the Group's credit card portfolio includes customers within promotional periods. The level of repayment immediately post promotional period is a key sensitivity within the EIR assumptions. There is evidence to support the expected behaviour of customers after the end of promotional periods, however there is inherent risk that this data may not be indicative of actual future behaviour. If the proportion of customers who repay their balance post-promotion differs to Management's estimate it can have a material impact on the revised future cash flows.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

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

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

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

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

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

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

(b) Critical judgements in applying accounting policies

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

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

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

Notes to the consolidated financial statements

Note 2: Segmental analysis and reconciliation to underlying basis

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

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

Reconciliation of statutory results to underlying basis

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

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

		Adjusted for				
	Statutory results £m	IPO share based awards £m	Strategic items £m	Simplification costs £m	Fair value losses on financial instruments £m	Underlying basis £m
Year ended 31 December 2016						
Net interest income	522.4	–	(3.4)	–	–	519.0
Other income	59.0	–	–	–	8.9	67.9
Total income	581.4	–	(3.4)	–	8.9	586.9
Total operating expenses	(349.4)	2.0	5.8	5.6	–	(336.0)
Profit before tax from operating activities	232.0	2.0	2.4	5.6	8.9	250.9
Impairment	(37.6)	–	–	–	–	(37.6)
Profit before tax	194.4	2.0	2.4	5.6	8.9	213.3

Notes to the consolidated financial statements

Note 3: Net interest income

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

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

Note 4: Net fee and commission income

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

Notes to the consolidated financial statements

Note 5: Other operating income

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

Note 6: Operating expenses

	2017 £m	2016 £m
Staff costs:		
Wages and salaries	**161.9**	160.7
Social security costs	**15.5**	14.6
Other pension costs	**10.9**	10.7
Employee share schemes	**9.9**	12.8
	198.2	198.8
Premises and equipment:		
Hire of equipment	**4.6**	4.6
Rent and rates	**14.4**	14.3
Other property costs	**11.0**	9.6
	30.0	28.5
Other expenses:		
Marketing costs	**21.8**	21.0
Telecommunications and IT	**18.5**	17.4
Professional fees	**23.1**	20.0
Other	**29.1**	42.7
	92.5	101.1
Depreciation, amortisation and impairment:		
Depreciation of tangible fixed assets	**8.7**	5.6
Amortisation of intangible assets	**21.7**	15.4
Impairment of intangible assets	**4.8**	–
	35.2	21.0
Total operating expenses	**355.9**	349.4

Notes to the consolidated financial statements

Note 6: Operating expenses (continued)

Average headcount

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

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

Retirement benefit obligations

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

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

Fees payable to the auditors

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

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

All amounts are shown exclusive of VAT.

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

Audit and audit-related fees

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

Notes to the consolidated financial statements

Note 7: Share based payments

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

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

1 All awards have vesting conditions and therefore some may not vest.

2 Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme.

(A) Long-term incentive plan (LTIP)

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

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

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

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

(B) Deferred bonus share plan

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

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

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

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

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

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

Notes to the consolidated financial statements

Note 7: Share based payments (continued)

Movement in share options and conditional shares

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

	Ordinary Shares						
	Interest in share options[1]	Long-term incentive plan	Deferred bonus share plan	Phantom share award	IPO incentive scheme	Recruitment award	IPO share award
Shares in existence at 1 January 2016	625,328	1,399,453	1,157,800	3,061,820	332,334	175,810	139,041
Granted in year	–	1,572,717	1,695,266	–	–	–	–
Exercised or vested in year	–	(98,349)	(754,417)	(950,550)	(305,676)	(175,810)	(68,885)
Forfeited in year	–	(222,483)	–	(66,790)	(26,658)	–	(1,236)
Outstanding 31 December 2016	625,328	2,651,338	2,098,649	2,044,480	–	–	68,920
Of which exercisable	625,328	–	–	–	–	–	–

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

Notes to the consolidated financial statements

Note 8: Allowance for impairment losses on loans and receivables

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

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

Note 9: Taxation

(A) Analysis of the tax charge for the year

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

Notes to the consolidated financial statements

Note 9: Taxation (continued)

Analysis of tax charge recognised in Other Comprehensive Income:

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

(B) Factors affecting the tax charge for the year

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

	2017 £m	2016 £m
Profit before tax	**262.6**	194.4
Tax charge at standard tax rate of 19.25% (2016: 20%)	**(50.5)**	(38.9)
Factors affecting charge:		
Disallowed items	**(1.0)**	(1.8)
Bank corporation tax surcharge	**(18.9)**	(12.5)
UK corporation tax rate change	**(0.4)**	(0.2)
Deferred tax charge in respect of share schemes	**–**	(1.1)
Adjustments in respect of prior years	**0.3**	0.2
Total tax charge	**(70.5)**	(54.3)

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

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

Notes to the consolidated financial statements

Note 10: Earnings per share

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

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

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

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

Note 11: Dividends

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

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

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

Notes to the consolidated financial statements

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

	Held at amortised cost £m	Loans and receivables £m	Available-for-sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as hedging instruments: Fair value hedges £m	Derivatives designated as hedging instruments: Cash flow hedges £m	Total £m
As at 31 December 2017							
Financial assets							
Cash and balances at central banks	–	2,579.0	–	–	–	–	2,579.0
Derivative financial instruments	–	–	–	11.9	11.5	55.4	78.8
Loans and receivables:							
> Loans and advances to banks	–	359.4	–	–	–	–	359.4
> Loans and advances to customers	–	36,740.2	–	–	–	–	36,740.2
> Debt securities	–	0.3	–	–	–	–	0.3
Available-for-sale financial assets	–	–	1,051.8	–	–	–	1,051.8
Other assets	–	55.0	–	–	–	–	55.0
Total financial assets	–	39,733.9	1,051.8	11.9	11.5	55.4	40,864.5
Non financial assets							243.3
Total assets							41,107.8
Financial liabilities							
Deposits from banks	5,379.0	–	–	–	–	–	5,379.0
Customer deposits	30,808.4	–	–	–	–	–	30,808.4
Derivative financial instruments	–	–	–	10.7	82.5	0.3	93.5
Debt securities in issue	2,736.9	–	–	–	–	–	2,736.9
Other liabilities	215.1	–	–	–	–	–	215.1
Total financial liabilities	39,139.4	–	–	10.7	82.5	0.3	39,232.9
Non financial liabilities							50.0
Total liabilities							39,282.9
Equity							1,824.9
Total liabilities and equity							41,107.8

Notes to the consolidated financial statements

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

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

Notes to the consolidated financial statements

Note 13: Derivative financial instruments

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

	As at 31 December 2017			As at 31 December 2016		
	Contract/ notional amount £m	Asset fair value £m	Liability fair value £m	Contract/ notional amount £m	Asset fair value £m	Liability fair value £m
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges:						
Interest rate derivatives (gross)	**23,314.7**	**61.7**	**(91.0)**	21,584.8	34.7	(219.8)
Less: contracts centrally cleared	**(17,360.6)**	**(50.2)**	**8.5**	(8,194.1)	(13.7)	13.0
Interest rate derivatives (net)	**5,954.1**	**11.5**	**(82.5)**	13,390.7	21.0	(206.8)
Derivatives designated as cash flow hedges:						
Interest rate derivatives (gross)	**1,199.0**	**–**	**(2.9)**	1,287.0	3.5	(2.2)
Less: contracts centrally cleared	**(1,199.0)**	**–**	**2.9**	(1,287.0)	(3.5)	2.2
Interest rate derivatives (net)	**–**	**–**	**–**	–	–	–
Currency derivatives	**705.6**	**55.4**	**(0.3)**	520.3	64.7	–
Total derivative assets/(liabilities) – in accounting hedge relationships	**6,659.7**	**66.9**	**(82.8)**	13,911.0	85.7	(206.8)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives (gross)	**7,205.6**	**9.6**	**(10.4)**	7,549.6	15.7	(24.0)
Less: contracts centrally cleared	**(2,830.7)**	**(0.8)**	**2.8**	(3,665.1)	(2.5)	9.2
Interest rate derivatives (net)	**4,374.9**	**8.8**	**(7.6)**	3,884.5	13.2	(14.8)
Currency derivatives	**76.0**	**3.0**	**(3.1)**	56.0	3.4	(3.8)
Equity and other options	**25.7**	**0.1**	**–**	149.5	1.9	(4.3)
Total derivative assets/(liabilities) – in economic hedging relationship but not in accounting hedge relationships	**4,476.6**	**11.9**	**(10.7)**	4,090.0	18.5	(22.9)
Total recognised derivative assets/(liabilities)	**11,136.3**	**78.8**	**(93.5)**	18,001.0	104.2	(229.7)

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

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

Hedged cash flows

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

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

Notes to the consolidated financial statements

Note 13: Derivative financial instruments (continued)

Fair value losses on financial instruments

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

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

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

Note 14: Loans and advances to banks

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

Note 15: Loans and advances to customers

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

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

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

Notes to the consolidated financial statements

Note 16: Available-for-sale financial assets

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

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

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

Note 17: Collateral pledged and received

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

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

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

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

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

Notes to the consolidated financial statements

Note 18: Securitisation

Securitisation programmes

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

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

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

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

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

Transfers of financial assets

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

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

Notes to the consolidated financial statements

Note 19: Intangible assets

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

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

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

Notes to the consolidated financial statements

Note 20: Tangible fixed assets

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

Notes to the consolidated financial statements

Note 21: Deferred tax

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

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

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

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

Note 22: Other assets

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

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

Notes to the consolidated financial statements

Note 23: Deposits from banks

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

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

Note 24: Customer deposits

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

Note 25: Debt securities in issue

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

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

Securitisation programmes

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

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

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

Medium term notes

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

Notes to the consolidated financial statements

Note 26: Other liabilities

	2017 £m	2016 £m
Trade creditors and accruals	**66.3**	59.0
Provisions	**7.5**	8.5
Deferred income	**2.3**	3.0
Accrued interest	**110.9**	127.2
Other liabilities	**54.5**	102.2
Total other liabilities	**241.5**	299.9

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

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

Note 27: Share capital and share premium

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

Issued and fully paid share capital

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

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

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

Ordinary Shares

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Group. All Ordinary Shares in issue in the Company rank equally and carry the same voting rights and the same rights to receive dividends and other distributions declared or paid by the Company. The shares represented 81.6 per cent of the total share capital at 31 December 2017 (2016: 81.6 per cent).

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

> certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws);

> where Directors and certain employees of the Group require the approval of the Company to deal in the Company's Ordinary Shares; and

> pursuant to the rules of some of the Group's employee share plans where certain restrictions may apply while the Ordinary Shares are subject to the plan.

Notes to the consolidated financial statements

Note 27: Share capital and share premium (continued)

Deferred Shares

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

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

Note 28: Other equity instruments

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

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

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

- the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;
- the securities bear a fixed rate of interest of 8.750% and 7.875% from their issue dates up to their first reset dates on 10 November 2021 and 31 July 2019 respectively;
- interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;
- the securities are perpetual with no fixed redemption date and are repayable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the AT1 securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and
- all AT1 securities will be converted into Ordinary Shares of the Company, at a pre-determined price, should the Common Equity Tier 1 ratio of the Group fall below 7.0% as specified in the terms.

Notes to the consolidated financial statements

Note 29: Other reserves

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

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

Note 30: Retained earnings

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

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

Employee Benefit Trust (EBT)

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

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

Notes to the consolidated financial statements

Note 31: Contingent liabilities and commitments

Contingent liabilities

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

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

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

Loan commitments

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

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

Operating lease commitments – land and buildings

Minimum future lease payments under non-cancellable operating leases:

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

Operating lease commitments – other operating leases

Minimum future lease payments under non-cancellable operating leases:

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

Notes to the consolidated financial statements

Note 31: Contingent liabilities and commitments (continued)

Capital commitments

Capital commitments for the acquisition of fixed assets:

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

Note 32: Fair value of financial assets and financial liabilities

Fair value of financial assets and liabilities recognised at cost

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

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

Notes to the consolidated financial statements

Note 32: Fair value of financial assets and financial liabilities (continued)

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
At 31 December 2016					
Cash and balances at central banks	–	786.3	–	786.3	786.3
Loans and advances to banks	–	635.6	–	635.6	635.6
Loans and advances to customers	–	–	32,514.0	32,514.0	32,367.1
Debt securities classified as loans and receivables	0.7	–	–	0.7	0.7
Available-for-sale financial assets	–	–	0.3	0.3	0.3
Other assets	–	68.8	–	68.8	68.8
Total financial assets at fair value	0.7	1,490.7	32,514.3	34,005.7	33,858.8
Deposits from banks	–	2,132.5	–	2,132.5	2,132.5
Customer deposits	–	28,222.7	–	28,222.7	28,106.3
Debt securities in issue	2,610.8	–	–	2,610.8	2,600.0
Other liabilities	–	189.5	–	189.5	189.5
Total financial liabilities at fair value	2,610.8	30,544.7	–	33,155.5	33,028.3

Notes to the consolidated financial statements

Note 32: Fair value of financial assets and financial liabilities (continued)

Fair value hierarchy

The table above summarises the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Valuation methods for calculations of fair values of financial assets and liabilities recognised at cost are set out below:

Cash and balances at central banks

Fair value approximates to carrying value because cash and balances at central banks have minimal credit losses and are either short-term in nature or reprice frequently.

Loans and advances to banks

Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, the Group's policy is to hedge fixed rate loans in respect of interest rate risk, which limits the Group's exposure to this difference in value to be within the Group's risk appetite.

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

Debt securities classified as loans and receivables

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

Available-for-sale financial assets

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

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

Fair value is deemed to approximate the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Debt securities in issue

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

Notes to the consolidated financial statements

Note 32: Fair value of financial assets and financial liabilities (continued)

Fair value of financial assets and liabilities recognised at fair value

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

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

2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	–	104.2	–	104.2
Available-for-sale financial assets	850.9	–	7.6	858.5
Financial liabilities				
Derivative financial instruments	–	229.7	–	229.7

Level 1 Valuations

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

Level 2 Valuations

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

Level 3 Valuations

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

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

Notes to the consolidated financial statements

Note 33: Offsetting of financial assets and financial liabilities

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

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

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

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

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

Notes to the consolidated financial statements

Note 34: Cash flow statements

(a) Change in operating assets

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

(b) Change in operating liabilities

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

(c) Non-cash and other items

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

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

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

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

Notes to the consolidated financial statements

Note 35: Related party transactions

Key Management Personnel

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

	2017 £m	2016 £m
Compensation		
Salaries and other short-term benefits	**6.7**	7.4
Share based payments (refer note 7)	**6.1**	7.6
Post-employment benefits	**0.9**	0.8
Total compensation	**13.7**	15.8

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

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

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

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

Subsidiaries

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

Other transactions

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

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

Notes to the consolidated financial statements

Note 35: Related party transactions (continued)

Trademark licence fees paid to Virgin Enterprises Limited

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

Virgin Atlantic Airways Limited

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

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

Donations to The Virgin Money Foundation (the Foundation)

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

Dividend payment to Virgin Group Holdings Limited

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

Other costs paid to Virgin Management Group Companies

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

Note 36: Events after balance sheet date

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

Note 37: Future accounting developments

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

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

Background

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

Classification and Measurement

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

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

Hedge Accounting

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

Notes to the consolidated financial statements

Note 37: Future accounting developments (continued)

Impairment (Expected Credit Loss)

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

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

Key accounting judgements

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

Measurement of Expected Credit Loss

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

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

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

> Quantitative measures consider the increase in an accounts remaining lifetime PD compared to the expected residual lifetime PD when the account was originated. The Group will segment its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency.

> Qualitative measures include the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms.

> IFRS 9 includes a rebuttable presumption that 30 days past due is an indicator of a significant increase in credit risk. The Group considers 30 days past due to be an appropriate backstop measure and will not rebut this presumption.

Definition of default (movement to stage 3)

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

> IFRS 9 includes a rebuttable presumption that 90 days past due is an indicator of default. The Group considers 90 days past due to be an appropriate measure of default and will not rebut this presumption.

> Qualitative measures include the observation of specific events such as insolvency or enforcement activity.

Forward-looking information and multiple economic scenarios

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

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

IFRS 9 implementation programme and governance

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

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

Notes to the consolidated financial statements

Note 37: Future accounting developments (continued)

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

Impact of transition to IFRS 9

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

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

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

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

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

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

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

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

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

Note 38: Country by country reporting

The Capital Requirements (Country by Country Reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV.

The activities of the Group are described in the Strategic Report.

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

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

The Group received no public subsidies during the year.

Parent Company balance sheet

For the year ended 31 December

	Notes	2017 £ million	2016 £ million
Assets			
Loans and advances to banks		**23.0**	41.0
Derivative financial instruments		**1.4**	4.6
Investment in related undertakings	2	**1,380.3**	1,370.4
Deferred tax assets	3	**0.1**	0.1
Other assets	4	**3.7**	17.0
Total assets		**1,408.5**	1,433.1
Equity and liabilities			
Liabilities			
Deposits from banks		**1.3**	2.5
Derivative financial instruments		**–**	4.3
Other liabilities	5	**104.2**	86.2
Total liabilities		**105.5**	93.0
Equity			
Share capital and share premium	6	**654.6**	654.6
Other equity instruments	6	**384.1**	384.1
Retained earnings[1]	7	**264.3**	301.4
Total equity		**1,303.0**	1,340.1
Total equity and liabilities		**1,408.5**	1,433.1

1 The Company profit for the year was £11.3 million (2016: £56.3 million)

The accompanying notes are an integral part of the parent company financial statements.

The financial statements on pages 251 to 260 were approved and authorised for issue by the Board and were signed on its behalf on 26 February 2018.

Glen Moreno
Chair

Jayne-Anne Gadhia CBE
Chief Executive

Parent Company statement of changes in equity

For the year ended 31 December

	Share capital and share premium £ million	Other equity instruments £ million	Retained earnings £ million	Total equity £ million
Balance as at 1 January 2017	**654.6**	**384.1**	**301.4**	**1,340.1**
Profit for the year	**–**	**–**	**11.3**	**11.3**
Total comprehensive income for the year	**–**	**–**	**11.3**	**11.3**
Transactions with equity holders				
Capital contribution – share based payments	**–**	**–**	**9.9**	**9.9**
Purchase of own shares	**–**	**–**	**(8.5)**	**(8.5)**
Issue of Additional Tier 1 securities (net of issue costs)	**–**	**–**	**–**	**–**
Distribution to Additional Tier 1 noteholders	**–**	**–**	**(32.7)**	**(32.7)**
Tax attributable to Tier 1 securities	**–**	**–**	**6.8**	**6.8**
Dividends paid to ordinary shareholders	**–**	**–**	**(23.9)**	**(23.9)**
Balance as at 31 December 2017	**654.6**	**384.1**	**264.3**	**1,303.0**
Balance as at 1 January 2016	654.6	156.5	270.5	1,081.6
Profit for the year	–	–	56.3	56.3
Total comprehensive income for the year	–	–	56.3	56.3
Transactions with equity holders				
Capital contribution – share based payments	–	–	12.8	12.8
Purchase of own shares	–	–	(7.3)	(7.3)
Issue of Additional Tier 1 securities (net of issue costs)	–	227.6	–	227.6
Distribution to Additional Tier 1 noteholders	–	–	(12.6)	(12.6)
Tax attributable to Tier 1 securities	–	–	2.5	2.5
Dividends paid to ordinary shareholders	–	–	(20.8)	(20.8)
Balance as at 31 December 2016	654.6	384.1	301.4	1,340.1

The accompanying notes are an integral part of the parent company financial statements.

Parent Company cash flow statement

For the year ended 31 December

	Notes	2017 £ million	2016 £ million
Profit before taxation		**14.0**	55.5
Adjustments for:			
Change in operating assets	10(a)	**2.8**	(2.8)
Change in operating liabilities	10(b)	**(2.3)**	6.8
Non-cash and other items	10(c)	**9.4**	(58.7)
Movement in amounts from group undertakings		**(1.1)**	(0.9)
Net cash provided by/(used in) operating activities		**22.8**	(0.1)
Net cash outflow from investing activities			
Increase in investment in subsidiary undertaking		**(21.0)**	–
Investment in Additional Tier 1 instruments issued by subsidiary undertaking		**(2.3)**	(227.7)
Net cash used in investing activities		**(23.3)**	(227.7)
Net cash (outflow)/inflow from financing activities			
Issue of Additional Tier 1 securities (net of issue costs)		**–**	227.6
Distribution to Additional Tier 1 security holders		**(32.7)**	(12.6)
Purchase of own shares		**(8.5)**	(7.3)
Repayments of amounts due to group undertakings		**(17.0)**	(25.0)
Borrowings drawn from group undertakings		**64.6**	3.9
Dividends paid on ordinary shares		**(23.9)**	(20.8)
Net cash (used in)/provided by financing activities		**(17.5)**	165.8
Change in cash and cash equivalents		**(18.0)**	(62.0)
Cash and cash equivalents at beginning of year		**41.0**	103.0
Cash and cash equivalents at end of year	10(d)	**23.0**	41.0

The accompanying notes are an integral part of the parent company financial statements.

Notes to the Parent Company financial statements

Note 1: Basis of preparation

1.1 Basis of preparation and accounting policies

The financial statements of Virgin Money Holdings (UK) plc, (the Parent Company, the Company), which should be read in conjunction with the Group Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU including interpretations issued by the IFRS Interpretations Committee and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. No individual statement of comprehensive income is presented for the Company, as permitted by Section 408 of the Companies Act 2006.

1.2 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments.

The preparation of the financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

1.3 Accounting policies

The accounting policies of the Company are the same as those of the Group which are set out in note 1 of the consolidated financial statements except that the Company has no policy in respect of consolidation and the Group has no policy in respect of investments in related undertakings.

Investments in related undertakings are recognised at historical cost, less any provision for impairment. They are reviewed annually for impairment, or more frequently when there are indications that the investment may be impaired. An impairment loss is recognised for the amount by which the carrying amount of the investment exceeds its recoverable amount, which is defined as the higher of its fair value less costs of disposal or its value in use.

These accounting policies have been applied consistently to all years presented in these financial statements.

Note 2: Investment in related undertakings

	2017 £m	2016 £m
At 1 January	**1,370.4**	1,127.6
Increase in investment in subsidiary undertaking	**21.0**	–
Decrease in investment in subsidiary undertaking	**(21.0)**	–
Capital contribution – share based payments	**9.9**	12.8
Investment in Additional Tier 1 instruments issued by subsidiary undertaking	**–**	230.0
At 31 December	**1,380.3**	1,370.4

Change in investment in subsidiary undertakings

The transfer of stocks and shares ISA contracts from Virgin Money Personal Financial Service Limited (VMPFS) to Virgin Money Unit Trust Managers Limited (VMUTM) was completed in March 2017, following approval by the Directors of those companies. Subsequent to the transfer, all new stocks and shares ISA sales are written by VMUTM. The transfer was funded through a new share issuance made by VMUTM to the Company, resulting in an increase in the investment held in VMUTM, with a related decrease in the investment held in VMPFS.

The decrease in the investment held in VMPFS of £21.0 million was determined based on a value-in-use calculation, using cash flow projections based on financial budgets approved by the Board covering a three year period, applying a discount rate of 11%.

Notes to the Parent Company financial statements

Note 2: Investment in related undertakings (continued)

Related undertakings

The following entities were related undertakings of the Company during the year, including SPVs controlled by the Company in accordance with note 1.5 to the consolidated financial statements:

Name	Class of Share	Holding
Subsidiary undertakings		
Direct holdings		
Virgin Money plc[1]	Ordinary	100%
Virgin Money Personal Financial Service Limited[1]	Ordinary	100%
Virgin Money Unit Trust Managers Limited[1]	Ordinary	100%
Virgin Money Management Services Limited[1]	Ordinary	100%
Virgin Money Giving Limited[1]	Ordinary	100%
Indirect holdings		
Eagle Place Covered Bonds LLP[1,2]	N/A	N/A[3]
Virgin Money Nominees Limited[1,2]	Ordinary	100%
Northern Rock Limited[1,2]	Ordinary	100%
Associated undertaking		
The Virgin Money Foundation[1]	N/A	N/A[3]

Notes to the Parent Company financial statements

Note 2: Investment in related undertakings (continued)

Name	Class of Share	Holding
Special purpose vehicles		**Nature of business**
Gosforth Funding 2011-1 plc[4]		Issue of securitised notes
Gosforth Funding 2012-1 plc[4]		Issue of securitised notes
Gosforth Funding 2012-2 plc[4]		Issue of securitised notes
Gosforth Funding 2014-1 plc[5]		Issue of securitised notes
Gosforth Funding 2015-1 plc[5]		Issue of securitised notes
Gosforth Funding 2016-1 plc[5]		Issue of securitised notes
Gosforth Funding 2016-2 plc[5]		Issue of securitised notes
Gosforth Funding 2017-1 plc[5]		Issue of securitised notes
Gosforth Mortgages Trustee 2011-1 Limited[4]		Trust
Gosforth Mortgages Trustee 2012-1 Limited[4]		Trust
Gosforth Mortgages Trustee 2012-2 Limited[4]		Trust
Gosforth Mortgages Trustee 2014-1 Limited[5]		Trust
Gosforth Mortgages Trustee 2015-1 Limited[5]		Trust
Gosforth Mortgages Trustee 2016-1 Limited[5]		Trust
Gosforth Mortgages Trustee 2016-2 Limited[5]		Trust
Gosforth Mortgages Trustee 2017-1 Limited[5]		Trust
Gosforth Holdings 2011-1 Limited[4]		Holding company
Gosforth Holdings 2012-1 Limited[4]		Holding company
Gosforth Holdings 2012-2 Limited[4]		Holding company
Gosforth Holdings 2014-1 Limited[5]		Holding company
Gosforth Holdings 2015-1 Limited[5]		Holding company
Gosforth Holdings 2016-1 Limited[5]		Holding company
Gosforth Holdings 2016-2 Limited[5]		Holding company
Gosforth Holdings 2017-1 Limited[5]		Holding company

1 Registered office: Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.
2 Dormant companies.
3 The entity does not have share capital.
4 These companies are in the process of liquidation and their registered office is C/O KPMG LLP, 8 Princes Parade, Liverpool, L3 1QH.
5 Registered office: Fifth Floor, 100 Wood Street, London, EC2V 7EX.

Note 3: Deferred tax

The Company has not recognised deferred tax assets in respect of gross unused tax losses of £31.1 million (2016: £31.1 million).

Note 4: Other assets

	2017 £m	2016 £m
Amounts owed from subsidiary undertakings	**–**	13.7
Group relief owed from related parties	**3.7**	3.3
Total	**3.7**	17.0

Amounts owed from subsidiary undertakings of £8.2 million were waived during the year as a result of a simplification of the Group's intercompany structure. A further amount of £6.6 million was waived in January 2018 and so was provided for at the balance sheet date.

Notes to the Parent Company financial statements

Note 5: Other liabilities

	2017 £m	2016 £m
Other creditors	**3.4**	–
Trading amounts owed to subsidiary undertakings	**0.6**	3.1
Loan amounts owed to subsidiary undertakings	**100.2**	83.1
Total	**104.2**	86.2

Loan amounts owed to subsidiary undertakings is analysed further below:

	2017 £m	2016 £m
At 1 January	**83.1**	163.9
Repayments	**(17.0)**	(25.0)
Borrowings drawn	**64.6**	3.9
Amounts offset against dividends received from subsidiary undertakings	**(30.5)**	(59.7)
Total	**100.2**	83.1

Note 6: Share capital, share premium and other equity instruments

Details of the Company's share capital, share premium and other equity instruments are given in notes 27 and 28 of the consolidated financial statements.

Note 7: Retained earnings

	Subsidiary contribution £m	Investment in own shares £m	Retained profits £m	Total £m
At 1 January 2016	38.5	(2.9)	234.9	270.5
Profit for the year	–	–	56.3	56.3
Dividends paid to ordinary shareholders	–	–	(20.8)	(20.8)
Distributions to Additional Tier 1 security holders (net of tax)	–	–	(10.1)	(10.1)
Purchase of own shares	–	(7.3)	–	(7.3)
Award of shares from own shares	–	3.3	(3.3)	–
Capital contribution – share based payments	12.8	–	–	12.8
As at 31 December 2016	51.3	(6.9)	257.0	301.4
Profit for the year	**–**	**–**	**11.3**	**11.3**
Dividends paid to ordinary shareholders	**–**	**–**	**(23.9)**	**(23.9)**
Distributions to Additional Tier 1 security holders (net of tax)	**–**	**–**	**(25.9)**	**(25.9)**
Purchase of own shares	**–**	**(8.5)**	**–**	**(8.5)**
Award of shares from own shares	**–**	**7.4**	**(7.4)**	**–**
Capital contribution – share based payments	**9.9**	**–**	**–**	**9.9**
As at 31 December 2017	**61.2**	**(8.0)**	**211.1**	**264.3**

Notes to the Parent Company financial statements

Note 8: Analysis of financial assets and financial liabilities by measurement basis

2017	Financial liabilities at amortised cost £m	Loans and receivables £m	Derivatives not in IAS 39 hedges £m	Total £m
Financial assets				
Loans and advances to banks	–	23.0	–	23.0
Derivative financial instruments	–	–	1.4	1.4
Amounts owed from subsidiary undertakings	–	–	–	–
Total financial assets	–	23.0	1.4	24.4
Non financial assets				1,384.1
Total assets				1,408.5
Financial liabilities				
Deposits from banks	1.3	–	–	1.3
Derivative financial instruments	–	–	–	–
Amounts owed to subsidiary undertakings	100.8	–	–	100.8
Total financial liabilities	102.1	–	–	102.1
Non financial liabilities				3.4
Total liabilities				105.5
Equity				1,303.0
Total liabilities and equity				1,408.5

2016	Financial liabilities at amortised cost £m	Loans and receivables £m	Derivatives not in IAS 39 hedges £m	Total £m
Financial assets				
Loans and advances to banks	–	41.0	–	41.0
Derivative financial instruments	–	–	4.6	4.6
Amounts owed from subsidiary undertakings	–	13.7	–	13.7
Total financial assets	–	54.7	4.6	59.3
Non financial assets				1,373.8
Total assets				1,433.1
Financial liabilities				
Deposits from banks	2.5	–	–	2.5
Derivative financial instruments	–	–	4.3	4.3
Amounts owed to subsidiary undertakings	86.2	–	–	86.2
Total financial liabilities	88.7	–	4.3	93.0
Total liabilities				93.0
Equity				1,340.1
Total liabilities and equity				1,433.1

Notes to the Parent Company financial statements

Note 9: Fair value of financial assets and financial liabilities

				2017		2016	
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m	Total fair value £m	Total carrying value £m
Financial assets							
Loans and advances to banks	–	**23.0**	–	**23.0**	**23.0**	41.0	41.0
Amounts owed from subsidiary undertakings	–	–	–	–	–	13.7	13.7
Financial liabilities							
Amounts owed to subsidiary undertakings	–	**100.8**	–	**100.8**	**100.8**	86.2	86.2
Deposits from banks	–	**1.3**	–	**1.3**	**1.3**	2.5	2.5

The Company has £1.4 million (2016: £0.3 million) of net derivative financial instruments classified as level 2 in the fair value hierarchy.

Note 10: Cash flow statements

(a) Change in operating assets

	2017 £m	2016 £m
Change in derivative financial assets	**3.2**	(3.1)
Change in other operating assets	**(0.4)**	0.3
Change in operating assets	**2.8**	(2.8)

(b) Change in operating liabilities

	2017 £m	2016 £m
Change in derivative financial liabilities	**(4.3)**	3.6
Change in other operating liabilities	**2.0**	3.2
Change in operating liabilities	**(2.3)**	6.8

(c) Non-cash and other items

	2017 £m	2016 £m
Amounts offset against dividends received from subsidiary undertakings	**(30.5)**	(59.7)
Other non-cash items	**28.8**	16.1
Non-cash movement in investments	**11.1**	(15.1)
Total non-cash and other items	**9.4**	(58.7)

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

Cash and cash equivalents consists of loans and advances to banks of £23.0 million at 31 December 2017 (31 December 2016: £41.0 million).

Notes to the Parent Company financial statements

Note 11: Related party transactions

Key Management Personnel

The Key Management personnel of the Company are Key Management personnel of the Group, with relevant disclosures given in note 35 to the consolidated financial statements. The Company has no employees (2016: nil).

As discussed in note 7 of the consolidated financial statements, the Group provides share based compensation to employees of subsidiary undertakings through a number of schemes. These awards are all in relation to shares in the Company and the cost of providing those benefits is not recharged to the subsidiary undertaking, therefore is recognised as a capital contribution.

Other transactions

	Transaction value Year ended 31 December		**Balance outstanding at 31 December**	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Recharges and trading balances owed (to)/from subsidiaries	**(0.7)**	(0.7)	**3.1**	0.3
Net loans owed (to)/from subsidiaries	**(16.4)**	(2.2)	**(100.2)**	(69.5)
Dividend payment to Virgin Group Holdings Limited	**(8.4)**	(7.3)	**–**	–

Amounts owed from subsidiary undertakings of £8.2 million were waived during the year as a result of a simplification of the Group's intercompany structure. A further amount of £6.6 million was waived in January 2018 and so was provided for at the balance sheet date.

Other information

Virgin Money Lounge, Manchester

Alternative Performance Measures

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

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

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

Banking Net Interest Margin (NIM)	Net interest income, calculated on an underlying basis, as a percentage of simple average interest-earning banking assets.
Cost of funds (spread)	Funding costs divided by average funding balances less the average 3 month Libor interest rate for the period.
Cost of risk	Impairment charges, net of debt recoveries, divided by simple average gross loans for the period.
Cost:income ratio	Operating expenses divided by total income, calculated on an underlying basis.
JAWS	The difference between the period on period percentage change in total income less the period on period change in operating expenses calculated on an underlying basis.
Loan-to-deposit ratio	The ratio of loans and advances to customers, net of allowances for impairment, divided by customer deposits (each excluding adjustments for fair value of portfolio hedging).
Net interest margin (NIM)	Net interest income, calculated on an underlying basis, as a percentage of simple average interest-earning assets.
Return on assets	Profit attributable to equity owners divided by closing total assets.
Return on tangible equity (RoTE)	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by simple average tangible equity. Tangible equity is calculated as total equity less other equity instruments and intangible assets.
Tangible net asset value per share	Net assets excluding intangible assets and Additional Tier 1 securities divided by the closing number of Ordinary Shares (excluding own shares held).
Underlying basic earnings per share	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by the weighted-average number of Ordinary Shares outstanding during the period (excluding own shares held).
Underlying net interest income	Statutory net interest income adjusted for a subset of certain items as detailed on page 48.
Underlying profit/(loss) before tax	Statutory profit/(loss) before tax adjusted for certain items as detailed on page 48.
Underlying return on assets	Underlying profit before tax (adjusted to deduct distributions to Additional Tier 1 securities) less tax calculated using the statutory effective tax rate of the Group, divided by a simple average total assets.
Underlying total income	Statutory total income adjusted for a subset of certain items as detailed on page 48.

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

Glossary

Advanced Internal Ratings Based (AIRB) Approach	A CRD IV approach for measuring exposure to credit risks. The method of calculating credit risk capital requirements uses internal probability of default (PD), loss given default (LGD) and exposure at default (EAD) models. AIRB approaches may only be used with Prudential Regulation Authority (PRA) permission.
Basel III	Global regulatory standard on Bank Capital Adequacy, Stress Testing and Market and Liquidity proposed by the Basel Committee on Banking Supervision in 2010. See also CRD IV.
Basis Point (bps)	One hundredth of a per cent (0.01%). 100 basis points is 1%. Used when quoting movements in interest rates or yields.
Capital at Risk (CaR)	Approach set out for the quantification of interest rate risk expressed as the impact to the present value of the Group's capital under interest rate sensitivity analysis.
CASS	Client Assets Sourcebook, included in the FCA Handbook and sets out the requirements with which firms must comply when holding or controlling client assets.
Certificates of Deposit	A certificate issued by a bank to a person depositing money for a specified length of time at a specified rate of interest.
Charge-Off	Charge-off occurs on outstanding credit card balances where in-house collections and recoveries have been exhausted. This involves the removal of the balance and associated provision from the balance sheet with any remaining outstanding balance recognised as a loss. Charged-off accounts may be subject to debt-sale, where by additional recoveries will be taken to profit or loss.
Common Equity Tier 1 Capital (CET1)	The highest quality form of capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
CRD IV	In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in.
Credit Enhancements	Risk reduction techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation.
Credit Valuation Adjustments (CVA)	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Cross-Currency Swaps	An arrangement in which two parties exchange specific principal amounts in different currencies at inception and subsequent interest payments on the principal amounts.
Debt Securities	Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Earnings at Risk (EaR)	Approach set out for the quantification of interest rate risk expressed as the impact to forecast net interest income under interest rate sensitivity analysis.
Expected Loss (regulatory)	Regulatory expected loss represents the anticipated loss, in the event of a default, on a credit risk exposure modelled under the Advanced Internal Ratings Based approach. Expected loss is determined by multiplying the associated PD, LGD and EAD.
Expected Credit Loss (IFRS 9)	Expected Credit Losses are a provision held on the balance sheet for all financial instruments. Expected Credit Losses may be recognised on either a 12 month or lifetime basis. The level will be determined by the performance of individual assets, and take into consideration associated credit risk attributes, including a significant increase in credit risk or any credit impairment. An expected credit loss may either be individual or collective as a result of the raising of a charge against profit for the expected loss inherent in the lending book. An expected credit loss may either be individual or collective.
Exposure at Default (EAD)	An estimate of the amount expected to be owed by a customer at the time of a customer's default.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties; or for where the contractual terms have been cancelled for credit cards. Forbearance options are determined by assessing the customer's personal circumstances.
Full Time Equivalent (FTE)	A full time employee is one that works a standard five day week. The hours worked by part time employees are measured against this standard and accumulated along with the number of full time employees and counted as full time equivalents.
Funding for Lending Scheme (FLS)	The Bank of England launched the Funding for Lending scheme in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to households and businesses by lowering interest rates and increasing access to credit.
Funding Risk	The inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.

Glossary

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

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

Abbreviations

AGM Annual General Meeting

AIRB Advanced Internal Ratings Based

AT1 Additional Tier 1

BOE Bank of England

CET1 Common Equity Tier 1 Capital

CRD Capital Requirements Directive

CRR Capital Requirements Regulation

CVA Credit Valuation Adjustment

DTR Disclosure Guidance and Transparency Rules

EBO Everyone better off

EAD Exposure At Default

EIR Effective Interest Rate

EPS Earnings per share

FCA Financial Conduct Authority

FLS Funding for Lending Scheme

FRC Financial Reporting Council

FSCS Financial Services Compensation Scheme

FTE Full Time Equivalent

FTP Funds Transfer Pricing

GDPR General Data Protection Regulation

GHG Greenhouse Gas

HMRC Her Majesty's Revenue & Customs

HPI House Pricing Index

HQLA High Quality Liquid Assets

IAS International Accounting Standards

IASB International Accounting Standards Board

ICAAP Internal Capital Adequacy Assessment Process

IFRS International Financial Reporting Standards

ILAAP Individual Liquidity Adequacy Assessment Process

IPO Initial Public Offering

IRRBB Interest Rate Risk in the Banking Book

ISA Individual Savings Account

ISDA International Swaps and Derivatives Association

LIBOR London Inter-Bank Offered Rate

LCR Liquidity Coverage Ratio

LGD Loss Given Default

LTIP Long-Term Incentive Plan

LTV Loan-to-Value

MREL Minimum Requirements for Own Funds and Eligible Liabilities

NIM Net Interest Margin

NPS Net Promoter Score

NSFR Net Stable Funding Ratio

PCA Personal Current Account

PD Probability of Default

PRA Prudential Regulation Authority

PSD2 Second Payment Services Directive

PwC PricewaterhouseCoopers LLP

RoTE Return on Tangible Equity

RMBS Residential Mortgage Backed Securities

RWAs Risk-weighted Assets

SID Senior Independent Director

SME Small or Medium-sized Enterprise

SPV Special Purpose Vehicle

TFS Term Funding Scheme

TNAV Tangible Net Asset Value

TSYS Total System Services, Inc

Shareholder Information

Annual General Meeting (AGM)

The AGM will be held on 9 May 2018 at the offices of Allen & Overy at One Bishops Square, London, E1 6AD. Further details about the meeting, including the proposed resolutions, can be found in our Notice of AGM which will be issued to shareholders and available on our website in due course.

Shareholder concentration

As of 31 December 2017	Number of shares – millions	Shareholdings	%
Individuals	0.4	451	0.1
Banks & Nominees	251.5	409	56.5
Other companies	178.2	94	40.1
Other corporates	14.8	38	3.3
	444.9	992	100.0

Range of shareholdings:	Number of shares – millions	Shareholdings	%
1-1,000	0.2	474	0.0
1,001-10,000	0.7	179	0.2
10,001-100,000	5.1	134	1.1
100,001-1,000,000	49.7	139	11.2
1,000,001-10,000,000	163.0	60	36.7
>10,000,001	226.2	6	50.8
	444.9	992	100.0

Shareholder Information

Registrar

The Group's share register is maintained by Equiniti Limited. Equiniti is responsible for keeping the Group's register of members up to date and for administering the payment of dividends.

Enquiries

Please contact Equiniti if you have any enquiries about your shareholding, including the following:

> Change of name or address.

> Change of bank account details.

> Loss of share certificate, dividend warrant or tax voucher.

> To obtain a form for dividends to be paid directly to your bank or building society account (tax vouchers will be sent to your registered address unless you request otherwise).

> Request for copies of the report and accounts in alternative formats for shareholders with disabilities.

> Lost or out of date dividend payments.

> Share transfers.

> Information regarding the administration of your shareholding.

UK – **0371 384 2937**
Textphone – **0371 384 2255**
Overseas – **+44 (0)121 415 0857**

Lines are open 8.30am to 5.30pm Monday to Friday (except UK public holidays).

Equiniti operates a web-based enquiry and portfolio management service for shareholders www.shareview.co.uk

Address: Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.

Issued by Virgin Money Holdings (UK) plc.
Registered office: Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL
Registered in England and Wales no.03087587