

The CYBG logo is located at the top center of the page. It consists of the letters 'CYBG' in a white, sans-serif font, enclosed within a red speech bubble shape that points downwards.

CYBG

ANNUAL REPORT  
& ACCOUNTS

20  
16

Our first year as an  
independent company

YEAR ENDED 30 SEPTEMBER 2016

CYBG PLC

## HIGHLIGHTS

### DELIVERING ON KEY METRICS IN 2016:

2.26%

Net Interest  
Margin (NIM) 226  
basis points (bps),  
up 3bps vs FY2015

6.1%

SME core book grew  
6.1% with over £2.2bn  
of new loans and facilities  
(+15% vs FY2015)

6.5%

Annual growth  
in mortgages

12.6%

Well capitalised – CET1  
ratio remains strong

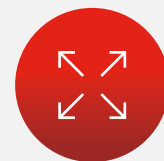
### POSITIVE JAWS

Income growth 2.6%,  
underlying costs in line with  
FY2015 and £33m lower  
than original guidance

£350m

Investing more than £350m in the next two years to deliver  
better services and experience for customers and create a  
more efficient business.

### GOOD PROGRESS IN DELIVERING ON OUR PLAN:



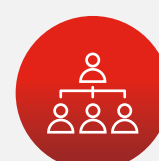
Successfully completed  
demerger and Initial  
Public Offering (IPO).  
CYBG PLC became an  
independent company on  
8 February 2016.



Listed on the London  
Stock Exchange (LSE)  
and the Australian  
Securities Exchange (ASX).



Strong franchise, with a  
clear strategic agenda and  
execution focus, delivering  
sustainable growth.



Board refreshed  
and Executive  
Leadership Team  
strengthened



Delivering on omni-channel  
strategy – first products  
launched on digital platform,  
providing point of  
differentiation from peers.  
Further launches planned  
for 2017.



B successfully launched  
and acquiring more  
customers in target  
segments.

## HIGHLIGHTS







Clydesdale Bank was established in Glasgow in 1838 and  
Yorkshire Bank was founded in 1859 in Halifax.  
Both brands are built on strong foundations,  
dedicated to serving the people, business and  
communities around us.

The Forth Bridge, North Queensferry

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Overview

CYBG PLC (the "Company")<sup>(1)</sup> together with its subsidiary undertakings (which together comprise the "Group"), operate under the Clydesdale Bank, Yorkshire Bank and B brands. It offers a range of banking services for both retail and business customers through retail branches, Business Banking centres, direct and online banking, including B, and brokers.

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

The forward looking statements disclaimer can be found on page 300.

<sup>(1)</sup>Formerly known as Planodove PLC



The image shows the Kelpies, two large horse-head sculptures made of corrugated metal, illuminated at night. The sculptures are positioned on a dark, flat surface. At the base of the sculptures, several vertical flames are visible, creating a dramatic effect. The sky is a deep blue, and the overall scene is lit with a warm, golden light from the flames and the sculpture's internal lighting.

# STRATEGIC REPORT





# CHAIRMAN'S STATEMENT

## CHAIRMAN'S STATEMENT

“ 2016 has been a landmark year in the long history of our bank as we became independent for the first time since the 1920s.

This year has heralded big changes for our bank – the demerger from National Australia Bank (NAB) and IPO at the start of the calendar year gave rise to CYBG PLC, a FTSE 250 company, holding a dual listing on both the London Stock Exchange (LSE) and Australian Securities Exchange (ASX) – and we became an independent company for the first time since the 1920s.

I'm delighted to deliver the first Annual Report of CYBG, and I would like to thank the Board, the Executive Leadership Team, and my colleagues throughout the business for their hard work in delivering a successful set of results in 2016. Everyone has played a part in making this a landmark year for our business.

Our ambition is straightforward: to become the credible alternative to the big UK banks. We intend to achieve this using our scalable infrastructure to support our growth ambitions, and our enhanced digital capability to streamline processes and deliver a superior customer experience.

As outlined at our Capital Markets Day in September, our strategy is also straightforward: drive shareholder returns through sustainable customer growth, increased efficiency and capital optimisation.

We have a strong international shareholder base who have shown great support for our business, a high calibre leadership team and we have strengthened the Board with Clive Adamson, David Bennett, Paul Coby, Fiona MacLeod and Tim Wade appointed as new independent Non-Executive Directors, complementing the Board's expertise and governance oversight. At the same time we have put in place appropriate control and governance standards for a listed company, which we benchmark against the market leaders.

In our first year as CYBG we have demonstrated significant progress in delivering on our plan. Despite the uncertainty in the wake of Brexit, we believe the strength of our franchise – a robust capital position, strong asset quality, low cost diversified funding and resilient, scalable infrastructure – combined with our talent and capability gives us the flexibility to adapt to the changing operating environment. Our focus for next year is to build on the progress and achievements of 2016, and continue to build a culture that puts the customer at the heart of everything we do. I am confident that we can deliver on our strategy, further improve our performance and enhance returns for our shareholders.

Jim Pettigrew | 21 November 2016





## CHIEF EXECUTIVE OFFICER'S STATEMENT

“ I am pleased to report that in our first year as a PLC, CYBG has delivered on our promises to our customers and shareholders. We have built strong foundations and positive momentum going into 2017. We are optimistic about the future as the only true full service, challenger bank of scale to the status quo in the UK market.

Our 2016 results demonstrate the progress we have made on our journey towards being a more customer focused and commercially minded bank with continued mortgage loan growth ahead of the market; our SME book returning to growth for the first time in four years; a stable net interest margin; costs £33m below our initial guidance for the year; a reduced bad debt charge; and underlying profit before tax up 39% year on year.

Our strategy remains unchanged – our priorities of sustainable customer growth, efficiency and capital optimisation will be delivered by a strong customer focused culture, a robust approach to change management and investment, and development of our omni-channel capabilities, all within a framework of prudent risk management and governance. My focus, and that of my leadership team, is on execution, and our organic plan is predicated in large part on improving areas of our performance that we can control, such as costs and efficiency, thereby reducing the risk in delivering on our targets.

We will continue to evaluate potential inorganic opportunities to enhance our business, provided they are in line with our strategic objectives and will create value for our shareholders. We have established a set of capabilities (including a scalable digital platform, customer service excellence and senior management cadre) that give significant confidence in our ability to execute, should such inorganic opportunities arise.

In September we updated our medium term targets, bringing forward delivery of key metrics such as our CIR – now 55%-58% by FY2019, previously below 60% by FY2020 – and RoTE, where we are bringing our target of double digit percent forward to FY2019 from FY2020.

CYBG is committed to providing customers with a banking experience that is useful, simple and rewarding. We know that people want to manage money on their terms, not ours, so we will invest more than £350m over the next two years to simplify our business, drive cost and capital efficiency, maintain the resilience of our platforms and support the continued roll out of

our omni-channel model. The delivery of our strategy will provide an improved branch experience, supported by a strong digital offering, reflecting the new face of banking and putting customers at the heart of what we do. We have already embarked on that journey with online account opening, B, and Apple Pay all going live during the year, and further launches planned for 2017.

CYBG is perfectly placed to disrupt the market – we have the full service capabilities that no challenger bank can offer, yet we are smaller and more agile than the complex structures of the 'big 5'. We are well capitalised, have a high quality loan book and prudent risk appetite, along with powerful, established local brands, now joined by an innovative new brand in B which is already broadening our customer demographic and reach outside of our core regions.

We firmly believe that our size and scale, strong funding base and balance of assets across retail and business lending give us a solid foundation. Our flexibility will also enable us to selectively target growth opportunities in specific market segments as they arise and we remain focused on delivering improved returns for shareholders while adapting to the new economic environment.

While it is still too early to draw firm conclusions regarding the impact of the referendum vote to leave the EU, we are mindful of the greater uncertainty now facing the UK economy and how this will impact on our customers and the demand for credit. We will continue to support customers through the current period of uncertainty and beyond with our range of products for both consumers and SMEs.

Across CYBG we are focusing on the future with confidence. Over the next twelve months I am confident we will show continued progress against our targets and delivery of commitments for our customers, our people and our shareholders. Finally, I am very grateful to the Chairman and the rest of the Board for their backing and insight as we embark on the journey ahead.

## STRONG PROGRESS IN DELIVERING OUR STRATEGIC TARGETS

Maiden annual results show improved financial performance, with growth and momentum across business including enhanced customer experience

### Delivering on Strategic Objectives

Our strategy is simple – drive shareholder returns through sustainable customer growth, improved efficiency and capital optimisation underpinned by a strong culture of risk and control.

This will be achieved by a cultural transformation of our business, and the simplification and streamlining of operations and processes to enhance productivity.

Underpinning the Group's strategy is a balanced and controlled approach to the management of risk. The principles of the Group's approach are to firmly embed a strong risk culture across the Bank. The fair treatment of customers is central to the delivery of this, as is managing the Group's risk framework within clearly defined risk appetite measures which set the context for the strategic plan.

We delivered 6.5% growth in mortgages in 2016, and saw growth in our SME book for the first time in four years, with over £2.2bn of new loans and facilities for SMEs made available, and continued growth in current accounts. We have also delivered on key financial metrics with a stable net interest margin and costs running below initial expectations.

We have already begun the process of streamlining our operating model, while continuing to invest in delivering a better service to our customers. We have identified 22 key processes or customer journeys where we see great opportunity to simplify, introduce more automation and digitise. We are moving the business towards being more focused on customers, being more commercial and more accountable.

### Sustainable customer growth

Our customers are right at the heart of our strategy and we have been laying the foundations for a truly seamless service – our digitally enabled omni-channel strategy. We are moving to a model where customers can interact with us through whichever channel they choose – online, mobile, tablet, phone, branch – whenever they want and in a seamless way. We have built a new digital platform to enable this, and the first service we've launched is B, developed in response to direct feedback from our customers. It has intuitive and intelligent features such as "savings pots", "financial projections" and a unique timeline of transactions on all accounts to help customers in budgeting, saving and managing their finances. Initially offering a current and savings account and a debit card, B was successfully launched in May, attracting both new and existing customers. Of initial account openings, 63% were by customers aged under 45, and c.30% in our target segment of younger, more affluent customers (around a third higher than the proportion in our existing base). B customers are also more engaged, with a +47% net promoter score (NPS), so more likely to recommend the B account to friends and family.

B's functionality will be developed further in 2017 with the launch of a credit card and development of a B for Business proposition to help small businesses manage their finances.

Our branch network remains a key element of our omni-channel approach, and this year we announced changes to the network reflecting the evolving patterns in customer usage. A significant number of branches will extend their opening hours, opening on Saturdays, ensuring investment is diverted to the areas where demand is growing. A programme of refurbishments, relocations, co-locations, concept branches and digital development is ongoing as our network adapts to customers' changing preferences.



During the year we maintained our momentum in the mortgage sector, with above market growth of 6.5%. We saw a change in mortgage origination mix, as expected, with a higher proportion of owner occupied mortgages compared to buy-to-let (BTL) than in 2015, despite very strong BTL volumes in our second quarter in advance of the changes to stamp duty.

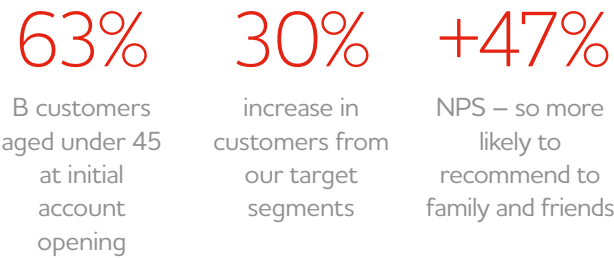
Reflecting the hard work of colleagues across the Bank and a commitment to delivering a superior experience to customers, over the last 12 months, Clydesdale and Yorkshire Banks collected 35 accolades, of which 25 were for first place in their respective category. These included: winning Best First Time Buyer Mortgage Provider and Best Personal Loan Provider at the Moneynet awards; achieving "outstanding" ratings for our 2 and 5 year fixed mortgages and Gold MasterCard 0% purchase offer from Moneyfacts; Yorkshire Bank winning Best Regional Lender at the Your Mortgage awards; and winning Scottish Volunteering Team and Scottish Employee Volunteer of the Year Awards at the Business in the Community Scotland Awards 2016. Further details of our awards are on pages 25 and 28.

In SME, building on our strong origination performance last year we saw growth in the total loan book for the first time in four years, with gross new loans and facilities up 15% year on year.

We also continued to grow our deposit base, with strong underlying growth of 6% year on year and at a lower cost vs FY2015.

We have much more to do to create a truly integrated offering for our customers and continue to align our investment and approach to emerging customer needs and commercial and statutory requirements and imperatives based

### B SUCCESSFULLY LAUNCHED



on data analytics and customer economics. We have solid plans in place to develop a truly omni-channel model and the focus is now on delivery.

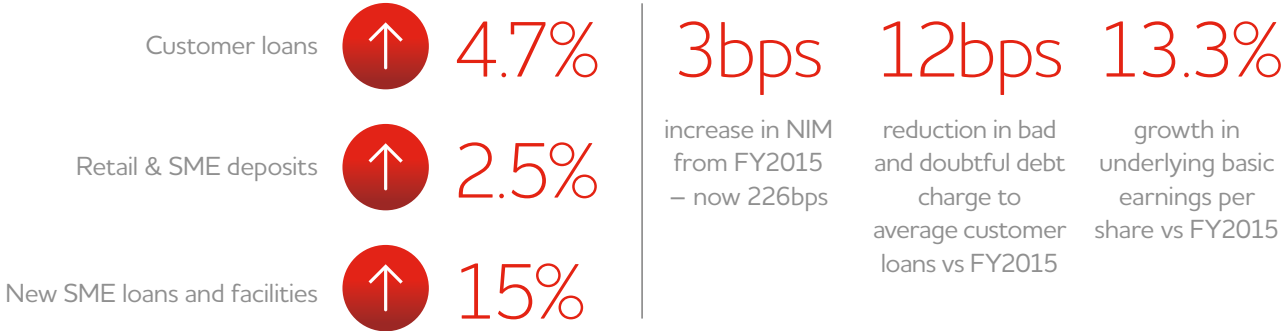
### Efficiency

We are making good progress in creating the right cost structure for our bank. Our underlying CIR of 74% is still too high, but has improved from last year (2015: 75%). As a management team we have already taken action with underlying operating and administrative expenses for 2016 of £729m (4% below the initial expectations we gave during our IPO), as a result of a number of measures to reduce the cost base, including reduced standalone costs vs initial expectations, the closure of 27 branches and a reduction in core Full Time Equivalents (FTEs). While our core employee numbers fell to below 6,500 by the end of the year, the reduction of around 500 principally came from managing vacancies and attrition; 150 also came from a voluntary severance scheme for senior grade staff, which is part of our programme to simplify our organisational structure.

We recognise that the business can be run more efficiently. As such, we updated our medium term targets in September to deliver £100+m of cost savings by 2019, and an underlying cost base in that year below £630m. We have a structured approach to cost reduction, built on the progress made this year, with clear accountability for delivering the programme. We also view lower costs from a customer, as well as a shareholder perspective, and will ensure that the business will still be able to support our growth ambitions, and that our initiatives to reduce costs are aligned with our risk appetite.



CHIEF EXECUTIVE  
OFFICER'S REVIEW



There are four areas of focus within our cost reduction programme:

- 1. Customer Banking transformation** is expected to account for around 25% of cost savings, through optimising our branch network, accelerating transaction activity to digital self-service and improving productivity in the front line. This will lead to fewer people and a smaller number of branches as customers change the way they bank.
- 2. Improved customer service** – We have identified 22 key customer journeys that will be optimised end-to-end through simplification and automation. We are also creating a platform for the future digitisation of processes, a key enabler of our omni-channel model, which will support our growth ambitions through an enhanced customer experience. This area is expected to account for around 15% of cost savings.
- 3. Right model** – this addresses how we organise ourselves, rightsizing of our organisational support functions so that they are smaller and more efficient and targeting a maximum of six organisational layers. We will also change how we deliver large investment programmes, reducing the cost of investment. This area is expected to account for around 20% of cost savings.
- 4. Getting more for less** will improve how we procure services from third parties, the suppliers we use and the value we receive. We will implement a comprehensive supplier contract review, and enhance our procurement capability to deliver a greater than 10% reduction in our current third party spend of around £300m. We will take steps to improve the management of our capital investment profile, with a framework in place to ensure cost savings are sustained. These actions will create a change in “cost culture” within our business and deliver around 40% of our targeted savings.

We anticipate that the cost to deliver these initiatives will be c. £200m pre-tax, with £45m already incurred in FY2016, and this is included within our CET1 guidance.

Capital optimisation

We have begun discussions with the Prudential Regulation Authority (PRA) and have a detailed programme of work in flight to progress the adoption of an Internal Ratings Based (IRB) approach for calculation of credit risk capital. Moving to IRB will improve our competitive positioning, bring a stronger alignment of risk appetite and strategy and also reduce the intensity of our risk weighted assets (RWAs) and potential future bail-in debt requirement (MREL). Our initial focus is firstly on achieving IRB accreditation for our mortgage portfolio, which we currently anticipate to be during FY2018, subject to regulatory approval. Our subsequent focus will be IRB treatment of other retail asset portfolios and the SME book, with the remainder of the bank moving to IRB approximately one year later.

Financial performance

We have delivered on our key financial targets in 2016. Underlying profit on ordinary activities before tax increased to £221m from £159m in the prior year, driven by higher operating income and lower bad debt charges, with broadly flat operating expenses compared to FY2015, despite the additional costs of being a standalone business.

We remain focused on sustainable, prudent growth and are well positioned in both the retail and business banking segments in which we operate. Customer loans grew by 4.7% and asset quality remains strong. The mortgage book grew by 6.5% year on year to £21,836m and owner occupied mortgages accounted for around 60% of new business flows. Front book yields declined broadly in line with swap rates, used to price fixed rate mortgages, which accounted for around 90% of new business written in the year.

Our core SME book, which was £6,358m at 30 September, grew by 6.1% and we continue to run off lower yielding assets,

“Against a backdrop of a challenging economic and regulatory environment, we will maintain appropriate risk appetite for lending, a prudent approach to funding and margin dynamics, and a strongly capitalised balance sheet.”

with our non-core book reducing by £270m in the period, supporting overall SME yields. New loans and facilities totalled £2,223m this year, an increase of 15% vs 2015, with average yields on the front book of 351bps continuing to be above average yields on the back book (321bps).

The loan impairment charge as a proportion of gross average balances was 9 bps (2015: 21 bps), reflecting strong asset quality underpinned by our prudent underwriting standards.

We have continued to see growth in current account balances. Overall customer deposits grew by 2.5% during the year, with strong underlying growth offset by management actions to optimise the mix, pricing and liquidity value of the deposit base, which included the run off of large highly liquid corporate deposits. Excluding these actions underlying customer deposits grew by 6.2%.

We also re-priced our ISA offering in March 2016, while still remaining competitive in the market, which in part helped reduce our overall cost of deposits to 72bps from 78bps in FY2015 and will continue to benefit funding costs next year.

NIM was 226bps, an increase of 3 basis points compared with FY2015 and in line with our guidance of broadly stable. Pressure on asset yields was offset by balance sheet action on liabilities, including the re-pricing of savings products and run off of non-relationship corporate deposits with low liquidity value.

Our funding position remains strong. The loan to deposit ratio (LDR) increased from 109% to 112% due to growth in customer lending combined with a managed reduction in short term corporate deposits. This remains well within our FY2016 target of <115%. The Group's CET1 ratio remained robust at 12.6%, notwithstanding the impact of restructuring costs in the year and volatility in the pension scheme.

Economic and regulatory environment

The economic and regulatory environment is challenging and we will maintain appropriate risk appetite for lending, a prudent approach to funding and margin dynamics, and a strongly capitalised balance sheet. This will be done while ensuring we continue to deliver on our overarching principle of treating all of our customers fairly.

Since the EU referendum vote we have seen a limited impact on our business. The mortgage pipeline remains robust whilst our pipeline for SME lending is currently higher than at the same time last year. Clearly the EU referendum vote means a more complex economic and market environment in the future and as negotiations between the UK and EU progress we will monitor developments, retain our flexibility, and react accordingly. As set out at our Capital Markets Day in September, we expect and are planning for a slowdown in the economy, with GDP between 1%-2% over the next three years and unemployment increasing moderately to 5%-6%. The current prolonged period of low interest rates, with the Bank of England (BoE) base rate at 25 bps following a further 25 bps reduction in August, has created challenges and put downward pressure on margins. The BoE Term Funding Scheme should help to offset some of this pressure by providing low cost funding, and our planning assumption is for 0% base rates until FY2020.

We welcome the measures taken by the Financial Policy Committee of the BoE to support lending to UK businesses and households, by reviewing capital levels including the counter cyclical buffer. This creates additional capacity, subject to customer demand and our normal risk appetite criteria, to make over £2bn of new mortgage loans or nearly £1bn of new SME loans.



CHIEF EXECUTIVE  
OFFICER'S REVIEW

The regulatory environment continues to evolve, with consultations and new guidance emerging from the Basel Committee, as well as the PRA and Financial Conduct Authority (FCA).

We continue to make progress on resolving legacy conduct issues. As part of our half year report at 31 March, we determined that a further charge of £450m was required to deal with expected future costs in relation to Payment Protection Insurance (PPI), incorporating the Group's estimate of the impact of CP 15/39 and a reassessment of the costs of processing cases and the impact of experiential adjustments. Only 9.7% of the charge impacts the Group's income statement (£44m) as a result of the conduct indemnity provided by NAB.

We welcome the FCA's statement as part of its further consultation (CP 16/20) that the package of proposals on PPI complaints laid out in CP 15/39 should be taken forward albeit with the deadline for complaints now likely to be the end of June 2019. We look forward to the rules and guidance concerning the deadline, the consumer communications campaign fee, and PPI complaints and Plevin, being published by the end of December 2016. In advance of this date, reflecting our current experience and expectations we have not made any further changes to existing unutilised provisions related to PPI. We consider that the total cover remaining of £1.5bn (unutilised provisions and conduct indemnity) is sufficient to cover the costs of dealing with all legacy conduct matters including PPI.

People

The ability of the Bank to execute its strategic plan is predicated on ensuring that the appropriate talent, capabilities and experience are in place throughout the organisation. This starts with the Board and the Executive Leadership Team.

The Board has been further strengthened, with Clive Adamson, David Bennett, Paul Coby, Fiona MacLeod and Tim Wade appointed as independent Non-Executive Directors, complementing the Board's expertise and governance oversight. I have reorganised and strengthened the Leadership Team for better individual and collective accountability, and created the right mix of experience that we need to meet forthcoming challenges.

- Fergus Murphy joined the bank as Products Director in January, with over 20 years of experience in financial services, including as Director of Corporate and Institutional Banking at Allied Irish Banks plc (AIB).
- Gavin Opperman joined as Director of Customer Banking in November, with a 20 year career at Barclays Group in Asia, and most recently Regional Head of Consumer Banking at Standard Chartered plc.
- Kate Guthrie joined as Group Human Resources Director in January, with over 30 years of domestic and international HR experience, most recently spending more than a decade at Lloyds Banking Group plc.
- Mark Thundercliffe joined as Chief Risk Officer from HSBC in September, where he had management and oversight of risk for HSBC's retail banking and wealth management businesses in 18 countries including the UK, Europe, Middle East and Africa.
- Enda Johnson was appointed to the Executive Leadership Team in June as Director of Corporate Development and Stakeholder Engagement. Before joining CYBG in 2015, Enda was Head of Corporate Affairs & Strategy at AIB.

In addition, we have made a number of appointments at senior levels across the organisation, as we seek to deepen our talent and capabilities. Key to our success will be the continued development in the strength and capability of our leadership population.

NEW APPOINTMENTS

BOARD



DAVID BENNETT  
Deputy Chairman



PAUL COBY  
Independent  
Non-Executive  
Director



FIONA MACLEOD  
Independent  
Non-Executive  
Director



TIM WADE  
Independent  
Non-Executive  
Director



CLIVE ADAMSON  
Independent  
Non-Executive  
Director

EXECUTIVE LEADERSHIP TEAM



FERGUS MURPHY  
Products Director



GAVIN OPPERMAN  
Customer Banking  
Director



KATE GUTHRIE  
Group Human  
Resources Director



MARK  
THUNDERCLIFFE  
Chief Risk Officer



ENDA JOHNSON  
Director of Corporate  
Development  
and Stakeholder  
Engagement



CHIEF EXECUTIVE  
OFFICER'S REVIEW

Employee engagement score  UP TO 79% Advocacy score  UP TO 70%

£5 million

raised so far for our chosen charity - Hospice UK



As we begin to transform our culture to create a high performance, customer centric bank, the results from our employee engagement survey in June were encouraging. Our engagement score of 79% is an improvement on last year and 2 percentage points above the UK financial services norm. Our advocacy score (confidence in recommending the Bank to friends and family) increased by 10 percentage points to 70%. 92% of our people understand how the work they do contributes to the achievement of the Company's goals and objectives.

Given the significant amount of change in the Group over the past 12 months, these results are a positive indication of where we are on our journey.

We aim to create a high performing, customer centric organisation and drive accountability and responsibility, alongside appropriate reward structures. Key to our progress is the engagement and commitment of all of our people. To support this we have introduced an integrated communications strategy to assist in the delivery of our key strategic areas. We have also undertaken a comprehensive review of reward, ensuring it is closely linked to the delivery of our strategy. We have simplified our performance

management approach to ensure it fully aligns our colleagues' individual objectives with the strategic plan.

We want to be an employer of choice, engaging and inspiring our employees to build a bank of which they can be proud. We are building on our existing strengths and capabilities by hiring the very best talent. We are developing our cultural framework to ensure that we have a clear vision and values which form the foundation of our performance management framework with clear links to reward and with diversity and respect for difference built in.

We have a long tradition of supporting local communities. So far we have raised £5m for our chosen charity, Hospice UK, and have relationships with a number of local organisations such as Scotland's Charity Air Ambulance, Royal Zoological Society of Scotland and Cycle Yorkshire. Through our Spirit of the Community Awards, now in their fourth year, we will donate £150,000 to 30 charities this year and we have an active volunteering programme. We encourage every employee to take two days' paid leave for volunteering and provide Employee Volunteer Grants for those who volunteer in their own time. A fifth of our people donate to charity via Payroll Giving.

Outlook

In September this year we laid out our targets for the coming financial year ending 30 September 2017 which are detailed in the table below. The operating environment continues to be dynamic, the impact of Brexit is not yet fully understood, and our markets remain competitive.

Short term performance targets

Metric	FY2016	FY2017e
NIM	2.26%	Broadly stable
Underlying costs	£729m	c. £690m-£700m
Loan growth	4.7%	Mid single digit %
LDR	112%	< 120% <sup>(1)</sup>
CET1	12.6%	12%-13% range

<sup>(1)</sup> Assuming participation in Term Funding Scheme.

Looking further ahead, we also refreshed plans for the next three years to 2019, bringing forward and improving two key targets: we now anticipate that we will deliver, by the end of 2019, a CIR ratio of 55%-58% (previously <60% by 2020) and double digit RoTE (previously by 2020).

Updated Medium Term Targets

Metric	IPO targets	Updated guidance
CIR	Below 60% by FY2020e	55% - 58% by FY2019e
Retail lending	Implied 8% CAGR to FY2020e	Mid single digit % CAGR to FY2019e
SME lending	Implied 4% CAGR to FY2020e	Mid single digit % CAGR to FY2019e
CET1	12% - 13%	Unchanged
LDR	up to 115%	< 120% <sup>(2)</sup>
Dividend	Target modest inaugural dividend for FY2017; in time 50% payout of earnings <sup>(1)</sup>	Unchanged
RoTE	Double digit by FY2020e	Double digit by FY2019e

<sup>(1)</sup> After paying Additional Tier 1 (AT1) distributions.

<sup>(2)</sup> Assuming participation in Term Funding Scheme.

In order to deliver these targets we are targeting more than £100m of sustainable cost reductions by 2019, in addition to the cost savings already delivered in 2016, after incurring pre-tax restructuring costs of c.£200m. We also expect to fully transition to the IRB basis of measuring RWAs on a whole bank basis during FY2019, subject to regulatory approval. Our CET1 ratio is expected to remain in the range of 12% to 13% throughout this period.

We also confirmed that our dividend ambition remains unchanged, targeting a modest inaugural dividend with

respect to 2017 with a longer term goal to pay out up to c.50% of earnings (after paying AT1 distributions).

Across CYBG we are focusing on the future with confidence. Delivering brilliantly simple service to our customers is at the heart of our bank and over the next year we are confident we will show continued progress against our targets and delivery of commitments for our customers, our people and our shareholders as part of our two year £350m investment programme.

David Duffy | 21 November 2016



## BUSINESS MODEL AND STRATEGY

### OUR BUSINESS MODEL

1

Our strategy is clear and its execution allows us to create value for our stakeholders through:

- Life-long customer relationships built on trust and confidence.
- Segment and value-led approach to new customer acquisition and proposition development.
- Holistic balance sheet management approach, focus on sustainable growth within prudent risk appetite.
- Capturing increasing organisational efficiencies: right-sizing our network, automation of processes, digitisation of customer journeys, increasing operating model productivity.
- Optimisation of capital allocation within an improved risk management framework.

2

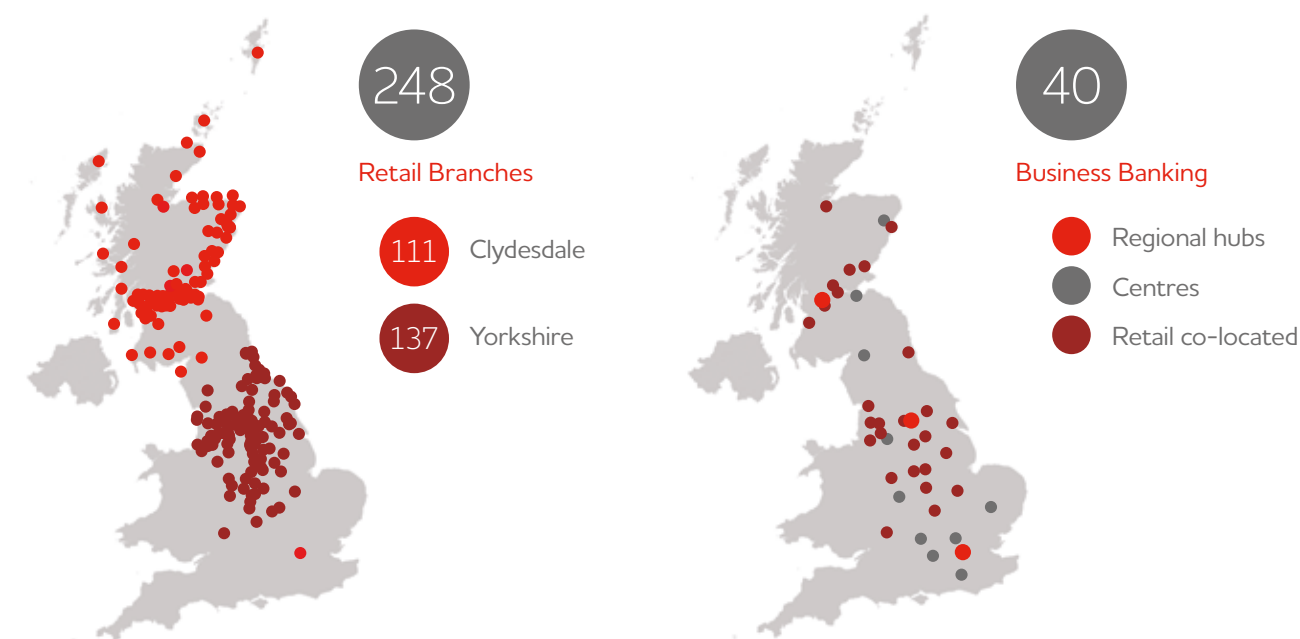
...by offering customers:

- Full service retail and SME banking propositions to a growing customer franchise, supported by well-established, respected brands.
- Simple, straightforward financial products supported by great customer service.
- An increasingly integrated omni-channel distribution model that provides customers with seamless access to relevant information, services and products via mobile, online and telephone banking and across our branch and advisor network.

3

...leveraging our competitive advantages:

- Established, trusted brands that resonate in our core regions.
- Highly engaged colleagues focused on customer service.
- New, highly experienced and energised leadership team and Board members.
- Strong and enduring relationships with customers and intermediary brokers.
- Resilient customer deposit franchise providing low cost, sustainable funding.
- New cutting edge, scalable digital platform underpinning distribution plans.
- Scale and scope of large incumbent players with the agility of much smaller UK challenger banks.



### OUR STRATEGY IS UNDERPINNED BY THE GROUP'S CORE BUSINESS STRENGTHS

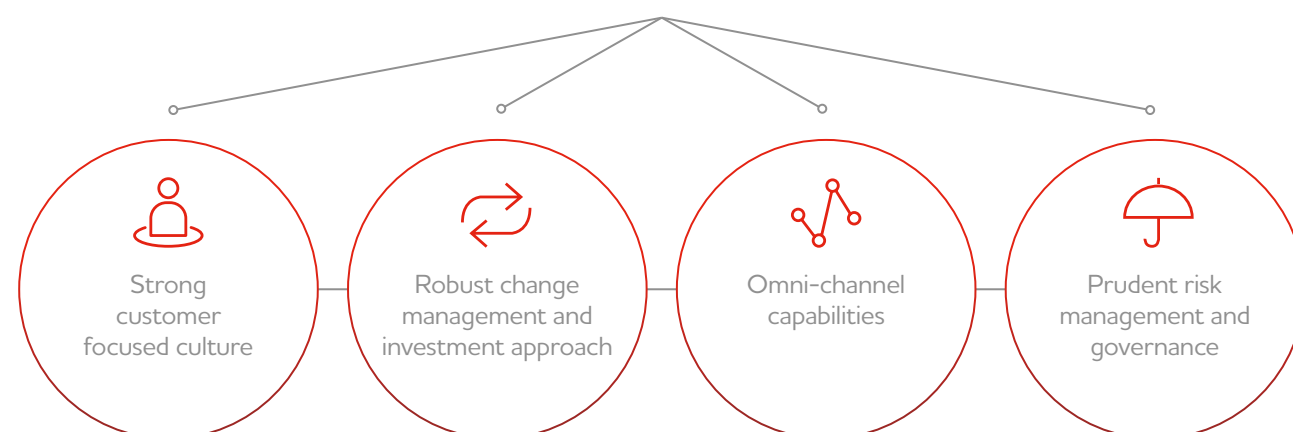




## BUSINESS MODEL AND STRATEGY



## SUPPORTED BY DEVELOPMENT OF OUR CORE CAPABILITIES



### Our strategic priorities

The Group is committed to delivering a strong, customer-centric banking proposition in the UK.

We believe customers want straightforward and transparent products combined with the ability to access their products and services through the channel of their choice. Service remains one of the key drivers of customer satisfaction with customers increasingly less forgiving of poor service. Demand for omni-channel banking is established and customers expect to be able to manage their finances whenever and wherever is most suitable for them, whether by telephone, online, or by using their mobile device.

Our strategy is simple:

- drive sustainable customer growth
- improve efficiency
- optimise capital

### Drive sustainable customer growth

- The Group's goal is to be a strong, customer-centric bank that proactively responds to changes in customers' needs and builds long-standing relationships, delivering customer-driven product and service propositions across both retail and business banking.
- A "deposit first" philosophy – we aim to secure the primary account relationship to drive increased product penetration and low cost sustainable funding.
- We are focused on the acquisition of customers in key target segments – for example, a younger, more affluent customer demographic.
- We aim to deliver an agile approach to product proposition development, targeted at our key customer segments.
- We will ruthlessly focus on simplifying operational processes to drive customer experience which is "brilliantly simple". Progress is monitored through a number of metrics including surveys, resolution of complaints and NPS.
- We will drive stronger performance – and a focus on end to end product profitability – through an integrated product, portfolio and balance sheet management capability.
- Further integration of product and service across channels will drive enhanced customer experience and efficiency.

### Improve efficiency

- Significant opportunities remain to improve the cost structure of the Group.
- In September 2016, management announced detailed plans to reduce the Company's cost structure, focusing on four areas: Customer Banking transformation; Improved customer service; Right model; and Getting more for less.
- We will build on the progress made in 2016 – during the year, the outlook for underlying costs was reduced by £33m, from a previously announced £762m cost base (4% reduction).
- Efficiency improvements will be viewed from a customer perspective. We are targeting sustainable cost improvements, while supporting our growth ambitions, which are aligned with our risk appetite.
- We have clear accountability for delivery.

### Capital optimisation:

- The Group has established a programme to progress an IRB capital approach to modelling risk, subject to regulatory approval.
- Moving to IRB will improve our competitive positioning, enhance our risk management capabilities and also lower the intensity of our RWA and future bail-in debt requirement (MREL).
- Our initial focus is firstly on achieving IRB accreditation for our mortgage portfolio which we currently anticipate to be during FY2018, subject to regulatory approval. Our subsequent focus will be IRB treatment of other retail asset portfolios and SME book, with the remainder of the bank moving to IRB approximately one year later.
- As an IRB accredited bank the PRA will continue to determine our ultimate capital requirements through supervisory processes.
- The Group also continues to have two portfolios that are in 'run off'. The first portfolio relates to tracker mortgages while the second is a cohort of low yielding SME lending. Both portfolios are high quality, but low returning. Running these portfolios down will enable capital tied up supporting these loans to be recycled, over time, into higher returning assets.

### Through omni-channel delivery

- Our strategy is underpinned by our omni-channel approach.
- We are focused on delivering seamless end to end customer journeys across different distribution channels – "anytime, any place, anywhere".
- Our omni-channel distribution model will allow us to differentiate on customer experience.

## BUSINESS MODEL AND STRATEGY

- Our digital strategy is an important part of our growth agenda driving efficiency, process simplification and customer acquisition.
- This will be supported by an investment programme to extend our digital platform, simplify our IT architecture and enhance our platform resilience, as well as support growth and improved efficiency, and ensure we keep our business safe and secure.

### Operating environment

#### UK economic environment

While overall the economic environment was benign for the majority of the year, the impact of the EU referendum on 23 June has created more uncertainty around the future direction of the UK economy.

UK GDP growth has been remarkably resilient post Brexit, growing by 0.5% in the July–September quarter, following growth of 0.7% in the April–June quarter<sup>1</sup>.

The BoE has raised its forecast for economic growth next year to 1.4% from 0.8%, but cut expectations for 2018 to 1.5% from 1.8%. In addition, global growth is coming under pressure, primarily due to a slowdown in emerging markets and falling commodity prices.

Other key UK macro-economic indicators were strong in 2016. The unemployment rate continued to fall, to 4.9% from 5.4% a year earlier<sup>1</sup>, and the employment rate rose to 74.5% which is the joint highest rate since records began in 1971.

Real earnings grew by 1.8%<sup>1</sup> from a year earlier and inflation, as measured by the Consumer Prices Index, rose to 1% in the year to September<sup>1</sup>, its highest level since November 2014, as a result of higher costs for petrol and clothes. Inflation is forecast to rise further to 2.7%<sup>2</sup> in 2017 and not return below the Monetary Policy Committee target of 2% until 2020, given the impact of Brexit and the falling pound.

The BoE base rate remained at 0.5% until August, when it was reduced for the first time since March 2009, to 0.25%, its lowest ever rate.

There were some indications that housing market activity ended FY2016 somewhat weaker than it started. While early in the year the continuation of positive domestic economic factors underpinned demand, post the EU referendum vote uncertainty could lead to a drop off in demand – BoE data showed mortgage approvals in August were down 10% year on year. However, despite this, growth in UK average house prices overall continued in 2016, up 8.4% in the year to August, continuing the strong growth seen since the end of 2013 and as a result of resilient economic conditions together with sustained low mortgage rates.

As announced in the 2015 Autumn Statement, people purchasing BTL properties and second homes paid an extra 3% in stamp duty from April 2016, which prompted a surge in BTL mortgage applications prior to the deadline, bringing forward demand from the second half of the year into the first half. Changes to mortgage interest tax relief from April 2017 could also impact on demand for BTL mortgages in FY2017, although the materiality of this is difficult to gauge at this time.

The outlook for the retail savings market continues to be strong. There are a number of macro-economic factors supporting this positive growth outlook, including continued real wage growth, increasing the capability to save and government policy, including increased ISA limits in 2017. The continued low base rate environment offers further opportunity to reduce the cost of deposits.

### Regulatory and political environment

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

- In March 2016 the BoE Financial Policy Committee announced that from 29 March 2017 the Countercyclical Buffer will be set at 0.5% in the UK up from 0%. In response to the EU referendum vote, the BoE Financial Policy Committee withdrew the countercyclical buffer to make more funding available to UK businesses

and households which is equivalent to a reduction in the Group's countercyclical buffer of around £100m. In addition, in December 2015 the BoE announced that banks with less than £175bn of assets will not be subject to Systemic Risk Buffer requirements.

- In response to the European Bank Recovery and Resolution Directive, the BoE launched a consultation on setting the Minimum Requirement for Own Funds and Eligible Liabilities (MREL), which completed on 11 March 2016. The BoE proposed that MREL will be calculated as the "loss absorption amount" plus the "recapitalisation amount", with the latter dependent on the agreed resolution strategy for the Group. A Statement of Policy was issued by the BoE in November 2016 and firms will be advised of their MREL requirements by the end of 2016. The requirement for firms to meet MREL will be phased in between 2016 and 2022. It is expected that MREL will lead to a requirement for increased qualifying debt issuance by CYBG, and the UK banking industry as a whole.
- In March 2016 the BoE announced details of its 2016 stress test to assess the resilience of major UK banks. This included a revision to the stress test hurdle framework so that each bank will now be expected to meet its minimum Pillar 1 and Pillar 2A CET1 capital requirements after the stress, which for the Group is 77% as at 30 September 2016.
- In December 2015, the Basel Committee on Banking Supervision (BCBS) published further proposals to revise the standardised approach to credit risk. They form part of the BCBS's broader work on reducing variability in RWAs, increasing risk sensitivity, reducing national discretions and enhancing comparability of capital requirements across banks. All things being equal, the proposals will increase the level of capital the Group is required to hold against portfolios that have not transitioned to IRB by the point of application.
- A supervisory statement of 29 September 2016 outlined the PRA's expectation of minimum standards that firms should use to underwrite BTL mortgages, which included affordability tests using a minimum increase of 2 percentage points in BTL mortgage interest rates (and assume a minimum rate of 5.5% for the first 5 years), specialist underwriting for customers

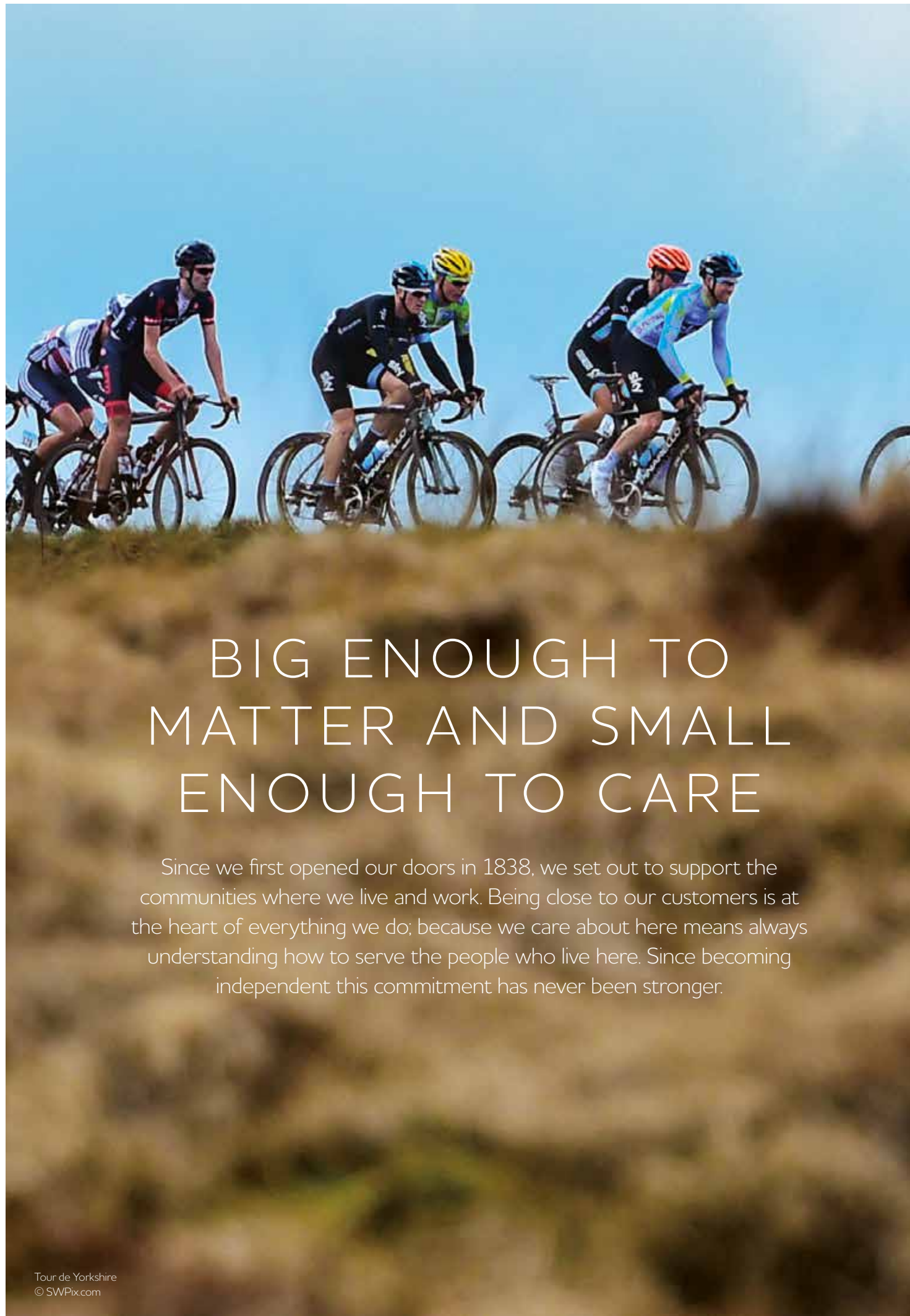
with four or more BTL properties (so called portfolio landlords), and adequate risk management with limits on the flow and stock of BTL lending, including LTV limits. Affordability stress tests need to be met by 1 January 2017, the remaining principles by 30 September 2017. CYBG already meets the core elements of these expectations.

- The Competition and Markets Authority (CMA) issued its final report on 9 August on the supply of PCAs and banking services to small and medium-sized enterprises. The CMA will implement a package of reforms, including requiring the largest banks to implement "Open Banking" to allow customers to manage their accounts with multiple providers through a single digital app and compare products; banks to publish quality of service information on their websites and in branches; make switching easier, with changes to the CASS (Current Account Switching Service) to improve its performance and increase customer awareness; changes to unarranged overdraft fees including sending customers alerts to help them avoid charges, and requiring banks to set a monthly cap on these charges; measures to help small businesses to compare BCAs, lending products, and other products and services, including online quotes and eligibility checks and standard terms and conditions. B is well placed to comply with standards such as PSD 2 (Payment Services Directive 2) to allow customers to manage accounts with multiple providers through the B app and we welcome measures that deliver more choice, functionality and a better experience for customers. It is anticipated that it will take until summer 2018 for all elements of the CMA's package to come into force, though some remedies will be in place sooner.
- On 26 November 2015, the FCA issued a consultation (CP 15/39) in relation to the introduction of a deadline by which consumers would need to make their PPI complaints and also on how firms should handle PPI complaints in light of the Supreme Court decision in the Paragon vs Plevin case ("Plevin"). The FCA issued a further consultation on 3 August (CP 16/20) which the Group has responded to. The revised proposals in CP 16/20 are expected to become rules in December 2016 based on the FCA's current timetable.

<sup>1</sup> Source: Office for National Statistics

<sup>2</sup> Source: BoE





# BIG ENOUGH TO MATTER AND SMALL ENOUGH TO CARE

Since we first opened our doors in 1838, we set out to support the communities where we live and work. Being close to our customers is at the heart of everything we do; because we care about here means always understanding how to serve the people who live here. Since becoming independent this commitment has never been stronger.

## DELIVERING TO OUR STAKEHOLDERS

### SUPPORTING COMMUNITIES WHERE WE LIVE AND WORK

To be sustainable we need to create value that lasts for our stakeholders. Financial performance isn't the only indicator of success and we take pride in managing our business responsibly for our customers, colleagues, communities and other key stakeholders.

#### Our aim is to:

- Ensure we get the basics right for our customers with quality products and services;
- Invest in the skills, aspirations and capabilities of our colleagues;
- Recognise our responsibility to society – by managing our environmental impact from our day to day operations and supporting the many projects which we undertake through our community partnerships.

#### How we achieve this

By building an open and honest culture and engaging actively with stakeholders we aim, wherever possible, to understand the impacts that are created through our operations, products and services. We also integrate environmental and social considerations into day to day business decision making and operational practices to help make this a great place to work. 'We care about here' – a simple statement that encapsulates our enduring focus on serving our key stakeholders – creates a sense of pride in everything we do and shines a light on the customer focus that is core to our DNA.

#### We focus on four key areas:

- Caring for our customers and providing products and services that meet their evolving needs and expectations;
- Creating an engaging and supportive working environment for our colleagues;
- Managing our environmental impacts – direct and indirect;
- Investing in the communities in which we operate.

We do this while working with our suppliers to find the best operating performance as well as meeting due governance and accountability standards.

#### Customer

We pride ourselves on our customer focused culture. It's why this year we've listened and responded to our customers' needs by investing in our branch network, digital journey, restructuring our business and Executive Leadership Team to provide an even greater focus on service, and launched our new flagship product – B.

Beyond getting the basics right for our customers with quality products and services, we aim to attract new customers by being innovative and providing market leading services. Our omni-channel approach allows us to continue to recognise issues of accessibility, financial inclusion and responsible lending while also providing support for our vulnerable customers. We've worked tirelessly to improve the complaint handling process and speed of response to existing and new customers.

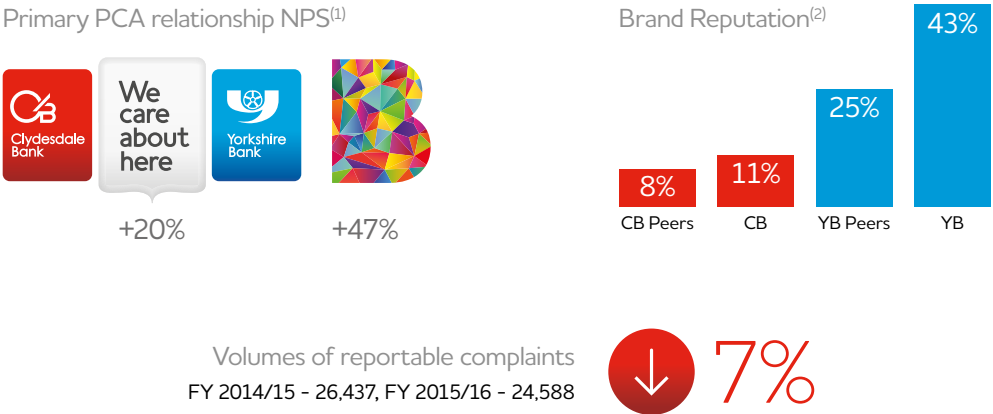
#### Progress in 2016

Customer numbers remained level during the year at 2.8 million. Customer satisfaction and advocacy remained a key measure – NPS showed improvement with our brands in line with their peer groups. Brand reputation exceeded that of our peer groups.

We understand how we would like to be treated and try to treat our customers with the same trust and respect. We aim to get our service right first time every time, learning from mistakes and driving continuous improvements. The total number of complaints received from customers (excluding PPI) reduced year on year by 41% and the number of reportable complaints (excluding PPI) reduced year on year by 7%, reflecting our progress in this area. When we do make mistakes, our goal is to provide our customers with fair outcomes, consistently and promptly.

DELIVERING TO  
OUR STAKEHOLDERS

HIGH NET PROMOTER SCORE WITH REPUTATION TRACKING AHEAD OF PEERS



In addition, when complaints are referred to the Financial Ombudsman Service (FOS) the number of instances when FOS disagrees with the Group's decision has continued to reduce during the year, demonstrating favourable comparison against the industry averages.

We continued to respond to customers' needs by almost doubling the number of branches open on a Saturday. We also introduced free Wi-Fi and issued iPads to our branches to provide easy online access. Retail and business staff were brought together into Customer Banking Centres.

In November, we held our fifth Business week of activities entitled, 'Growth through innovation', which involved 760 events and visits across the country and over 10,000 business customers and employees took part.

In difficult times we have continued to support our customers. During the winter floods we contributed to the UK Community Foundation (UKCF) Winter Flood Recovery Appeal with our employees offering practical assistance as well as collecting donations via our West Yorkshire branches. A £20k donation was made from our charitable foundation.

Products and services – a new way of banking

Customers told us that they wanted a digital banking proposition which would not only meet their expectations of mobile banking, but compared favourably with the very best digital experience. They asked for a product that would put them back in control, and give them tools to analyse their spending better, as well as budget and plan for the future. In May 2016 we responded to our customers with the launch of B.

Over 11,000 customers were engaged during the development of B and while meeting many of their needs at launch, our ongoing programme of work and regular feature updates are based on their feedback. We are proud of our market leading offering and customers have given us overwhelmingly positive feedback. B has supported us in acquiring a younger demographic with a wider range of financial needs. The platform has also helped to extend our reach and appeal outside of our core regions.

In addition to B, we also took steps to improve our other products and services. This resulted in us winning awards across our main product areas: mortgages, current accounts, loans, insurance and credit cards. We recognise customer requirements continue to grow, hence we continue to invest to meet these changing expectations.

<sup>(1)</sup> Source: Internal NPS survey August 2016.

<sup>(2)</sup> "Source: YouGov BrandIndex, Reputation metric. Data based on the period 1st January to 31st July 2016. Data has been filtered by those who have an opinion (positive or negative) of the brands. YB score is based on respondents in the North East, North West, Yorkshire and the Humber, East Midlands, West Midlands and CB score is based on respondents in Scotland. Sample sizes are as follows: YB n=1,379; CB n=409."



Moneynet.co.uk Awards 2016  
Best First Time Buyer Mortgage Provider and Best Personal Loan Provider

Your Mortgage Awards 2016  
Yorkshire Bank – Best Regional Lender

Moneyfacts Awards 2016  
Best Card Provider (Introductory Rate) and Current Account Provider of the Year

Help for our customers

Caring for our customers and providing products and services that meet their evolving needs and expectations is a key area for us. We recognise that sometimes events or circumstances take over and our customers can become vulnerable. We launched a new learning module to be completed by all employees, to help them better understand and identify their roles and responsibilities in the identification and support of vulnerable customers. We also increased the prominence of the support available by providing easy access via the home page of cbonline and ybonline.

In addition:

- We launched our mortgage calculators to help customers understand their personal circumstances better whilst searching for their dream home.
- We ran our first ever Fraud Week, holding customer events to provide tips and guidance about how to avoid financial crime.
- We partnered with Get Safe Online as our online safety awareness partner and published top tips for safe online and mobile banking.
- We expanded our email communications to customers and introduced lifestyle articles into our regular communications.
- In August we emailed over 700,000 customers to ask them for feedback on the bank, over 20,000 provided detailed feedback.

Priorities for next year

Our priorities for the year ahead are to build on the success of this year, listen to our customers and continue to invest in our products. We will roll out further functionality for B and continue to invest in capability that allows customers increased flexibility in how and when they choose to bank with us.

Colleagues

Our people are integral to the ongoing success of the Bank. As the public face of our business, they connect us with our customers and other external stakeholders, and act as a valuable source of ideas for ways in which we can continually improve our processes, products and services.

Only through the engagement and support of our people can we help our customers achieve their financial goals. Our annual feedback survey, myVoice, showed a 6 percentage point increase in engagement relative to the previous year, taking us to 2 percentage points above the UK financial services industry norm. It also showed a 10 percentage point increase in colleague advocacy.

As we continue to build a high performing PLC, our aim is to foster a culture that attracts, retains, motivates and rewards people who consistently deliver the right customer-focused outcomes regardless of where they work or what they do across the Bank.

Supporting and empowering our people

Continuing our digital transformation we have maximised the use of technology, introducing tools that enable our people to develop the right skills, knowledge and experience to deliver great customer outcomes.

Offering our people access to the highest quality personal development material is a key part of our approach and why we invested in a new interactive learning tool known as myLearning at the start of the year. myLearning delivers an end-to-end learning experience that encompasses technical skills, compliance and personal development to help people perform their role and progress their career with the Bank.



# DELIVERING TO OUR STAKEHOLDERS

The launch of our new intranet, Our World, was another important step in our digital journey, bringing together the information people need to perform their role. Containing information on our strategy, brand, the communities where we live and work, as well as the latest products and services available, it is a valuable resource for colleagues across all parts of the Group.

Recognising the unique requirements of those working across our network, this year we developed our first ever tablet based application for colleagues. The myComms app helps us communicate better with customer facing colleagues who don't always have instant access to email or the intranet. It has been extremely popular, has enabled colleagues to spend more time on supporting customers and paved the way for more innovation in this area.

## Equality, Diversity and Inclusion

Equality, diversity and inclusion are integral to who we are. We strive to provide our customers with high quality experiences every day, and to do so from a workforce that represents those communities in which we are proud to live and work. Recognising 'diversity of thought' and valuing differences amongst our colleagues are key to achieving this. That is why we are committed to fostering and sustaining an inclusive culture where every colleague can reach their full potential.

We aim to create an open and transparent workplace where respect, dignity, fair treatment, equality, tolerance and understanding are at the core of how people behave and interact.

We are committed to creating an environment in which people from all backgrounds can work together harmoniously and where all colleagues are entitled to:

- be treated with dignity and respect at work
- a workplace free from bullying, harassment or victimisation
- experience no form of discrimination, and
- be valued for their skills and abilities

## Disability Symbol

Two Ticks is the symbol that shows we are a Disability Friendly Employer and like Opportunity Now and Race for Opportunity, demonstrates to customers and employees that we embrace diversity and inclusion.

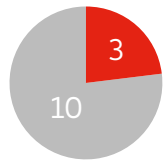


Our strong, diverse, and engaged network of colleagues includes:

- 6,313 Core FTE as at 30 September
- Our board now has three women and ten men
- We've introduced more women into our Executive Leadership Team, with three out of nine being women
- 73% of our senior management are male, 27% female as at 30 September
- 65% of our staff are female, 35% male

CYBG once again participated in the Business in the Community Diversity and Well Being Benchmark survey. This is the UK's most comprehensive gender and race benchmark, which now introduces elements of age, diversity and employee well-being. Assessment against a robust diversity, inclusion and well-being framework identifies strengths and weaknesses by peer comparison. We have achieved Gold for Gender Banding.

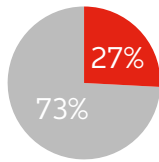
7,673 Total number of employees  
(6,313 Core FTE)



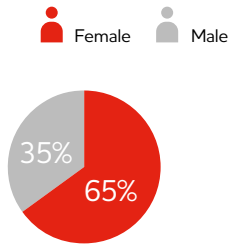
Board Members



Executive Leadership Team



Senior Management



Staff

Gender split based on total number of employees.



s1jobs Recruitment Awards 2016  
Best Recruitment Campaign and Best Digital Creative

Chartered Institute of Public Relations (CIPR) Excellence Awards 2016  
Best Corporate and Business Communications Campaign

Business in the Community Scotland Awards 2016  
Scottish Volunteering Team and Scottish Employee Volunteer of the Year

Our employee network groups also play an important role in making sure our colleagues feel included, engaged and supported. They offer advice, support, guidance and opportunities in all areas of equality, diversity and inclusion.

Over the year, these groups have sponsored, led and participated in many events and activities that reflect our brand and vision. These include World Aids Day, West of Scotland Deaf Children's Society and International Women's Day.

## Awards

The importance we place on the recruitment and development of our colleagues has been recognised through a number of awards this year:

- Young Thinker Awards
- National Diversity Nomination
- S1 Recruitment Award for Best Employer Brand

We are delighted that our colleagues have been recognised as role models and leaders, both in the financial services industry and beyond:

- Our Internal Communications team won Best Communication Strategy as well as the Gold Award for the best submission across all categories from the Institute of Internal Communications Scotland Awards (March 2016)
- Our Media Team were awarded Best Corporate and Business Communications Campaign at the Chartered Institute of Public Relations Awards (June 2016)
- Peter Bevilacqua from our SME segment was named England and Wales Young Thinker (Autumn 2015) and Nicola Baillie from our Operations and IT graduate programme received the Scotland Young Thinker Award (Winter 2015)
- Douglas Peacock from Procurement and Supplier Services was named Employee Volunteer of the Year by Business in the Community Scotland.

- Paul Skovron from our Innovation and Change Team and Chairman of our LGBT+ employee network, was nominated as a positive role model for the upcoming National Diversity Awards
- Chief Executive Officer (CEO), David Duffy, was shortlisted for CEO of the Year at the Scottish Business Awards and nominated for Business Leader of the Year at the Yorkshire Variety Business Awards.

## Priorities for next year

Our aim is to create a culture that supports a high performing business, encouraging greater accountability, customer centricity and commercial viability. Ensuring we nurture and reward those who actively foster that culture is a priority. From a new reward structure to the development of talent and leadership across our business, we have a number of initiatives in plan to help achieve that.

Introducing operational excellence in our core support areas is helping design and deliver best-in-class operational capabilities, while investing in our people to develop enhanced leadership, coaching and capability skills.

Recognising the benefits flexible working brings to our people, our customers and our business overall, we are investing in new and innovative digital solutions that will provide more flexibility and create a greater sense of community for colleagues, regardless of where they work.

Following the recent introduction of our Simply Thank You employee recognition scheme and our new approach to bonus, we will continue to evolve and grow our reward and recognition package, enabling us to recognise positive customer-focused behaviours and performance consistently and fairly across the Bank.



# DELIVERING TO OUR STAKEHOLDERS

## Community

We believe that the strength and sustainability of our business is related to the health and wellbeing of the communities we serve. We play a positive role in the communities where we operate through direct donations to charities and working in partnership with a broad range of organisations. We encourage our employees to get involved and play an active role working with charities and projects as well as volunteering in their local communities.

## Charitable Foundation

Our independent Charitable Foundation sanctions our donations to charities and our support for employee volunteering both in time and grants. In its fourth year, our annual *Spirit of the Community Awards* provided grants of £5,000 to 30 charities supporting a wide range of community activities under the headings of Employability, Financial Education and Environment. In total, 113 charities have received awards totalling £700,000.

## Financial Education

Our *Count Me In* 123 financial education programme has been running for over 10 years. As well as helping pre-school children with numeracy skills via libraries in Glasgow and Leeds, our online materials provide access for all parents and carers to engage with their pre-school children and have fun

with maths. Over 50,000 *Count Me In* activity booklets have been supplied via our branches. The activity booklets also promote the online story book and game which is available to download on Apple and Android services.

## Charity Partnership

Our official charity partner, for the ninth year, was *Hospice UK*, the umbrella organisation providing support to hospices across the UK. Our Customer Banking Centres are twinned with 87 local hospices across the country and fundraising by our employees is matched by the Group. To date over £5.2m has been raised for hospice care in the UK. *Wear One Thing Yellow to Work Day* took place on 1 March and raised over £20k for the charity. Also, 124 employees volunteered to take part in a marathon hike on 16 September in the Yorkshire Dales and raised over £100k for hospice care.

## Employee Engagement

We encouraged our employees to support their local community by taking two days' paid leave for volunteering per year. In addition, for those who volunteer in their own time we provided Employee Volunteer Grants of £500 for their chosen charities and community groups. Over 11,000 volunteering hours were recorded during the year and 331 grants were made with a total value over £163k. 20% of our employees donated to charity via Payroll Giving, one of the highest take up rates of the UK high street banks.



## Community Partnerships

We consciously moved away from traditional sponsorship assets and engaged with a range of charities and not-for-profit organisations that demonstrate our social purpose and that we care about the communities where we live and work. These community partnerships vary depending on the geographic and social needs of the customers and communities served by our separate brands.

For Clydesdale Bank we have three strong partnerships aligned to our brand that demonstrate that we know our neighbourhood:

- Our community partnership with *Scotland's Charity Air Ambulance* was launched in May 2014. Our support helps keep Scotland's only charity-funded emergency air ambulance in the air and saving lives. Our staff have volunteered their skills and time to help this new charity become sustainable by fundraising, as well as sharing their marketing skills. We have helped promote the life-saving work of the charity by raising awareness on social media, online banking and ATMs as well as featuring the charity in one of our television adverts.
- The *Royal Zoological Society of Scotland* community partnership, *Wild about Scotland*, was launched in August 2014. It provides an education service for primary school children and the wider communities where they live about



Scotland's native species and natural habitat. A double decker bus has been converted into a unique classroom. The bus has visited over 330 schools across all of Scotland's 32 regions and over 37,000 people have been engaged with the programme. In 2016 we introduced planting trees at each school to help balance the emissions from the bus. To date, 420 trees have been planted. To complement the visits, online learning was launched to provide pre and post lessons for schools and pupils. In addition to the bus visiting schools and community groups, our community partnership enabled over 6,500 people from charities supporting young people and families such as Barnardo's to have a fun *Wild about Scotland* day at Edinburgh Zoo and Highland Wildlife Park that they otherwise would not have been able to afford.

Our community partnership with the *Royal Zoological Society for Scotland* received a Silver Award from the British and Irish Association of Zoos and Aquariums.

- The *Hydro* partnership was launched in 2012. One of the busiest entertainment venues in the world, it enables us to reward and engage our customers and the wider public through hospitality and seat upgrades. Our quarterly Centre Stage Programme continued to recognise deserving people for helping in their local communities and to date over 1,000 winners have benefitted from upgrades to our exclusive VIP area, The Vault, and Centre Stage places.



DELIVERING TO  
OUR STAKEHOLDERS



© Charlotte Graham

For our Yorkshire Bank brand we recognise the importance of cycling in the region and the ambitious aim for every child in Yorkshire to have access to a bike. Our *Yorkshire Bank Bike Libraries* community partnership with Welcome to Yorkshire was launched in December 2014. To date, over 4,000 bikes have been donated and there have been over 20,000 opportunities for children to borrow a bike at 32 Yorkshire Bank Bike Libraries. The bike libraries are social enterprises that have received awards of up to £10,000 from the Yorkshire Bank Bike Libraries Social Enterprise Fund. So far, over £222,000 has been awarded to libraries across Yorkshire.

Our support for the Tour de Yorkshire (TdY) was established in March 2015. Yorkshire Bank is an official Partner of TdY and sponsors the Sprinter Jersey. Our sponsorship enabled us to raise awareness of our community support for cycling via the Yorkshire Bank Bike Libraries initiative. Activities around the event included supporting materials and competitions in our Yorkshire Bank branches, online activities, customer communication and television advertising. The social activity reached over 32m people and the media activity reached over 20m people. The event proved very popular on the ground and over 2m people lined the streets to watch the three day event. Thousands took part in the free fun activities that we organised in our marquees at the start and finish lines each day.

In addition to the partnerships described above, a number of our colleagues working within the broader bank framework have actively been involved in their communities with both the bank and some of our staff being nationally recognised:

- May 2016 - The Banks were awarded the HM Government Platinum Payroll Giving for 20% of our employees donating through Payroll Giving.
- November 2015 - Clydesdale & Yorkshire Banks awarded Outstanding Contribution to Hospice Care – Hospice UK awards.
- Amy Robertson, Craig J Ryce, Sarah Lindsay, Patricia Khan, David H Black, Thomas Mathie, Emma Cooke and Stevie Quinn from Business Change won Volunteering Team of the Year through Business in the Community Scotland in recognition of their support of the charity Possibilities for Each & Every Kid (PEEK), a former winner of Clydesdale Bank's Spirit of the Community Awards in 2014.
- April 2016 - Kevin Elliot, Head of Business & Private Banking at Yorkshire Bank in South Yorkshire, received a national award for volunteering, celebrating his commitment to helping young people gain the skills they need for career success. The award, given by national charity Career Ready, recognises Kevin's hard work in giving his time, energy and passion to support young people as they prepare for the world of work.

Priorities for 2016/17

Continue to deepen our relationships with the communities we are part of through our employees who donate their time and skills; develop brand partnerships that align to our strategy and provide a range of charitable support, including financial education, through our independent Charitable Foundation.

Environment

As well as our commitment to our customers and communities, we believe in the importance of doing this in the most sustainable way. This is not only good for the environment but is also important for the long term growth and success of the Group.

Our commitment to managing our business' environmental impact is guided by our Environmental Standard that recognises the Group's commitment to meet key legislative compliance requirements and voluntary commitments and covers our approach to environmental management, controls and reporting, including:

- environmental risk
- setting of environmental targets
- direct operational environmental impacts
- indirect (via customers and suppliers) impacts of our operations
- reporting and assurance
- employee awareness and community involvement
- governance

Achievements in 2015/16

By measuring, monitoring and controlling our consumption we aim to mitigate harmful impacts on the environment by conducting our business in a sustainable, ethical and responsible way. During the year, we made a contribution towards the drive for a low carbon and more resource efficient economy:

- We continued to roll out advanced building efficiency management systems as part of the branch refurbishment programme. Such systems are monitored centrally and help automate controls to ensure we only operate air conditioning units and boilers within set operational hours and can respond quickly to changes in temperatures. We have also implemented a number of energy saving initiatives including replacement of standard bulbs with LEDs and centrally monitored automated lighting controls to allow us to power down non-essential lighting when appropriate.
- During the course of the year we re-procured 100% renewable green energy for electricity contracts within the Group's direct control. We continued with a policy of no travel months in December and January and we also installed video conferencing in more locations to enable tele and video conferencing to help reduce travel. This has associated benefits for employees in terms of reducing business travel during periods when there is an increased

risk of delays due to bad weather, and has benefits for the environment in terms of reducing emissions from air, car and rail travel.

- In December 2015 we completed a review to ensure compliance with the requirements of the Energy Saving Opportunities Scheme (ESOS) and we also completed the process to obtain our Carbon Trust Standard Recertification for the next two year period and retained our ISO14001 accreditation in our Leeds offices.

In the last 12 months we have also continued to work with some of our key suppliers, in areas we can influence, to ensure products and services used in our business are environmentally sound and that any waste is minimised.

Reporting on Greenhouse Gas emissions

The reporting period for Greenhouse Gas (GHG) emissions in the Group runs from 1 July 2015 to 30 June 2016. The table below shows the Group has reduced total emissions by 7% in the last year driven both by the initiatives outlined above and changes to the property estate.

Scope	2016 CO <sub>2</sub> e tonnes	2015 CO <sub>2</sub> e tonnes
<b>Scope 1</b> emissions Generated from the gas and oil used in all buildings where 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 plant to service the Group's property portfolio. Δ	<b>3,835</b>	3,829
<b>Scope 2</b> emissions Generated from the use of electricity in all buildings from which the Group operates. Δ	<b>16,743</b>	18,216
<b>Scope 3</b> emissions Relates to business travel undertaken by all colleagues using rail, private vehicles, hired vehicles, contracted taxi services and air travel.	<b>7,630</b>	8,339
<b>Total</b>	<b>28,208</b>	30,384

Δ KPMG LLP undertook a limited assurance exercise using the assurance standards ISAE 3000 and ISAE 3410 over this GHG data.





The Humber Bridge, near Kingston upon Hull

We continue to raise awareness and the profile of environmental initiatives to ensure that all colleagues are empowered to make a difference.

DELIVERING TO  
OUR STAKEHOLDERS

Intensity Ratio

The Group has chosen to use an intensity ratio of GHG per FTE. Using FTE offers a simple way to measure and monitor our performance on emissions and is also a useful way to benchmark and compare with others.

Scope (1,2&3)	2016 CO <sub>2</sub> e tonnes	2015 CO <sub>2</sub> e tonnes
GHG emissions per average FTE	3.88	3.92

We have achieved full compliance with the Regulations for the whole of our property portfolio. The only estimated emissions in the GHG emission data relate to energy consumed in properties where the landlord controls the supply and recharges the Group via a service charge arrangement. In these instances an average rate per Kwh has been used.

Independent Assurance

KPMG LLP were engaged to undertake a limited assurance exercise using the assurance standards ISAE 3000 and ISAE 3410 over the GHG data highlighted in this report with a triangle (Δ). KPMG has issued an unqualified opinion over the selected GHG data. The full opinion can be seen on the CYBG website.

Use of Resources

Our systems and process to measure resources used are improving year on year. The table below shows how the Group has performed against five environmental targets in comparison to a baseline in June 2013. All five targets have been met and the Group is working towards establishing a new set of environmental targets and measures for the three year period to 2019. At the same time we continue to raise awareness and the profile of environmental initiatives to ensure that all colleagues are empowered to make a difference.

Area	Target	2013 Year 0	2016 Year 3	%	Target Met?
GHG (CO <sub>2</sub> emissions (tonnes))	5% reduction	33,464	28,208	-16%	Yes
Waste & Recycling (incl 2nd line)*	Increase to 98% from 82% on 2nd line	82%	100%	n/a	Yes
Water Meters	On > 90% properties	89%	94%	n/a	Yes
Water Consumption (KL)	Zero increase	84,910	77,286	-9%	Yes
Energy (GJ)	5% reduction in gas & electric usage	210,672	169,114	-20%	Yes

\* 2nd line recycling refers to waste which is manually sorted into all categories of recycling including composting and fuel. By 2016 100% of our waste was diverted from landfill.



## RISK MANAGEMENT

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy. The Group has implemented significant changes to strengthen its risk capabilities since becoming stand alone and continues to develop in line with industry developments and best practice.

### Risk Principles

The Group's approach to risk management is based on a principle that risk management capability must be embedded across all areas of the Group to be effective. This overriding principle embodies the following concepts:

- Commercial decisions are made on the basis of proactive consideration of risk and the potential impact on customers;
- Business managers use the Risk Management Framework to support decision making involving risk and reward trade offs; and
- Employees are responsible for risk management in their day to day activities.

Further detail is provided in the Risk Report from page 138.

### Risk Culture

The consistent fair treatment of customers is fundamental to the success of the Group's business model and strategy and is underpinned by a risk culture which shapes behaviours and decision making at all levels of the bank. The interests of customers, employees, shareholders and our communities are aligned to deliver the Group's strategic aim of sustainable customer growth. This is supported by a robust Risk Framework and independent Risk Management Function driven by the Group's core principles and 'We Care About Here' ethos.

A strong risk culture is founded on a risk management accountability model and formal delegation framework where personal accountability empowers employees to take ownership. It is a consideration in all people management practices, particularly performance management. It is also supported by independent escalation procedures for employees to raise concerns.

### Achievements in 2016

<b>Standalone Bank:</b>	Risk Management delivered on a number of initiatives and activities to support the IPO and transition to a standalone bank: <ul style="list-style-type: none"> <li>• The establishment of a standalone Risk Model including enhancements to the Risk Management Framework, refreshing responsibilities across the 3 Lines of Defence and delivery of Policy Standards aligned to the Group's risk profile;</li> <li>• The successful delivery of new external reporting requirements through the Pillar 3 disclosure framework;</li> <li>• The inception of a comprehensive insurance programme tailored to the Group's risk profile providing mitigation for any future loss in respect of operational or financial crime risks.</li> </ul>
<b>Commencing the IRB Journey</b>	To enhance already strong and well embedded risk management disciplines, a programme has been initiated to support the Group's objective of securing regulatory approval to adopt an IRB approach to determine Credit RWAs. This programme is also supporting changes in the Collective Provision calculations required by IFRS9 which will be adopted on 1 October 2018. (For further information on IFRS 9, please refer to pages 214 to 215).
<b>Growth</b>	<i>SME</i> - A number of operational improvements, including Lending Authority enhancements, were delivered to improve both efficiency and customer service levels.  <i>Retail</i> - To further support customers, enhancements have been made to Responsible Lending procedures and ongoing support has been provided to Digital Growth initiatives.
<b>Improving system infrastructure</b>	As part of the ongoing investment plan and to support demerger activities, system enhancements to further strengthen the Group's infrastructure have been implemented maintaining continuity of service whilst delivering new standalone systems and strengthening transaction monitoring functionality. Areas of focus have included Financial Crime, Operational Risk and certain Credit systems.
<b>Regulatory Change</b>	Significant support has been provided to enable the implementation of the Senior Managers & Certification Regimes including the design of required processes, controls and ongoing training for participants in the two Regimes.

### Priorities for 2017

<b>IRB Journey</b>	The Group continues to work towards attaining IRB accreditation alongside delivering IFRS 9 implementation. As this journey continues, Risk Management will support the new requirements whilst maintaining business as usual.
<b>Digitisation</b>	As the industry and environment in which the Group operates continues to evolve, the Group's digital operations continue to be developed through new systems, enhanced monitoring and streamlining processes whilst maintaining appropriate risk awareness.
<b>Macro Environment</b>	Whilst the Group operates in an uncertain macro environment, work continues to monitor risk profiles and ensure that appropriate mitigating actions are in place. Of particular focus is the ongoing uncertainty stemming from the vote to leave the EU and operating within a 'low for longer' interest rate environment.
<b>Transitional Service Agreement (TSA) Exits</b>	Focus remains on successfully completing the TSA exit strategy as referred to on page 36, ensuring that sufficient control and oversight is maintained.
<b>Regulatory Change</b>	The Group continues to embrace the changing regulatory environment and will remain fully compliant with all applicable current and future regulations.
<b>Balance Sheet risks</b>	The Group remains focused on maintaining the Balance Sheet strength with particular attention being paid to regulatory developments including the Countercyclical Capital Buffer (CCyB) and MREL.
<b>Growth &amp; Efficiency</b>	The Group continues to drive growth in the Lending portfolios, appetite settings will ensure controlled growth, and regulatory guidance relative to areas such as BTL will be monitored and addressed. Equally, initiatives to deliver efficiencies and simplification across the Group will be subject to continued risk assessment.
<b>Assurance Framework</b>	During FY2016, considerable progress has been made to simplify risk policies, standards and frameworks. Many benefits flow from these enhancements including greater consistency of application of the Risk Management Framework across all 3 Lines of Defence. Further steps will be taken during FY2017 to further strengthen risk capabilities, risk identification and mitigation.

## RISK OVERVIEW

### Principal risks and mitigating actions

Principal risks	Key mitigating actions
<b>Credit Risk</b> is the risk of loss of principal or interest stemming from a borrower's failure to meet contracted obligations to the Group in accordance with the terms agreed. Credit risk is evident at both a portfolio and transactional level.	<ul style="list-style-type: none"> <li>- Significant credit risk strategies, credit risk appetite and tolerances for credit risk are approved and reviewed by the Board and Board's Risk Committee, and are inherent in the Group's business model.</li> <li>- The credit portfolio is closely monitored including risk sensitivity analysis with reviews of asset quality metrics with actions initiated where required.</li> </ul>
<b>Balance Sheet &amp; Prudential Regulation Risks</b> cover a number of categories of risk, which affect the manner in which the Group can support its customers in a safe and sound manner. The risks include the need to withstand times of stress for the loss of funding (liquidity), the impact of restricted access to future sources of deposits (funding), the impact of providing a defined benefit scheme to employees (pension) and the need to withstand severe unexpected losses (capital). The Group may face changes in values of asset and liabilities as a result of movements in market factors such as interest rates, foreign exchange rates, volatility and credit spreads which may give rise to losses (Market Risks). Balance Sheet risks are subject to rules and guidance (Prudential Regulation) and these are subject to a high level of change. There is a risk of failing to understand and comply with relevant rules or inadequate change management.	<ul style="list-style-type: none"> <li>- Liquidity is managed in accordance with standards that are approved by the Board and supported by annual Funding and Contingency Funding Plans.</li> <li>- Liquidity is managed on a daily basis ensuring normal daily cash requirements are met and adequate sources of liquidity are available to support unforeseen cash outflows.</li> <li>- The Group completes a formal annual assessment of Liquidity Adequacy which is shared with the PRA; this includes analysis of key risks with consideration of stress scenarios.</li> <li>- Capital is forecast and monitored on a monthly basis by Treasury overseen by the Asset and Liability Committee.</li> <li>- The Group completes a formal annual assessment of its capital requirements which is shared with the PRA; the outcome of the process influences the allocation and quantum of capital and feeds directly into risk appetite.</li> <li>- The Group has a designated Prudential Risk team who independently monitor, oversee and challenge Balance Sheet risks.</li> <li>- The Group undertakes a detailed assessment of the capital requirements inherent in its strategy including consideration of the impact of significant loss scenarios in order to inform the Board of potential areas of weakness in the Group's business model and also to ensure an appropriate level of capital is held in both business as usual and stressed environments.</li> </ul>
<b>Regulatory and Compliance Risk</b> consists of regulatory strategy and change risk, regulatory relationship risk and the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, industry codes of conduct and voluntary initiatives.	<ul style="list-style-type: none"> <li>- The Group proactively assesses the impacts of legal and regulatory developments, liaises with the various regulatory bodies and participates in industry fora.</li> <li>- Continued and significant senior management focus and levels of business resource are directed towards maintaining full regulatory compliance and this is considered when setting Risk Appetite.</li> <li>- The Board or Executive Risk Committee approves all material changes to regulatory policy and protocols. The Group's governing principles include the management and maintenance of regulatory policies and regulatory engagement.</li> </ul>
<b>Conduct Risk</b> is defined as the risk of treating customers unfairly and / or delivering inappropriate outcomes resulting in regulatory fines, compensation, redress costs and / or reputational damage.	<ul style="list-style-type: none"> <li>- The Group has a Conduct Framework, with supporting target outcomes and operating principles.</li> <li>- Products are designed to meet customer needs and expectations, with governance processes embedded to ensure those objectives are met.</li> </ul>

Principal risks	Key mitigating actions
<b>Operational Risk</b> is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Impacts from Operational Risks arise from the day to day activities of the Group, which may result in direct or indirect losses and could adversely impact the Group's financial performance and position.	<ul style="list-style-type: none"> <li>- The Group has an established Operational Risk Framework to enable identification, management and mitigation of Operational Risks.</li> <li>- Risk categories are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.</li> <li>- Supplier relationships are categorised based on criticality of the support provided. Contingency planning focuses on alternative options and management approaches in the event of an outage with regular scenario tests performed.</li> <li>- Regular reviews and oversight of the Group's systems and infrastructure including the risk of cyber attack.</li> </ul>
<b>Financial Crime Risk</b> is the risk that the Group's Products and Services will be used to facilitate Financial Crime against the Group, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes. It also includes risks associated with external or internal acts intended to defraud, misappropriate, or circumvent existing controls.	<ul style="list-style-type: none"> <li>- The Group has an established Financial Crime Framework supporting ongoing management, monitoring and mitigation of Financial Crime Risk.</li> <li>- The Group completes ongoing risk assessments, monitoring and reporting, with appropriate Know Your Customer (KYC) procedures.</li> <li>- The Group operates zero tolerance for internal fraud and has a control framework in place to mitigate against this risk.</li> </ul>
<b>Strategic, Business and Financial Performance Risk</b> is the risk of significant loss, loss of earnings and / or damage arising from business decisions that impact the long term interests of stakeholders or from an inability to adapt to external developments.	<ul style="list-style-type: none"> <li>- The Board approves and oversees the execution of the Strategic Plan and associated strategic risk following the recommendations of the CEO and Executive Leadership Team.</li> <li>- A consolidated report outlining the triggers and exposure to strategic risk is independently prepared and presented to the Board's Risk Committee by the Chief Risk Officer (CRO).</li> </ul>
<b>People Risk</b> is the risk of not having sufficiently skilled and motivated employees who are clear on their responsibilities and accountabilities and who behave in an ethical way. This could lead to inappropriate decision making that is detrimental to customers, other employees or shareholders and could ultimately lead to Regulatory sanction.	<ul style="list-style-type: none"> <li>- Roles, responsibilities and performance expectations are defined in role profiles and expanded through objective setting and ongoing performance management.</li> <li>- The quality and continuity of our leadership is reviewed and assessed through succession planning and talent management activity.</li> <li>- Decisioning authorities and delegations are clearly articulated and approved at least annually by the Board.</li> <li>- A robust and proportionate employment screening policy is applied at the point of recruitment.</li> <li>- A mandatory suite of compliance learning is assigned to all employees.</li> </ul>



## RISK OVERVIEW

### Emerging risks

The Group monitors the environment in which it operates to identify emerging risks that may have an impact on its operations and strategy; the Group currently considers its top emerging risks to be:

<b>The UK Vote to Leave the EU (Brexit)</b>	The outcome of the EU Referendum has created a period of economic uncertainty for the UK and wider environment. Without certainty or clarity as to exit plans, a number of market commentators have predicted a slowdown in the economy. The Group has implemented appropriate monitoring and oversight activities with external implications continuing to be assessed and has, where possible, established mitigating actions.
<b>Macroeconomic environment</b>	While the Group's customer base is, and is expected to remain, predominantly UK based, its business will be subject to inherent risks arising from macroeconomic conditions in the UK and geopolitical uncertainty. The impact of the sustained low interest rate environment following the recent reduction in the BoE Base Rate places increased pressure on NIM and has an adverse effect on valuations of the Defined Benefit Pension Scheme with a resultant adverse impact on Capital. In addition, depressed oil prices may also impact economic growth and have implications relative to the Group's strategic objectives. The Group's credit portfolio continues to be monitored closely with appetite adjusted where appropriate and risk sensitivity analysis conducted on an ongoing basis. Regular assessments of strategic plans are undertaken to minimise and negate potential impacts.
<b>Separation from NAB</b>	There is a risk that the functions and processes developed and restructured as part of the separation from NAB may not operate as intended or may not have been properly created or completed, which could result in operational difficulties. TSAs and associated exit plans are in place with NAB to provide ongoing support for a small number of functions and processes over agreed timeframes. Other functions and processes already transitioned were tested for readiness and are now subject to oversight through the Group's Risk Management Framework.
<b>BTL lending</b>	Regulatory and taxation changes such as limits to the income tax relief on mortgage interest expense and additional stamp duty may result in lower yields on BTL property investments and may negatively affect mortgage supply and demand. The Group has a balanced portfolio with growth through a number of channels and products. The lending portfolio is subject to regular monitoring and stress testing. Customer affordability checks and full BTL credit assessments are conducted at the point of application. Risk Appetite includes a number of BTL measures which are regularly reviewed and adjusted as appropriate.
<b>Cybercrime and IT</b>	An inability to appropriately respond to the increased threat of cybercrime associated with digital expansion, or maintain pace with industry trends and customer expectations may materially affect the Group's financial and operational performance. The Group continues to invest and enhance information security defences in response to emerging and known threats. Procedures are in place to ensure compliance with data protection regulations by both employees and third party service providers, and to implement security measures to help prevent cyber theft.
<b>Regulatory capital requirements</b>	The Group may be impacted by certain revisions in the methodology for calculating regulatory capital which may include, amongst other things, changes to the approach for calculating the standardised approaches for credit risk and operational risk, on which the BCBS is consulting. The Group continually assesses the impact of changes to prudential requirements and, when appropriate, will seek to mitigate the impact by applying changes to business processes including the implementation of IRB.

### Banking reform, ring fencing and resolution

The relevant regulatory authorities in the UK and Europe have proposed reforms to a number of aspects of the banking sector. While the impact of these remains uncertain, the evolution of these and future initiatives may impact on the business, financial conditions and results of operations. The majority of the Group's activities are expected to be permitted activities for ring fenced banks under the proposed rules and therefore, the Group does not expect to make material changes to its current legal structure or operations.

### MREL

The BoE has published its policy to implement the Bank Recovery and Resolution Directive (BRRD) requirement for firms to meet the Minimum Requirements for own funds and Eligible Liabilities (MREL), designed to ensure firms have sufficient loss absorbing capacity and continuity of critical functions without making recourse to public funds. MREL is set annually on a case by case basis and the requirement for firms to meet MREL will be phased in between 2016 and 2022. The BoE will communicate the Group's MREL requirements. There are risks that in order to comply with MREL the Group will need to begin issuing debt instruments that satisfy MREL and this may be at a significantly higher cost to other forms of debt leading to a deterioration in the Group's financial results. Amongst other factors, the cost will be influenced by the market's response to MREL and the Group's credit rating and it is uncertain what impact MREL will have on credit ratings. MREL requirements will be applied across the industry and the relative impact on the Group compared to competitors is not known; however, there is a risk that the relative impact may adversely impact the Group's competitiveness.

### Potential changes to UK corporation tax

The UK tax environment for banking groups is unsettled. Recent material changes have included a new 8% surcharge on taxable profits (without relief for losses) from 1 January 2016, compounding the adverse impact of 2015 changes that made charges for compensation payments largely non deductible for tax. Further, from 1 April 2016, only 25% of a Bank's taxable profit can be relieved by brought forward losses, greatly increasing the horizon over which losses may be used whilst accelerating cash tax outflow. This change, enacted alongside a further reduction, to 17% from 1 April 2020, in the mainstream rate of tax, has triggered a reassessment of the carrying value of deferred tax assets and resulted in a pre-tax profit becoming a post-tax loss. Other changes announced but not yet enacted include a proposed restriction on the tax deductibility of interest and interest like amounts. Any restriction in interest expense could increase the tax charge. The application of this proposed change to Financial Services businesses remains subject to consultation between the industry and HM Treasury, with further announcements expected in draft legislation due in December 2016.

### Use of data

The EU Commission's General Data Protection Regulation is to be introduced from 25 May 2018 meaning that the Group will be subject to increased regulatory burden when processing personal customer, employee and other data in the course of its business and may be subject to increased sanctions for breach. Changes to legislation may also inhibit the Group's ability to use data to carry out its business objectives. The Payment Services Directive 2 (PSD2) requiring to be implemented from 13 January 2018, introduces changes to the use and control of customers' data. Assuming that customers provide consent, their banks will have to provide merchants, Third Party Payment Providers and Account Information Service Providers, such as aggregator sites, access to details of their bank accounts. Another feature of PSD2 is the requirement to introduce strong customer authentication systems to increase the security around payments.



## RISK OVERVIEW

### Risk Management, Internal Control & Viability Reporting

#### Assessment of principal risks

As described in the Risk Report on page 138, the Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve its strategic objectives.

In line with the UK Corporate Governance Code (the 'Code') requirements, the Directors have performed a robust assessment of the principal risks facing the Group, including those that would threaten its business model and future performance, solvency or liquidity.

The principal risks the Group actively monitors and manages are described in pages 34 to 35 of the strategic report.

#### *Risk management and internal controls*

As described in the Corporate Governance report on page 83 and the Risk Report on pages 142 to 144, the Board actively monitors the Group's risk management and internal control systems. A review of the effectiveness of those systems has been performed incorporating all material controls, including financial, operational and compliance controls.

#### Viability

In accordance with the UK Corporate Governance Code, the Directors have assessed the prospects of the Group over a three year period to 30 September 2019.

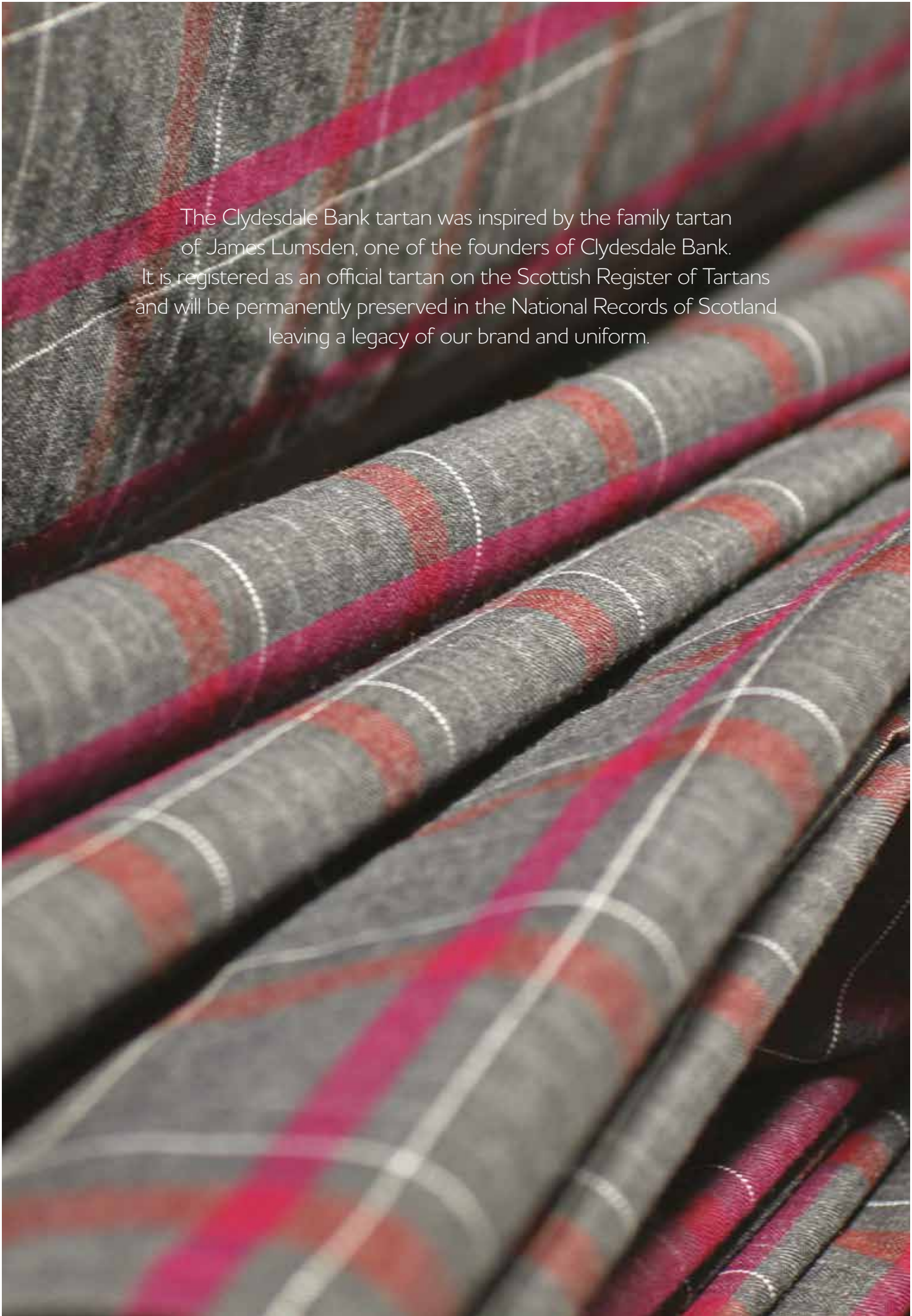
The Directors have determined that a three year period is an appropriate period over which to perform the assessment. This is the period over which forecasts have a greater level of certainty. The Board monitors a longer term strategic and financial plan which extends beyond the three year period. This longer term strategic and financial plan provides less certainty of outcome, but provides a robust planning tool against which strategic decisions can be made.

In making this assessment the Directors have considered a wide range of information, in particular, this included the Directors' robust review and challenge of the ICAAP and ILAAP, which assess the Group's future projections of capital adequacy, liquidity and funding. The Board have also considered the results of stress testing which is performed as an integral part of both the ICAAP and ILAAP. Furthermore, the Directors have considered the current state of the balance sheet, principal and emerging risks which could impact the performance of the Group and the Group's strategic and financial plan which includes future projections of profitability alongside capital funding and liquidity in a manner aligned to the ICAAP and ILAAP. The strategic and financial plan makes certain assumptions about the performance of the Group and the economic, market and regulatory environments in which it operates. To support the planning process, downside scenario analysis has been performed to consider how the Group's performance would be affected by changing economic and market conditions throughout the planning period.

Information relevant to this assessment can be found in the following sections of the annual report and accounts:

- a financial summary, including a review of the latest income statement and balance sheet is provided in the Financial Results section pages 40-57;
- the Group's capital position is included in the Balance Sheet & Prudential Regulation Risks section of the Risk Report pages 169-176;
- the Group's liquidity position is described in the Funding and Liquidity Risk section of the Risk Report pages 177-185;
- the Group's principal risks and policies and processes for managing those risks are described in the Risk Report and summarised on pages 34-35;
- the Group's emerging risks are disclosed in the Strategic Report pages 36-37;
- the Group's business model and strategy are described in the Strategic Report pages 14-19; and
- the Group's approach to stress testing and reverse stress testing are described in the Risk Report on page 146.

Based upon this assessment, the Directors have concluded that there is a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three years to 30 September 2019.



The Clydesdale Bank tartan was inspired by the family tartan of James Lumsden, one of the founders of Clydesdale Bank. It is registered as an official tartan on the Scottish Register of Tartans and will be permanently preserved in the National Records of Scotland leaving a legacy of our brand and uniform.



An aerial photograph of the London skyline at sunset. The sun is low on the horizon, casting a warm, golden glow over the city. The Shard, a tall, dark, tapering skyscraper, stands prominently on the left. To its right is The Gherkin, a distinctive, rounded building with a glass facade that reflects the sunset. Other skyscrapers and dense urban buildings fill the background and foreground. The overall atmosphere is serene and majestic.

# FINANCIAL RESULTS

SUMMARY OF GROUP RESULTS





Our business has performed well in 2016. Year on year underlying operating profits are up 9% and underlying profit before tax is 39% ahead. We have delivered sustainable balance sheet growth and made progress in managing down our cost base.

Ian Smith, Chief Financial Officer

## SUMMARY OF GROUP RESULTS

THE GROUP HAS CONTINUED TO MAKE  
PROGRESS TOWARDS ACHIEVING THE  
BUSINESS COMMITMENTS COMMUNICATED  
TO THE MARKET:

6.5%

Growth in the  
mortgage book

6.2%

Underlying growth  
in deposits

6.1%

Growth in the Core  
SME lending book

39%

Growth in underlying  
PBT to £221m

112%

LDR

12.6%

CET1

2.26%

NIM – in line  
with guidance

74%

Underlying  
CIR reduced

5.2%

Underlying RoTE  
broadly stable

The Group made a statutory profit before tax of £77m. The Group's statutory loss after tax of £164m in the year was impacted by an exceptional tax charge of £197m, following changes in tax legislation which reduced the corporation tax rate and further restricted the use of historical losses.

Group underlying profit before tax of £221m increased from £159m for the year ended September 2015; this was primarily due to an increase in operating income, reflecting a reduction in funding costs across both retail deposits and wholesale funding, and a reduction in impairment losses as a result of strong credit performance.

Key Performance Indicators are set out on page 55.



## CONSOLIDATED INCOME STATEMENT

The consolidated income statement is presented on an underlying basis which includes adjustments to present items that the Group believes are non-recurring, or not otherwise indicative of the underlying performance of the business. As explained further in note 1: Basis of Preparation, the results

shown for the year ended 30 September 2016 comprise the results of CYBG PLC consolidated with those of its subsidiaries. The comparative figures provided are those of the CYB Investments Limited Group (CYBI).

Consolidated income statement – underlying basis	2016 £m	2015 £m	2016 vs 2015 %
Net interest income	806	787	2.4
Non-interest income	183	177	3.4
<b>Total operating income</b>	<b>989</b>	964	2.6
Total operating and administrative expenses	(729)	(727)	0.2
<b>Operating profit before impairment losses</b>	<b>260</b>	237	9.3
Impairment losses on credit exposures <sup>(1)</sup>	(39)	(78)	(50.2)
<b>Underlying profit on ordinary activities before tax</b>	<b>221</b>	159	39.2
Conduct charges	(51)	(486)	
Restructuring expense	(45)	(17)	
Separation costs	(11)	(10)	
Net gain on capital and debt restructuring <sup>(2)</sup>	1	61	
Pension increase exchange gain	-	18	
Loss on impairment of intangible assets	(45)	(10)	
Gain on disposal of VISA share	7	-	
<b>Statutory profit/(loss) on ordinary activities before tax</b>	<b>77</b>	(285)	
Tax (charge) / credit	(241)	56	
<b>Statutory loss for the year</b>	<b>(164)</b>	(229)	

<sup>(1)</sup> Impairment losses on credit exposures relate solely to loans and advances to customers (refer to notes 16 and 17 to the financial statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in other assets and liabilities at fair value within non-interest income (refer to notes 6 and 14 to the financial statements).

<sup>(2)</sup> Includes a £1m gain on debt restructuring. The comparative period includes gains of £2m on debt restructuring, and a gain of £61m and a loss of £2m in relation to capital restructuring (refer to notes 6, 7 and 12 to the financial statements).

The Group made a statutory loss after tax of £164m in the current year which is 28% lower than the statutory loss after tax of £229m for the year to September 2015. The 2016 loss was primarily due to the write-off of deferred tax assets as a result of the enactment of Finance Bill 2016, reflecting the inherent uncertainty in the UK's approach to the taxation of Banking Groups.

The 2016 result also included a charge of £45m for restructuring and £45m for impairment of intangible assets. This impact was offset by lower conduct provisions driven by the impact of the Conduct Indemnity Deed with NAB.

## INCOME ANALYSIS

	2016 £m	2015 £m	2016 vs 2015 %
<b>Net interest income</b>			
Interest income and similar income	1,101	1,110	(0.8)
Interest expense and similar charges	(295)	(323)	(8.7)
<b>Total net interest income</b>	<b>806</b>	787	2.4

Net interest income increased by £19m (2.4%) from £787m to £806m. Gross interest income and similar income decreased in the year by £9m (0.8%) from £1,110m to £1,101m. Mortgage interest income grew due to the successful execution of our strategy to increase the size of the mortgage portfolio. The balance growth of 6.5% was well above system growth of 3.2%<sup>(1)</sup>. Interest income from SME lending fell marginally in the year due to lower average volumes and continued managed run off of the non-core portfolio. SME lending returned to growth in the year driven by the core book which grew by 6.1%. Unsecured personal lending interest income also fell in the year as a result of the decline in both the size of the book and lower customer interest rates. The decline was largely driven by the personal loan book, in a highly competitive market environment, where for much of the year the returns on the overall book were unattractive to the Group.

Gross interest expense reduced in the year from £323m to £295m. The main driver behind this is the reduction in average wholesale balances, replaced by growth in higher quality and lower cost customer funding, in particular savings accounts. In addition to this there was a continuation of the managed reduction in term deposit costs as more expensive term deposits were replaced at cheaper rates with volumes remaining broadly flat.

Structural hedges are used to minimise the volatility on income related to customer deposits and the Group's capital. Balances are hedged with interest rate swaps and the tenor is based on the expected life of the liabilities. During FY2016, the notional size of the hedge increased to £14.4bn and covered approximately £8.3bn of non and low interest bearing liabilities, £2.7bn of administered deposits and £3.4bn of equity. Notional Interest income from structural hedging was £86m (FY2015: £79m).

	2016 £m	2015 £m	2016 vs 2015 %
<b>Non-interest income</b>			
Gains less losses on financial instruments at fair value	9	2	Large
Fees and commission	151	144	4.5
Net fair value movement on investment properties	(1)	(1)	(36.9)
Other income	24	32	(25.6)
<b>Total underlying non-interest income</b>	<b>183</b>	177	3.4
Net gain on capital and debt restructuring	1	63	99.1
Gain on disposal of VISA share	7	-	Large
<b>Total statutory non-interest income</b>	<b>191</b>	240	(20.7)

Non-interest income reduced by £49m (20.7%) from £240m to £191m. The key driver in the reduction was the net gain on capital and debt restructure in 2015 which was not repeated in 2016. Underlying non-interest income increased from £177m to £183m in 2016. Fees and commissions across the industry remain under pressure and have been impacted by the European Interchange Fee Regulation which came into full effect from December 2015. Business lending non-interest

income fell in the year in line with average balances and also reflected the impact of the fee-free campaign for new Business Current Account customers. Fees and commission income benefitted by £13m following the transfer of the UK intermediary business from NAB to CYBG on 30 September 2015. This income primarily relates to commissions from third parties on the sales of insurance to CYBG customers. The other income streams were broadly in line with the prior year.

<sup>(1)</sup> System growth is sourced from the BoE "Mortgages outstanding by type of lender, UK (BOE)" report (MM4).

## OPERATING AND ADMINISTRATIVE EXPENSES

	2016 £m	2015 £m	2016 vs 2015 %
Operating and administrative expenses			
Personnel expenses	280	282	(0.6)
Depreciation and amortisation expense	88	83	6.0
Other operating and administrative expenses:	361	362	(0.2)
of which operating lease rentals	30	32	(6.4)
of which other occupancy charges	38	38	(0.1)
of which related entity charges	5	18	(73.9)
of which other operating and administrative expenses	288	274	5.2
<b>Total underlying operating and administrative expenses</b>	<b>729</b>	<b>727</b>	<b>0.2</b>
Conduct charges	51	486	(89.5)
Restructuring expense	45	17	Large
Separation costs	11	10	4.6
Pension increase exchange gain	-	(18)	(100.0)
Loss on impairment of intangible assets	45	10	Large
Loss on capital restructure	-	2	(100.0)
<b>Total statutory operating and administrative expenses</b>	<b>881</b>	<b>1,234</b>	<b>(28.6)</b>

Statutory operating and administrative expenses decreased by £353m (28.6%) driven by lower charges of a one-off nature, in particular lower conduct charges principally reflecting the impact of the Conduct Indemnity Deed. Total underlying expenses were broadly flat and moved from £727m in FY2015 to £729m in FY2016, reflecting an improvement versus the IPO guidance of £762m, delivered by strong cost control in the second half of the year. There was a reduction in personnel expenses due to the continued reduction in FTEs over the period, despite the non-recurrence of a bonus write back

credit of £9m recognised in 2015. During the year CYBG ran a voluntary severance programme which led to c.150 FTEs leaving from across the business. Core FTEs at 30 September 2016 were 6,313, being 535 lower than the prior year.<sup>(1)</sup>

The benefits from a reduction in related entity charges of £13m were offset by additional ongoing costs from the operation of the Group as an independent, listed PLC of £38m. This increase has been mitigated by a stringent approach to cost control across all categories.

	2016 £m	2015 £m	2016 vs 2015 %
Impairment losses on credit exposures	(39)	(78)	(50.2)

Impairment losses on credit exposure have reduced by £39m (50.2%) from £78m to £39m. The benign credit environment, prudent underwriting standards and controlled risk appetite have all contributed to the £28m (30.4%) reduction in the level of specific provisions. The reduced impairment charge also reflects write backs from provisions previously recognised of £18m (2015: £12m) which incorporates an £8m benefit from the sale of previously written off unsecured retail debt (2015: £Nil). There

was a net increase in the level of collective provision of £13m (9.4%) reflecting the growth in customer loans and the migration of previously categorised loans to the performing portfolio which on returning to performing attract a collective provision charge. Increased collective provision levels also reflect some downward pressure on the oil & gas and agriculture sectors which have had a softening effect on the portfolios.

<sup>(1)</sup> Core FTEs excludes FTEs who are involved in legacy conduct remediation activities.

## TAX (EXPENSE)/CREDIT

Tax (expense)/credit	2016 £m	2015 £m	2016 vs 2015 %
Tax expense on underlying profit	(44)	(24)	80.3
Other tax expense	(197)	80	Large
Tax (expense) /credit on statutory profit / (loss)	(241)	56	Large
UK Corporation tax rate	20.0%	20.5%	
Effective tax rate – Underlying Profit	20.2%	15.2%	
Effective tax rate – Statutory Profit	313.3%	19.8%	

The statutory effective tax rate of 313.3% is driven by the write off of deferred tax assets on losses.

further restricted banks' ability to offset tax losses. Further detail is provided in note 23.

The material deferred tax charge is largely a result of the derecognition of tax losses valued at £237m following changes to tax legislation enacted in September 2016, which

The underlying profits of the Group were taxed at an effective rate of 20.2%.

## SUMMARISED CONSOLIDATED AVERAGE BALANCE SHEET

Balance sheet (average balances)	2016 £bn	2015 £bn	2016 vs 2015 %
Total assets	39.0	38.7	0.8
Interest earning assets	36.3	35.8	1.3
Customer loans <sup>(1)</sup>	29.4	28.2	4.2
Customer deposits <sup>(2)</sup>	26.3	25.1	4.6

<sup>(1)</sup> Customer loans include gross loans and advances to customers, loans designated at fair value through profit or loss and amounts due from customers on acceptances.

<sup>(2)</sup> Customer deposits include both interest and non-interest bearing accounts and deposits.



## NET INTEREST MARGIN ANALYSIS

	2016			2015		
	Average balance £m	Interest income/ (expense) £m	Average yield/ (rate) %	Average balance £m	Interest income/ (expense) £m	Average yield/ (rate) %
<b>Interest earning assets:</b>						
Mortgages	21,261	672	3.16	19,576	647	3.31
SME lending <sup>(1)</sup>	6,904	263	3.80	7,339	278	3.78
Unsecured personal lending	1,216	119	9.76	1,274	138	10.83
Liquid assets	6,001	31	0.51	6,781	36	0.53
Due from other banks	680	2	0.30	-	-	-
Due from related entities <sup>(2)</sup>	195	1	0.37	810	3	0.40
Swap income / other	-	13	-	-	8	-
<b>Total average interest-earning assets</b>	<b>36,257</b>	<b>1,101</b>	<b>3.04</b>	35,780	1,110	3.10
<b>Total average non interest-earning assets</b>	<b>2,759</b>			2,928		
<b>Interest bearing liabilities:</b>						
Current accounts	10,701	(11)	(0.10)	10,416	(12)	(0.11)
Savings accounts	8,034	(63)	(0.78)	7,171	(54)	(0.75)
Term deposits	5,397	(114)	(2.11)	5,500	(129)	(2.35)
Other wholesale deposits	70	(1)	(0.95)	96	(1)	(0.85)
Debt securities in issue	4,163	(87)	(2.11)	3,868	(82)	(2.11)
Due to other banks	977	(8)	(0.84)	978	(5)	(0.54)
Due to related entities <sup>(2)</sup>	303	(11)	(3.54)	1,956	(40)	(2.07)
<b>Total average interest-bearing liabilities</b>	<b>29,645</b>	<b>(295)</b>	<b>(1.00)</b>	29,985	(323)	(1.08)
<b>Total average non interest-bearing liabilities</b>	<b>5,906</b>			5,693		
<b>Total average equity attributable to ordinary equity holders</b>	<b>3,465</b>			3,030		
<b>Net interest margin</b>	<b>2.26%</b>			2.23%		

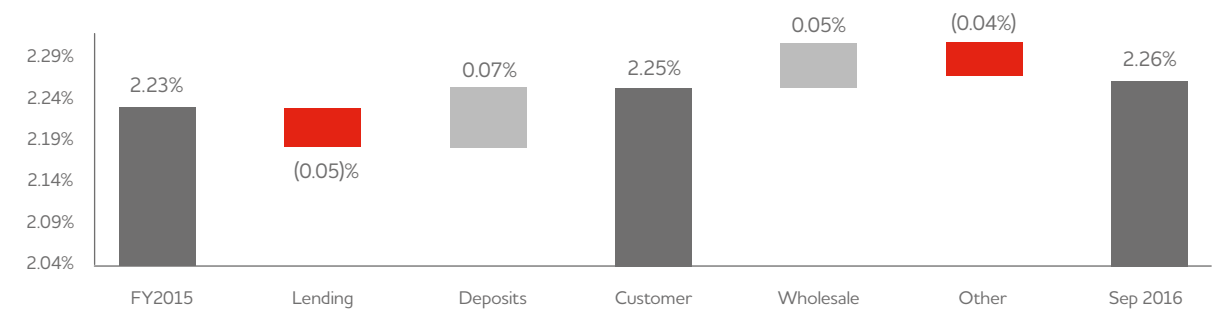
<sup>(1)</sup> Includes deferred fee income and loans designated at FVTPL.

<sup>(2)</sup> The average for the year includes the related party balances with NAB for the four months to January 2016. Effective from 8 February 2016 these have moved to the relevant third party lines.

The net interest margin increased by 3bps to 2.26% (2015: 2.23%). This increase was predominantly driven by the Group's management of its interest bearing liabilities. Lending yields reduced in the period driven by competition and swap rate movements, resulting in a broadly flat customer margin. Liquid assets remained comfortably above the levels required by the Regulator and the Group's overall liquidity asset rule (OLAR).

## NET INTEREST MARGIN ANALYSIS

NIM Waterfall



Lending margin declined by 5bps, driven by lower volumes and pricing in unsecured personal loans as price competition in the market remained intense coupled with an increase in promotional 0% interest rate balances on credit cards. Gross mortgage yields also reduced as mortgage market pricing mirrored the reduction in weighted average swap rates which reduced from 1.17% in FY2015 to 0.97% in FY2016 while mix also had an impact on the margin as the balance of higher margin SVR mortgages continued to fall. These reductions were partially offset by the benefits of growth in core SME lending and the continued run off of lower yielding non-core SME assets.

The improvement in the deposit margin of 7bps reflected the impact of the run off of non-core corporate deposits (4bps), which also led to lower required levels of low yielding liquid assets, and the managed reduction of relatively higher cost term deposit balances (4bps) along with the benefits of repricing activity in the year. This was partly offset by an increase in savings margins due to higher Cash ISA balances recruited in the second half of FY2015.

Wholesale funding costs have driven 5bps of NIM benefit as a result of a reduction in balances and an improved mix of wholesale liabilities.

## CUSTOMER LOANS

Customer loans as at 30 September <sup>(1)</sup>	2016 £m	2015 £m
Mortgages	21,836	20,504
SME lending		
- Core	6,358	5,992
- Non-core	800	1,070
Unsecured personal lending	1,153	1,218
<b>Total customer loans</b>	<b>30,147</b>	<b>28,784</b>
Loans and advances to customers	29,396	27,687
Other financial assets at fair value	747	1,093
Due from customers on acceptances	4	4
<b>Total customer loans</b>	<b>30,147</b>	<b>28,784</b>

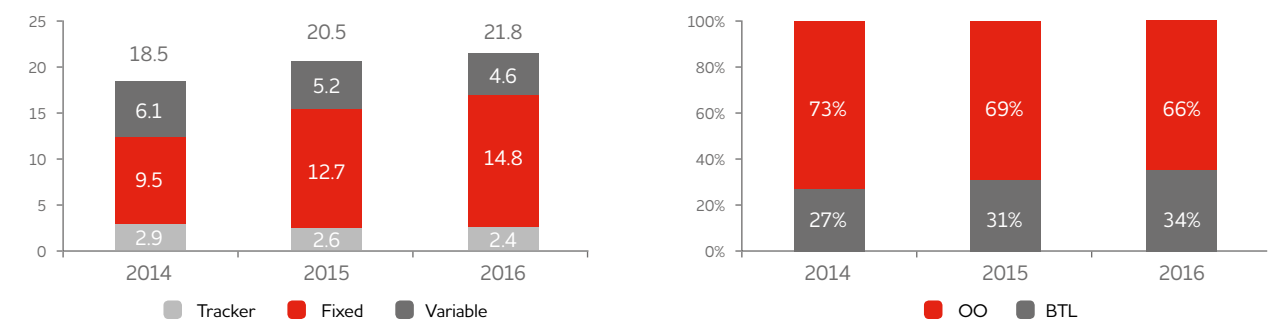
<sup>(1)</sup> Spot balances excluding accrued interest receivable provisions for impairments and unearned income.

Customer loans increased by £1,363m (4.7%) from £28,784m at 30 September 2015 to £30,147m at 30 September 2016, driven by strong growth in mortgages. SME lending balances increased year on year, with strong growth in the Core SME book being partly offset by the continued run off of the

non-core book. Unsecured personal lending reduced in the period reflecting the competitive market environment for fixed rate personal loans, partly offset by a return to growth in credit cards.

## MORTGAGES

Total Mortgage Book Split by Product and Mortgage Type (£bn)



Mortgages comprise the Group's largest asset portfolio and have a significant impact on its overall financial performance. The mortgage portfolio increased by 6.5% from £20,504m at 30 September 2015 to £21,836m at 30 September 2016. This was higher than system growth of 3.2%<sup>(1)</sup>. Gross origination in the year was £4,914m (2015: £4,935m). The growth in the year reflected the strong performance in and our commitment to the intermediary market, alongside continued investment in the branch network.

Growth slowed down in the second half of the year which was in part due to the impact of changes to Stamp Duty on BTL properties on 1 April 2016, which brought forward demand from the second half to the first half.

Whilst in the second half the Group continued to grow above market rates, the overall market slowed; this has been attributed by some external commentators to the impacts of the UK referendum decision to withdraw from the European Union (EU).

The stock portion of BTL mortgages increased from 31% as at September 2015 to 34% as at September 2016 and included the impact of the surge in demand relating to the changes in Stamp Duty.

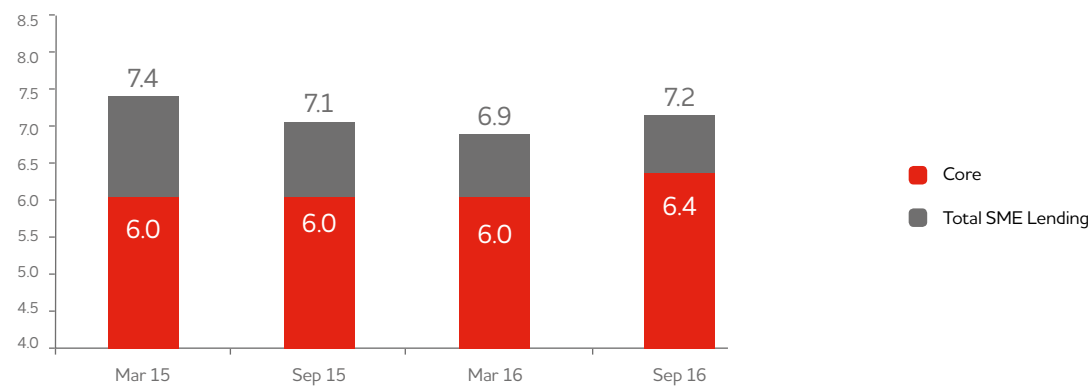
Growth continues to be predominantly through fixed rate mortgages, which accounted for 93% of mortgages drawn in the year.

<sup>(1)</sup> System growth is sourced from the BoE "Mortgages outstanding by type of lender, UK (BOE)" report (MM4).

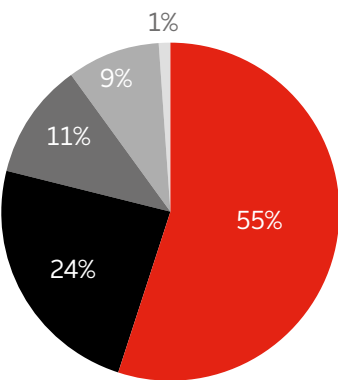


SME LENDING

SME Lending Total Book vs Core Book (£m)



2016 Gross New Loans & Facilities - SME Lending

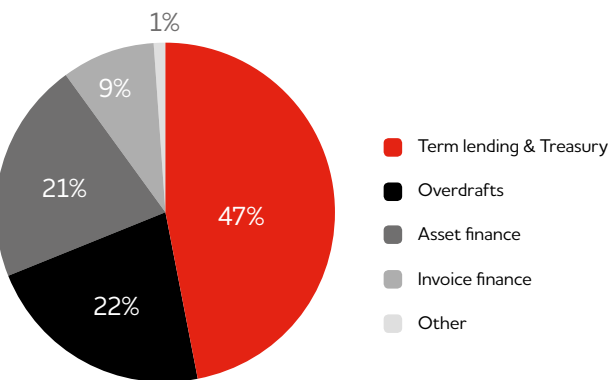


SME lending grew in the year from £7,062m at 30 September 2015 to £7,158m at 30 September 2016. The SME lending portfolio has been revitalised and the core book has returned to growth. The core book grew at 6.1% versus system growth of 2.2%<sup>(1)</sup>, increasing from £5,992m at 30 September 2015 to £6,358m at 30 September 2016.

The Group continues to run off the non-core portfolio which has fallen from £1,752m at September 2014 to £800m.

Origination activity improved in the year with a 15% increase in volumes of loans and facilities granted, and the book is well diversified across the product portfolio.

2015 Gross New Loans & Facilities - SME Lending



Unsecured personal lending

The Group's unsecured personal lending portfolio comprises credit cards, personal loans and overdrafts originated through branches or by way of digital or other direct channels. Unsecured personal lending balances decreased by 5.4% from £1,218m at 30 September 2015 to £1,153m at 30 September 2016. This was primarily due to reduced appetite for personal loan volumes via our digital platform, after competitive pressures reduced margins to unattractive levels. This impact offset an increase in origination via the branch network and direct (telephone) channel in the year. Credit card balances grew slightly in the year primarily as a result of competitive offers available to customers for the majority of the year.

<sup>(1)</sup> System growth is sourced from the BoE 'Industrial analysis of monetary financial institutions' lending to UK residents' report (c1.2), and excludes individuals and individual trusts, activities auxiliary to financial intermediation, insurance companies & pension funds and financial intermediation (excluding insurance and pension funds) results.

CUSTOMER DEPOSITS  
AS AT 30 SEPTEMBER

Customer deposits as at 30 September<sup>(1)</sup>

	2016 £m	2015 £m
Current accounts	13,248	12,982
Variable rate savings accounts	8,240	7,790
Fixed rate term deposits	5,500	5,483
Other wholesale deposits	12	94
Total customer deposits	27,000	26,349
Due to customers	26,954	26,282
Other financial liabilities at fair value	46	67
Total customer deposits	27,000	26,349

<sup>(1)</sup> Spot balances excluding accrued interest payable.

Customer deposits increased by £651m (2.5%), from £26,349m at 30 September 2015 to £27,000m at 30 September 2016, primarily due to an increase in current accounts and variable rate savings accounts.

Current accounts

Funding provided by current accounts increased by £266m (2.0%) from £12,982m at September 2015 to £13,248m at September 2016. There have been positive impacts from the £150 switching offer which was in place in the first half, the 25 month fee free offer on BCAs, as well as the launch of B (spot balance as at September 2016: £42m). These were offset by the managed run off of £740m non-core corporate deposits. Excluding this, underlying current account growth was 8.2%.

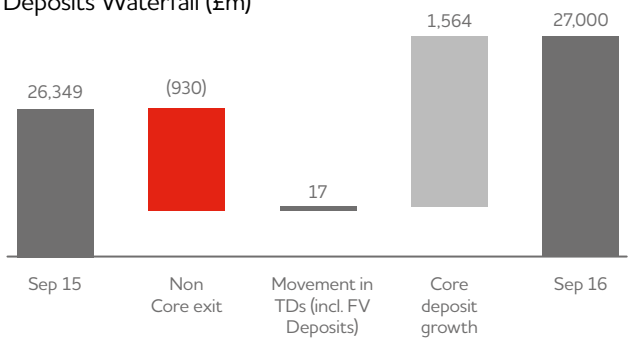
Savings accounts

Variable rate savings account balances increased by £450m (5.8%) from £7,790m at 30 September 2015 to £8,240m at 30 September 2016 primarily driven by a substantial increase in ISAs due to attractive pricing, with additional benefit from strong early performance on B savings (spot balance as at September 2016: £151m). This was in part offset by outflows as a result of ratings-sensitive customers exiting in response to credit rating changes following separation from NAB.

Fixed rate term deposits

Fixed rate term deposits increased by £17m (0.3%) from £5,483m at 30 September 2015 to £5,500m at 30 September 2016, driven by subdued market demand and in line with the Group's ongoing strategy to proactively run off the higher rate part of the book that originated in 2012.

Deposits Waterfall (£m)



Although total customer deposit balances have shown modest growth in the year, there was strong underlying growth within core customer deposits.

Offsetting this was the active run off of £740m of non-core corporate deposits and further outflows of £190m (of which £162m relates to savings) as a result of ratings sensitive customers exiting the bank following separation from NAB. The small net increase in term deposits incorporated the ongoing run off of higher cost term deposits which in many cases had no other customer relationship.

## CAPITAL AND FUNDING

### Debt securities

	2016 £m	2015 £m
Debt securities in issue as at 30 September <sup>(1)</sup>		
Retail mortgage backed securities (RMBS)	3,208	3,031
Covered bonds	797	721
Subordinated debt	477	-
Related party <sup>(2)</sup>	-	382
<b>Total debt securities in issue</b>	<b>4,482</b>	<b>4,134</b>

<sup>(1)</sup> Spot balances excluding accrued interest payable.

<sup>(2)</sup> Lannraig note issuance to NAB are now included in RMBS as they have moved from related to third party following the demerger and IPO.

Debt securities in issue increased by £348m (8.4%) from £4,134m at 30 September 2015 to £4,482m at 30 September 2016. A new Lanark note of £750m was issued in August 2016, the first major issuance post Brexit reflecting the strength of the franchise. This was offset by redemption of the remaining outstanding principal on the USD800m

Lanark 2012-2 1A, USD300m Lanark 2013-1A and £350m Lanark 2013-1B notes in line with the scheduled programme terms. Subordinated notes of £475m were issued to NAB upon demerger and subsequently successfully re-marketed to external investors in September 2016.

### Capital and Funding

	Capital change (bps)	CET1
Opening % 30 September 2015		13.2%
Underlying capital generated	123	
Absorbed by business growth	(75)	
AT1 distributions	(18)	
<b>Core business - net capital generated</b>	<b>30</b>	
Restructuring provisions	(21)	
Pension movements	(51)	
Conduct provisions	(26)	
Other	8	
<b>Closing % 30 September 2016</b>		<b>12.6%</b>

Whilst RWAs increased by £802m and the Group was required to absorb short term volatility in the IAS 19 pension position, underlying capital generation of 123bps ensured the CET1 ratio remained robust at 12.6%.

The Group continues to have a strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and management of liquidity risk, at an appropriate cost. The blended cost of deposits has reduced from 78bps to 72bps driven by re-pricing of more expensive term deposits. The overall blended cost of funding has reduced from 108bps to 100bps through the repricing of term deposits and a reduction in expensive wholesale funding, principally from the Group's historical owner NAB

which was repaid in advance of separation. The LDR increased from 109% to 112% due to growth in customer lending combined with a managed reduction in short term corporate deposits.

The Group's capital requirements are set by the PRA, consisting of an Individual Capital Guidance plus Capital Buffer Requirements and the Group had a surplus to these requirements at 30 September 2016. This included a Pillar 2A requirement set at 5.7% of RWAs, 3.2% of which must be met by CET1 capital.

In October the PRA updated the Group's capital requirements which included a revised Pillar 2A requirement to 4.6% of RWAs, 2.6% of which must be met by CET1 capital.

## KEY PERFORMANCE INDICATORS<sup>(1)</sup>

12 months to:	30 Sep 2016	30 Sep 2015*
<b>Profitability:</b>		
NIM <sup>(1)</sup>	2.26%	2.23%
Underlying return on tangible equity (RoTE)	5.2%	5.1%
Underlying cost to income ratio (CIR)	74%	75%
Underlying return on assets	0.45%	0.35%
Underlying basic earnings per share (EPS)	16.2p	14.3p
Statutory RoTE	(7.2)%	(10.3)%
Statutory CIR	88%	120%
Statutory return on assets	(0.42)%	(0.59)%
Statutory basic loss per share	(22.5)p	(28.7)p
<b>As at:</b>	<b>30 Sep 2016</b>	<b>30 Sep 2015</b>
<b>Asset Quality:</b>		
Bad and doubtful debt charge to average customer loans	0.09%	0.21%
90+ days past due (DPD) to customer loans	0.50%	0.50%
Gross impaired assets to customer loans	0.77%	0.91%
Specific provision to gross impaired assets	30.8%	39.2%
Total provision to customer loans	0.79%	0.93%
Indexed loan to value (LTV) of mortgage portfolio	54.3%	55.3%
<b>Regulatory Capital<sup>(2)</sup>:</b>		
CET1 ratio	12.6%	13.2%
Tier 1 ratio	15.0%	15.7%
Total capital ratio	18.2%	18.9%
Leverage ratio	6.8%	7.1%
<b>Funding and Liquidity:</b>		
Loan to deposit ratio (LDR)	112%	109%
Liquidity coverage ratio (LCR)	140%	131%
Net stable funding ratio (NSFR)	124%	120%

\*As explained further in note 1: Basis of preparation, the results shown for the year ended 30 September 2016 comprise the results of CYBG PLC consolidated with those of its subsidiaries. The comparative figures provided are those of CYBI.

<sup>(1)</sup> For a definition of each of the Key Performance Indicators, refer to the Glossary.

<sup>(2)</sup> The capital ratios include unverified profits. Comparative disclosures have been amended to conform with the current period's presentation.



## IMPAIRMENT ANALYSIS – LENDING AND PROVISIONS

	2016	2015
<b>Impairment charge on credit exposures (£m)</b>		
SME lending (including lease finance)	31	45
Retail lending	8	33
	39	78
Of which		
Specific charge for impairment losses	25	73
Collective charge for impairment losses	14	5
	39	78
<b>Impairment Provisions held on credit exposures (£m)</b>		
SME lending (including lease finance)	157	168
Retail lending	58	62
	215	230
Of which		
Specific provision	64	92
Collective provision	151	138
	215	230
<b>Credit risk adjustments held on loans at fair value (£m)</b>		
SME lending	24	38
Of which		
Individually assessed credit risk adjustments	8	11
Collectively assessed credit risk adjustments	16	27
	24	38
Impairment charge / (credits) on loans held at fair value	(11)	(18)
<b>Past Due and impaired assets (£m)</b>		
90+ DPD	150	143
Impaired assets <sup>(1)</sup>	233	263
<b>Asset Quality measures (%)</b>		
90+ DPD plus impaired assets to customer loans	1.27%	1.41%
Specific provisions to impaired assets <sup>(2)</sup>	30.8%	39.2%
Net write-offs to customer loans <sup>(3)</sup>	0.18%	0.35%
Total provision to customer loans <sup>(4)</sup>	0.79%	0.93%
Total impairment charge to average customer loans <sup>(5)</sup>	0.09%	0.21%

<sup>(1)</sup> Impaired assets for September 2016 and September 2015 includes £19m and £25m of impaired fair value loans respectively.

<sup>(2)</sup> Total specific provision includes the individually assessed credit risk adjustments on loans at fair value.

<sup>(3)</sup> Net write-offs includes loans at fair value.

<sup>(4)</sup> Total provision to customer loans includes the credit risk adjustments on loans at fair value through profit and loss.

<sup>(5)</sup> Total impairment charge to average customer loans includes loans held at fair value through profit and loss.

The Group's strategy to target selective areas for balance sheet growth particularly through mortgage origination has influenced the low impairment charge. High underwriting standards and a controlled risk appetite have resulted in a portfolio with strong asset quality which has, in turn, led to a low impairment charge to average customer loans ratio across all portfolios. Most asset quality measures improved in the period as the influence of a strong customer focused culture, prudent risk management and a stable UK economy took effect. Some economic pressure on the oil & gas and agriculture sectors has had a softening effect on the portfolios, evidenced by an increased level of collective provision. While the portfolio remains sensitive to economic shocks, broader based negative effects from Brexit have yet to be observed and prolonged economic stability underpinned by low interest rates and higher employment has supported customer confidence.

Retail asset quality remains strong with lower default rates and impairment losses observed across the period. The 'lower for longer' interest rate environment has sustained customer confidence, supporting strong growth in the mortgage portfolio and stable asset quality.

The level of impairment losses on credit exposures has reduced significantly in the period to September 2016 due to the lower levels of specific provision required, reflective of the reduction in the levels of defaulted and impaired lending. Stabilisation of asset values has also supported recoveries and write backs from provisions previously recognised.

Detailed credit risk disclosures are included in the Risk Report from page 148.



A photograph of the Ribblehead Viaduct, a long stone railway bridge with multiple arches, stretching across a green valley. The sky is blue with wispy clouds. In the foreground, there is a stream and tall grass. A person is visible on a path in the lower left.

# GOVERNANCE



# BOARD OF DIRECTORS



STANDING (left to right)

David Bennett  
Deputy Chairman

Fiona MacLeod  
Independent Non-Executive Director

Dr Teresa Robson-Capps  
Independent Non-Executive Director

Jim Pettigrew  
Chairman

Clive Adamson  
Independent Non-Executive Director

Debbie Crosbie  
Executive Director and Chief Operating Officer

Paul Coby  
Independent Non-Executive Director

Ian Smith  
Executive Director and Chief Financial Officer

SITTING (left to right)

David Browne  
Independent Non-Executive Director

David Duffy  
Executive Director and Chief Executive Officer

Tim Wade  
Independent Non-Executive Director

Richard Gregory OBE  
Senior Independent Non-Executive Director

Not shown  
Adrian Grace  
Independent Non-Executive Director

## BOARD OF DIRECTORS

Chair Remuneration Committee Risk Committee Audit Committee Governance & Nomination Committee

### Non-Executive Directors



**JIM PETTIGREW**  
Chairman

G Re

**Joined the Group:** September 2012 and became Chairman in 2014

**Key areas of expertise:** Finance, Governance, M&A

**Skills and experience:** Jim has over 30 years' experience in business and finance gained from executive and senior positions principally within financial services. Jim was formerly Chief Executive Officer at CMC Markets plc, Chief Operating Officer at Ashmore Group plc, Group Finance Director at ICAP plc and Deputy Group Finance Director and Group Treasurer at Sedgwick Group plc. He is a chartered accountant and has extensive Non-Executive Director experience in a listed environment. He was previously

Non-Executive Director at Aberdeen Asset Management PLC, Non-Executive Director at AON UK Limited and Non-Executive Director at Hermes Fund Managers Limited. He is the immediate past President of the Institute of Chartered Accountants of Scotland. His breadth of experience, credibility with key stakeholders and strong leadership qualities make him an effective Chairman.

**Key external appointments:** Chairman of The Edinburgh Investment Trust plc; Senior Independent Non-Executive Director of Crest Nicholson Holdings plc; Deputy Chairman of RBC Europe Limited; Chairman of Scottish Financial Enterprise; and Deputy Chairman of the Financial Services Advisory Board.



**DAVID BENNETT**  
Deputy Chairman

A G Re Ri

**Joined the Group:** October 2015

**Key areas of expertise:** Finance, M&A, Retail Banking

**Skills and experience:** David brings to the Board significant experience in retail banking gained from a career spanning more than 30 years and including executive and senior roles in both the UK and internationally. David was Group Finance Director of Alliance & Leicester plc for six years before becoming its Group Chief Executive. Following the acquisition of Alliance & Leicester plc by Banco Santander he was appointed Executive Director on the Board of Abbey National plc. His in-depth

experience of retail banking and involvement in organisational, operational and structural change is invaluable as we execute our Group strategy. He has significant Non-Executive Director experience in a listed environment which has included Non-Executive Director of Bank of Ireland (UK) plc, Non-Executive Director of easyJet plc, and Non-Executive Director of CMC Markets plc.

**Key external appointments:** Non-Executive Director of Ashmore Group plc, PayPal (Europe) S.a.r.l et Cie, S.C.A., Chairman of Homeserve Membership Ltd. and Non-Executive Director of various companies within the Jerrold Holdings Limited group.



**RICHARD GREGORY**  
OBE  
Senior Independent  
Non-Executive Director

Ri A G

**Joined the Group:** March 2000

**Key areas of expertise:** Risk, Retail Banking, SME Banking

**Skills and experience:** Richard has an extensive background in the banking, broadcasting, digital media, healthcare and higher education sectors. He had a 22 year executive career in TV programming and broadcasting and retired as Managing Director Broadcasting of Yorkshire TV in 2002. He is a strong advocate of the Clydesdale and Yorkshire Bank brands and is an ambassador for Yorkshire Bank in the business community and at customer events as Yorkshire Bank Chair. He has significant

experience at Board level as an Executive, Non-Executive Director and Chairman. He was previously Chairman of Chesterfield Royal Hospital NHS Foundation Trust, Science City York CLG; Imagesound PLC, Sheffield Hallam University, Yorkshire Innovation, Chairman of Yorkshire Initiative International Business Convention Limited, Deputy Chairman of Yorkshire Forward, and Chairman of the Yorkshire Bank Pension Trust. He was previously a Non-Executive Director of Sheffield Children's Hospital NHS Foundation Trust.

**Key external appointments:** Interim Chairman of the Derbyshire Healthcare NHS Foundation Trust.



**CLIVE ADAMSON**  
Independent Non-Executive Director

A Ri

**Joined the Group:** July 2016

**Key areas of expertise:** Governance, Financial Services Regulation, Risk

**Skills and experience:** Clive has considerable experience of UK and global economic, banking and regulatory matters gained from an extensive career in banking and financial services regulation. He held senior executive and advisory positions with the FCA, the former Financial Services Authority and the Bank of England. He was previously Head of Supervision and an Executive Director of the

Board of the FCA until May 2015. His strong understanding of the UK and global banking industry and related risks is invaluable to the Board.

**Key external appointments:** Chairman at JP Morgan International Bank Limited; Non-Executive Director of The Prudential Assurance Company Limited; and Non-Executive Director at Ashmore Group plc.



## BOARD OF DIRECTORS

### Non-Executive Directors



**DAVID BROWNE**  
Independent Non-Executive Director



**Joined the Group:** July 2012

**Key areas of expertise:** Finance, Risk

**Skills and experience:** David has over 30 years' experience in debt capital markets, treasury and investor relations. He was previously Head of Group Funding and External Relations at Man Group plc and spent a significant part of his career at JP Morgan where he held the positions of Assistant Vice President, Vice President and

Managing Director. David is a founding partner of Pinnacle Partners Limited, a treasury consulting firm.

**Key external appointments:** Director of Pinnacle Partners Limited and Trustee and Director of London Youth Rowing Limited.



**PAUL COBY**  
Independent Non-Executive Director

**Joined the Group:** June 2016

**Key areas of expertise:** Information Technology, Strategy

**Skills and experience:** Paul is an accomplished IT professional with significant e-commerce, international and systems technology experience. In particular his understanding of how technology has changed consumer behaviour, how advances in digital technology can impact customer outcomes and his appreciation of the end-to-end customer journey in an omni-channel context is invaluable to the Group as we develop new products and digital capability. Paul is the John Lewis Partnership's Chief Information Officer (CIO), responsible for leading and coordinating IT across the John Lewis, Waitrose and JLP Group. Prior to his CIO

role, Paul was IT Director at John Lewis and previously CIO at British Airways for 10 years. Paul's previous roles include Non-Executive Chairman of the Société Internationale de Télécommunications Aéronautiques (SITA), the global provider of systems, solutions and telecommunications to the air transport industry, Non-Executive Director at P&O Ferries Limited, Chairman of the eSkills UK CIO Board and Chairman of the oneworld CIO Group which co-ordinated IT links across the ten airline oneworld Alliance partners.

**Key external appointments:** CIO of the John Lewis Partnership and Non-Executive Director at Pets at Home Group plc.



**ADRIAN GRACE**  
Independent Non-Executive Director



**Joined the Group:** December 2014

**Key areas of expertise:** Finance, Financial Services Regulation, Strategy

**Skills and experience:** Adrian has extensive financial, business leadership and general management experience gained from a career which has spanned a range of consumer and commercial financial services sectors and involved a variety of senior roles. Adrian's experience of designing and implementing substantial change programmes and delivering transformational growth through simple customer focused visions and plans is aligned to the Group's strategy. Having started his career with the Leeds Permanent Building Society and then

Mercantile Credit, he became Managing Director of the Small Business Division at Sage Group plc. He was Chief Executive at Barclays Insurance and Managing Director of Commercial Banking within the Corporate Division of HBOS. Since 2011 Adrian has been Chief Executive Officer at Aegon UK having joined Aegon in 2009 as Group Business Development Director. He was previously on the boards of the Association of British Insurers and Scottish Financial Enterprise.

**Key external appointments:** Director of various companies within the Aegon Group and a member of the FCA Practitioner Panel representing the life and pensions sector.



**FIONA MACLEOD**  
Independent Non-Executive Director

**Joined the Group:** September 2016

**Key areas of expertise:** M&A, Marketing, Strategy

**Skills and experience:** Fiona has over 28 years' international business experience in leading complex, large scale business transformation and in managing the commercial, human resources and cultural aspects of change programmes. A substantial part of her career was at BP Group plc where she held various executive positions including latterly the role of President Retail,

USA & Latin America. Fiona's deep experience of operational business leadership, of transforming businesses and in understanding and managing the organisational design and people impacts of business change are invaluable to the Group as we focus on building a high performing, customer centric organisation and continue our cultural transformation.

**Key external appointments:** Senior Independent Director of SThree plc and Non-Executive Director of Denholm Oilfield Services Limited.

## BOARD OF DIRECTORS

### Non-Executive Directors



**DR TERESA ROBSON-CAPPS**  
Independent Non-Executive Director

A

**Joined the Group:** October 2014

**Key areas of expertise:** Finance, Strategy

**Skills and experience:** Teresa brings to the Board extensive financial, customer service and general management experience from across a range of industries including telecommunications, financial services and retail. She is a chartered management accountant and has a Doctorate in Accounting and Management Control. Teresa has a breadth of experience gained from executive leadership roles with BT Mobile,

Sears plc, Eagle Star/Zurich Financial Services, Cable & Wireless, Reality & Accenture. She joined HSBC Group in 2006 and from 2010 was Deputy Head, Direct Bank & First Direct. Teresa also has strong board experience gained as Chairman of ACS Clothing Group Limited and from her Non-Executive Director roles, which have previously included Towergate Insurance Limited and PowerPlace Insurance Services Limited.

**Key external appointments:** Non-Executive Director of Hastings Group Holdings PLC.



**TIM WADE**  
Independent Non-Executive Director

A

Ri

**Joined the Group:** September 2016

**Key areas of expertise:** Finance, M&A, Retail Banking, Risk

**Skills and experience:** Tim brings to the Board over 20 years' senior experience in retail financial services, including retail banking in both the UK and internationally. An Australian national, he is an experienced Chief Financial Officer, a chartered accountant and a Fellow of the Institute of Chartered Accountants of Australia. Tim was Managing Director at AMP International, responsible for AMP Bank and the Virgin Direct (now Virgin Money) joint venture. He began his career at Arthur Andersen working in Melbourne and Singapore, and in 1994 he joined Colonial

Limited, the mutual financial services group, as Chief Taxation Counsel. He became Group Chief Financial Officer in 1997 and Executive Director of State Bank of New South Wales. Tim subsequently oversaw the IPO of Colonial and was involved in Colonial's subsequent acquisition by Commonwealth Bank – at the time the largest acquisition in Australian corporate history. His previous Non-Executive Director board experience includes Friends Life Group Limited.

**Key external appointments:** Chairman at Macquarie Bank International Limited and Non-Executive Director of Chubb Europe Group Limited, Monitise PLC and Access Bank UK Limited.

### Executive Directors



**DAVID DUFFY**  
Executive Director and Chief Executive Officer

**Joined the Group:** June 2015

**Key areas of expertise:** Banking, Finance, M&A, Strategy

**Skills and experience:** David has significant international finance and banking experience gained from a career spanning almost three decades. David's proven ability to build and transform businesses and lead strong management teams brings significant value to all of the Group's stakeholders. Prior to joining the Group, David was Chief Executive Officer at Allied Irish Banks plc, one of the largest retail and commercial banks in Ireland. He was a former

Chief Executive Officer of Standard Bank International with responsibility for operations in the UK, Europe, Latin America and Asia. He was also previously Head of Global Wholesale Banking Network with ING Group and President & Chief Executive Officer of the ING wholesale franchises in the United States and Latin America. David is a past President of the Banking and Payments Federation of Ireland and a past Director of the European Banking Federation. David's broad-based skills, leadership, energy and strategic vision are invaluable to the Group as it continues its strategic journey and cultural transformation.



**DEBBIE CROSBIE**  
Executive Director and Chief Operating Officer

**Joined the Group:** June 1997

**Key areas of expertise:** Information Technology, Retail Banking, Strategy, Operations

**Skills and experience:** Debbie has broad experience and knowledge gained over 20 years in the banking sector, particularly around information technology, complex project delivery, material outsourcing and strategy & planning. She has significant experience at a senior management level and is a strong advocate for customers and improving the customer experience by driving a change and transformation journey which has the customer as its core focus. Since joining the Group in 1997

Debbie has held a variety of positions including Head of Technology Governance, Head of Strategic Projects and Head of the Group's Development Centre. She was Chief Information Officer from 2008 to 2011, became Operations & IT Director in 2011, and was appointed Executive Director in 2014 and Chief Operating Officer in 2015. Debbie was Acting Chief Executive Officer from February 2015 to June 2015 and during this period led the preparation for the demerger and IPO and was part of the management team who completed the transaction. She was previously a Non-Executive Director of the Scottish Court Service and is a Fellow of the Chartered Institute of Bankers.



**IAN SMITH**  
Executive Director and Chief Financial Officer

**Joined the Group:** November 2014

**Key areas of expertise:** Banking, Finance, M&A, Strategy

**Skills and experience:** Ian has considerable experience in finance, audit and advising on bank strategy from a corporate transaction perspective gained from a career spanning more than 20 years. He has held senior finance roles in HBOS plc and Lloyds Banking Group plc and has provided advice to boards considering significant

corporate transactions. He joined the Group in November 2014 from Deloitte LLP where he was a partner specialising in financial services.



EXECUTIVE  
LEADERSHIP TEAM



**DAVID DUFFY**  
Executive  
Director and  
Chief Executive  
Officer



**DEBBIE CROSBIE**  
Executive  
Director and  
Chief Operating  
Officer



**IAN SMITH**  
Executive  
Director and  
Chief Financial  
Officer



**ENDA JOHNSON**  
Director of  
Corporate  
Development  
and Stakeholder  
Engagement

**Joined the Group:** September 2015 and was appointed Director of Corporate Development and Stakeholder Engagement in June 2016

**Key areas of expertise:** Strategic projects, restructurings and capital markets transactions

**Skills and experience:** Enda has over 13 years' experience in financial services. Before joining the Group, he worked at Allied Irish Banks plc as Head of Corporate Affairs and Strategy and was a

member of the Executive Leadership Team. Enda previously worked in the banking unit of the Irish National Treasury Management Agency (NTMA) where he worked on the recapitalisation and restructure of Irish banks following the global financial crisis. Before the NTMA he worked internationally with Merrill Lynch in their investment banking and capital markets divisions.

**Responsibilities:** Leading the Group's strategic development and stakeholder engagement.



**KATE GUTHRIE**  
Group Human  
Resources  
Director

**Joined the Group:** January 2016

**Key areas of expertise:** Culture, capability and engagement

**Skills and experience:** Kate has over 30 years' domestic and international HR experience, having worked in six different blue chip organisations in four industrial

sectors, including most recently a decade with Lloyds Banking Group plc where she was latterly the HR Director responsible for leading the group culture, capability and engagement.

**Responsibilities:** Developing and leading HR strategy.



**FERGUS MURPHY**  
Products  
Director

**Joined the Group:** January 2016

**Key areas of expertise:** Products and strategy

**Skills and experience:** Fergus has over 20 years' experience in financial services gained from Allied Irish Banks plc (AIB), Rabobank Group, BNP Paribas Group and KBC Bank Ireland plc. At AIB, he held roles including Director of Products and Capital Markets and latterly, Director of Corporate and Institutional Banking. During his tenure with AIB, Fergus

redesigned the customer product offering to better meet customers' needs and led the rebuilding of AIB's operating model. He is a former CEO of Rabobank Asia and was responsible for the overall strategy and performance of Rabobank in the region, and was also a former Head of Global Treasury at Rabobank International.

**Responsibilities:** Delivery of the Group's product suite including pricing, liability strategy and capital allocation.



**GAVIN OPPERMAN**  
Customer  
Banking Director

**Joined the Group:** November 2015

**Key areas of expertise:** Banking operations and services

**Skills and experience:** Gavin has over 30 years' leadership experience in retail, commercial, corporate and investment banking. He was previously Regional

Head of Consumer Banking for Standard Chartered PLC based in China and prior to that held a number of senior positions in a career spanning 20 years with Barclays Group.

**Responsibilities:** Leading the Group's customer banking strategy.



**HELEN PAGE**  
Propositions and  
Marketing  
Director

**Joined the Group:** December 2012

**Key areas of expertise:** Marketing, customer experience and innovation, research and consultancy

**Skills and experience:** Helen has over 20 years' experience in marketing, consultancy, and customer and product innovation, principally within the financial services industry. Helen spent eight years at Royal Bank of Scotland Group plc in a number of roles and was latterly Managing Director for Marketing &

Innovation with responsibility for all UK brands across the Retail, Commercial and Corporate divisions. Helen was previously Head of Brand Marketing at Argos (part of the Home Retail Group plc) and prior to Argos held a number of product and marketing roles at Abbey National plc (now Santander) where she became Head of Marketing.

**Responsibilities:** Leading the Group's marketing and customer proposition strategy.



**MARK THUNDERCLIFFE**  
Chief Risk Officer

**Joined the Group:** September 2016

**Key areas of expertise:** Management and oversight of risk and compliance

**Skills and experience:** Mark has over 28 years' retail and business banking experience with international board and CEO experience in major banks. Mark was previously Chief Risk Officer at HSBC responsible for management and oversight of risk for HSBC's Retail Banking and Wealth Management

business across the UK, Europe, the Middle East and Africa. Mark has also held a number of senior international positions in financial services firms up to CEO and Executive Director level.

**Responsibilities:** Management of significant risks and opportunities across the Group including strategic, reputational, operational, financial, credit, regulatory and financial crime compliance.

## COMPANY OFFICERS



**JAMES PEIRSON**  
General Counsel

**Joined the Group:** November 2014

**Key areas of expertise:** Banking, treasury and corporate transactions

**Skills and experience:** James joined NAB in 2005 where he led the NAB London Branch legal team and held roles supporting NAB and Clydesdale Bank PLC Treasury activities as part of NAB's

capital and funding legal team in Melbourne and London. Prior to joining NAB he worked in private legal practice at Hogan Lovells International LLP.

**Responsibilities:** Supporting the Board and leading the Legal and Governance strategy.



**LORNA MCMILLAN**  
Company Secretary

**Joined the Group:** September 1994

**Key areas of expertise:** Governance, risk management

**Skills and experience:** Lorna has over 20 years' experience gained from various roles in the Group across retail and business banking, wholesale banking, risk management, and legal and governance

areas. Lorna was appointed Company Secretary in October 2014 and led the corporate governance preparation for the demerger and IPO.

**Responsibilities:** Supporting the Chairman and Board and leading the delivery of shareholder services.

## CORPORATE GOVERNANCE REPORT



“ Good corporate governance is critical to the success of our business and underpins the delivery of our strategy

Dear Shareholder,

I am pleased to present our Corporate Governance Report for 2016.

As Chairman of the Board I firmly believe that good corporate governance is critical to the success of our business and underpins the delivery of our strategy. The Board is committed to ensuring that good governance is embedded across our business. This report sets out our approach to governance in practice, the work of the Board during the year and includes reports from the Governance & Nomination Committee, the Audit Committee and the Risk Committee. Information about the work of the Remuneration Committee is included in the Directors' Remuneration Report on pages 104 to 130.

2016 has been a significant year for the Group as it became independent for the first time since the 1920s after our demerger and IPO in February 2016 with listed securities on the LSE and the ASX.

Set out below are the key corporate governance matters considered in 2016.

### Demerger and IPO

A Committee of the Board was established in early 2015 to oversee matters relating to the demerger and IPO and to make recommendations to the Board on key decisions. In addition to myself, members of the Committee were Richard Gregory, Chair of the Risk Committee, David Alvey (at the time, Chair of the Audit Committee – Mr Alvey retired from the Board on 31 March 2016), David Browne (an independent Non-Executive Director) and the Executive Directors.

In preparation for listing, the Board reviewed the Group's corporate governance framework to ensure that it aligned with the UK Corporate Governance Code.

### Engaging with shareholders

The Board recognises the need for a programme of engagement which offers all shareholders the opportunity for open and meaningful discussion with the Board, particularly with regard to strategy, governance and remuneration. In the period since listing, the Board and management have developed a programme of shareholder engagement which will remain a key area of focus going forward. The Board and management have taken the opportunity to meet with the largest institutional investors throughout the year, including active marketing to support the demerger and IPO, and the Capital Markets Day held in September 2016. The Board receives regular reports on investor relations activity, including shareholder sentiment and perspectives on our business, which helps inform our decision making. At the Company's forthcoming Annual General Meeting (AGM) both retail and institutional shareholders will have the opportunity to meet with Directors to discuss any issues they may have.

### Board composition

During the year succession planning and the composition of the Board and its Committees was a key focus for the Governance & Nomination Committee, which led a programme to review and refresh Board and Committee composition.



CORPORATE  
GOVERNANCE REPORT

The Board was further strengthened through the appointment of five new independent Non-Executive Directors complementing the Board's existing knowledge, skills, experience, and increasing diversity, namely, Clive Adamson, David Bennett, Paul Coby, Fiona MacLeod and Tim Wade. Their biographical details, skills and experience are described on pages 62 to 66. Details of Committee changes during the year are on pages 87, 91, 100 and 126.

During the year David Allvey, Barbara Ridpath and Alex Shapland retired from the Board. Richard Sawers, who represented NAB on the Board, stepped down as Executive Director on 2 February 2016 prior to the demerger.

Remuneration

The Remuneration Committee dedicated significant time since its formation to overseeing and implementing remuneration arrangements appropriate for a listed company. The Committee also spent significant time reviewing and developing an understanding of the remuneration reporting regime for public limited companies to ensure the Company was compliant with all requirements post listing. The Remuneration Committee has sought to ensure that the forward looking remuneration policy and practices detailed in the Directors' Remuneration Policy on pages 106 to 115 and in the Directors' Annual Report on Remuneration on pages 116 to 125, each to be put to a shareholder vote at the forthcoming AGM, are appropriate to supporting the delivery of the Group's desired culture, business strategy and objectives.

Board effectiveness

The Board carried out an externally facilitated evaluation of its effectiveness in 2015 prior to the IPO. We progressed the resulting recommendations leading to enhancements to the corporate governance framework to ensure it was fully appropriate for a listed company. This included strengthening Board composition through the appointment of five additional Non-Executive Directors complementing the Board's existing knowledge, skill, experience and increasing diversity; improving the Director induction and orientation programme; refreshing the responsibilities of each of the Committees and establishing a Remuneration Committee; improvements in Board and Committee reporting (including a greater focus on longer term, forward looking strategic risks and issues, with the Board being fully engaged on the development of the Strategic Plan and the supporting frameworks, including the Risk Appetite Statement); and improving interaction between the Risk and Audit Committees.

In view of the timing of the IPO, the changes to Board and Board Committee composition during the year, and enhancements already made to the corporate governance framework in

preparation for listing, the Board decided that there would be no Board, Committee or individual Director (including my role as Chairman) evaluation in 2016 but that a thorough evaluation would be conducted in 2017.

Risk management

The Board has continued to strengthen its oversight of risk management practices and the risks we face with the support of the Risk Committee and the Audit Committee. There has been rigorous challenge to management to gain assurance that robust controls are in place over key risks. The Board promotes a culture of risk awareness and ethical conduct and has worked to encourage and develop a strong risk culture that supports the delivery of the Group's Strategic Plan and furtherance of new opportunities. During the year the Board approved the Risk Management Framework, Risk Appetite Statement and Delegation of Authority Framework which support our risk culture.

The Board remains focused on putting the customer at the heart of everything we do and makes commercial decisions on the basis of proactive consideration of risk and the impact on customers. The Board has approved a Conduct Framework with supporting target outcomes and principles which underpins the management of conduct risk and ensures that customers are treated fairly. More information about our approach to risk management is in the Risk Overview section of the Strategic Report on pages 32 to 39 and in the Risk Committee Report on pages 99 to 103.

Looking ahead

Becoming an independent Company is a catalyst for our ongoing cultural and business transformation. Going forward, sustainable growth, lower costs and capital efficiency supported by a strong and effective corporate governance framework will drive improved performance and enhanced returns for our shareholders. I look forward to engaging with our shareholders during 2017.

In closing I would like to thank each of the Directors for their commitment during 2016 and their support during the demerger and IPO. I am confident that the Company is well positioned to build on the strong momentum in our business.



Jim Pettigrew  
Chairman

Statement Of Compliance

The UK Corporate Governance Code 2014 ('Code') has applied since 8 February 2016, the date of listing. The Code is publicly available at [www.frc.org.uk](http://www.frc.org.uk). The Board confirms that since the date of listing the Company has applied the main principles and complied with the provisions of the Code, with the exception of Code Provision B.6 which recommends the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual Directors. The Board carried out an externally facilitated evaluation of its effectiveness in 2015 and has made significant progress on the resulting recommendations as detailed in the Chairman's Letter. The Board decided that there would be no formal Board, Committee or individual Director (including the Chairman) evaluation in 2016 but that a thorough evaluation compliant with the Code provision B.6 would be carried out in 2017. The revised edition of the UK Code was published by the Financial Reporting Council in April 2016 and applies to companies with a premium listing on the London Stock Exchange with accounting periods beginning on or after 17 June 2016. These provisions will apply to the Company for the financial year ending 30 September 2017.

The Group has also adopted the British Bankers' Association Code for Financial Reporting Disclosure, which is available at [www.bba.org.uk](http://www.bba.org.uk), and the financial statements have been prepared in compliance with its principles.

Leadership

The Board is the principal decision making body of the Group and is collectively responsible to shareholders for promoting the long term success of the Company.

The Board's role is to provide leadership to the business as a whole within a framework of prudent and effective controls which enable risk to be assessed and managed. It sets strategy and oversees its delivery and establishes its culture, values, ethics and standards. It sets the Group's risk appetite, monitors operational and financial performance and reporting, ensures the Group is adequately resourced and has effective controls and remuneration policies, and that there are appropriate succession planning arrangements.

In order to assist the Board in carrying out its functions and to ensure that there is independent oversight of financial reporting, internal controls, risk management, governance and remuneration matters, the Board delegates certain clearly defined responsibilities to its four principal committees. Reports from the Governance & Nomination Committee, the Audit Committee, and the Risk Committee are contained in this report. A report from the Remuneration Committee is included in the Directors' Remuneration Report.

As required, the Board may also establish special purpose Committees to assist the Board in the oversight of specific areas that may require more detailed attention. Due to the preparation for the demerger and IPO there was an unusually high level of Board and Committee activity and a special purpose Committee was constituted that oversaw this process and met on a frequent, often weekly, basis. Additionally in May 2016, the Board established an IRB and Credit IFRS 9 Board Committee to oversee the delivery of transition from a standardised approach to calculating capital requirements for credit risk to an IRB approach, and the implementation of the credit element of the IFRS9 accounting standard.

The chart on page 143 of the Risk Report illustrates the Board and management structure as at 30 September 2016.

Matters Reserved to the Board and Delegated Authorities

In order to retain control of key decisions and ensure there is a clear division of responsibilities at the head of the Company, the Board has identified certain "reserved matters" that only it can approve. Other matters, responsibilities and authorities have been delegated to its Committees and the Chief Executive Officer.

The matters reserved to the Board are set out in the Charter for the Board and this, as well as the Charters for each principal Board Committee, is available to view on the Company's website (<http://www.cybg.com/about-us/corporate-governance>). The Charters are also available on request from the Company Secretary at the Company's registered office. During the year the Board and each of the Board Committees reviewed its Charter.

The authorities delegated by the Board to the Chief Executive Officer are set out in the Delegation of Authority Framework and this was renewed and updated during the year.

Board and Strategic Planning

During the year, the Board spent considerable time discussing with management the business strategy for the next five years and took part in two strategic planning days. The aim of the strategy is to leverage our capabilities in our existing core markets, continue our successful national growth strategy in selected products, deliver a superior performance for customers by moving to an omni-channel model and deliver enhanced shareholder returns. This was the first strategic planning exercise undertaken since the Group became an independent business. The Board remains committed to continuing its strategy, which is underpinned by a cultural transformation of its business and the simplification and streamlining of operations and processes to enhance productivity and customer journeys.

A key objective of the strategic process was to produce an integrated Strategic & Financial Plan within a framework of capital and liquidity, risk appetite, conduct and operational risk considerations. The Strategic & Financial Plan took into

account the transformational change agenda, our strongly customer focused business model and the regulatory and wider external environment.

Areas which were discussed in detail included: evolving customer expectations; digital transformation; the potential for interest rates to be lower for longer and the challenges this creates for income, margin and growth; the impact of the outcome of the EU Referendum on economic forecasts; the cost profile; investment priorities including costs to do and expected benefits realisation; organisational capability; and risk appetite.

These issues were considered very carefully by the Board to ensure that the business will be able to continue to drive sustained performance for the benefit of all stakeholders.

Outcomes from discussions held by Board Committees were also taken into account. For example, the Risk Committee considered: the Risk Appetite Statement; the Individual Liquidity Adequacy Assessment Process (ILAAP); and the Internal Capital Adequacy Assessment Process (ICAAP). In addition, the Governance & Nomination Committee and the Remuneration Committee provided oversight regarding organisational structure, capability and succession matters.

Board Roles and Responsibilities

The Board has agreed a clear division of responsibilities between the Chairman and Chief Executive Officer. The Chairman's priority is to lead the Board and ensure its effectiveness and the Chief Executive Officer's priority is to manage the day to day running of the Group's business. The roles of the Chairman, Chief Executive Officer and other Directors are clearly defined so that no single individual has unrestricted powers of decision. Their key responsibilities are set out below.

Chairman	Jim Pettigrew	Leading the Board and its effectiveness by organising its business and setting its agendas, ensuring that the Board as a whole plays a full and constructive part, being forward looking, and primarily focused on strategy, performance and key value creation issues. Promoting the highest standards of corporate governance and ensuring that the Board receives accurate, timely and high quality supporting information. Ensuring properly constructed Board induction, evaluation and development, and effective communications with the Group's shareholders.
Deputy Chairman	David Bennett	Supporting the Chairman, and when required, acting as the Chairman's delegate and ensuring continuity of Chairmanship, supporting the Chairman in representing the Board and acting as spokesperson. Being available to the Board for consultation and advising and representing the Group's interests at official enquiries and with review bodies.
Chief Executive Officer	David Duffy	Leading the day to day management of the Group's business ensuring its effective running. Leading the Executive Leadership Team, being responsible for developing, coordinating and proposing to the Board all activities to implement the Group's strategy and its overall objectives in accordance with the Group's risk appetite, and maintaining a close working relationship with the Chairman.
Senior Independent Director	Richard Gregory	Providing a sounding board for the Chairman and serving as a trusted intermediary between the Chairman and the other Directors when necessary, and ensuring that the views of all Directors are conveyed to the Chairman. Being available to shareholders in the event of any matters which cannot be resolved through the normal channels of communication with the Chairman or the Executive Directors. Maintaining contact as required with major shareholders to understand their issues and concerns, maintaining stability and cohesion within the Board particularly during periods of stress. Meeting with the Non-Executive Directors without the Chairman present at least annually and leading the Non-Executive Directors in the ongoing monitoring and annual evaluation of the Chairman.
Independent Non-Executive Directors	Clive Adamson, David Bennett, David Browne, Paul Coby, Adrian Grace, Richard Gregory, Fiona MacLeod, Dr Teresa Robson-Capps, and Tim Wade	Bringing an external perspective, knowledge, experience and insight from other industries and applying sound judgement and objectivity to the business of the Board. Developing and setting the Group's strategy and monitoring its implementation, reviewing the Risk Management Framework, and supporting and constructively challenging Executive Directors. Satisfying themselves on the integrity of financial information, considering and taking account of the views and concerns of the Company's shareholders and other stakeholders. Having a principal role in appointing and, where necessary, removing Executive Directors. Devising appropriate succession plans and approving appropriate levels of remuneration for the Executive Directors following recommendations from the Remuneration Committee.



Board Attendance

The core activities of the Board were carried out in 13 scheduled meetings of the Board. Four additional ad hoc meetings of the Board were arranged when matters required to be brought to the Board's attention or when decisions were required outside scheduled meetings.

The attendance of Directors at scheduled Board meetings, which they were eligible to attend, and the number of meetings attended in the year ended 30 September 2016 is shown below:

Director	Number of scheduled Board meetings eligible to attend	Number of scheduled Board meetings attended
Chairman		
Jim Pettigrew	13	13
Non-Executive Directors		
Clive Adamson <sup>(1)</sup>	2	2
David Allvey <sup>(2)</sup>	7	6 <sup>(5)</sup>
David Bennett <sup>(3)</sup>	13	12 <sup>(6)</sup>
David Browne	13	13
Paul Coby <sup>(8)</sup>	3	2 <sup>(6)</sup>
Adrian Grace	13	11 <sup>(5)</sup>
Richard Gregory	13	12 <sup>(5)</sup>
Fiona MacLeod <sup>(9)</sup>	1	1
Barbara Ridpath <sup>(4)</sup>	9	5 <sup>(5)</sup>
Dr Teresa Robson-Capps	13	12 <sup>(5)</sup>
Alex Shapland <sup>(4)</sup>	9	5 <sup>(5)</sup>
Tim Wade <sup>(9)</sup>	1	1
Executive Directors		
David Duffy	13	11 <sup>(5)</sup>
Debbie Crosbie	13	12 <sup>(5)</sup>
Richard Sawers <sup>(7)</sup>	4	4 <sup>(5)</sup>
Ian Smith	13	12 <sup>(5)</sup>

<sup>(1)</sup> Clive Adamson was appointed to the Board on 1 July 2016.  
<sup>(2)</sup> David Allvey retired from the Board on 31 March 2016.  
<sup>(3)</sup> David Bennett was appointed to the Board on 22 October 2015.  
<sup>(4)</sup> Barbara Ridpath and Alex Shapland retired from the Board on 20 May 2016.  
<sup>(5)</sup> The Directors were unable to attend meetings due to unavoidable prior business commitments.  
<sup>(6)</sup> The Board schedule was set before the Director joined the Board and as a result he was unable to attend meetings due to unavoidable prior business commitments.  
<sup>(7)</sup> Richard Sawers retired from the Board on 2 February 2016.  
<sup>(8)</sup> Paul Coby was appointed to the Board on 1 June 2016.  
<sup>(9)</sup> Fiona MacLeod and Tim Wade were appointed to the Board on 12 September 2016.

Board Activity

Setting the Board agenda

There is a comprehensive and continuous process in place for ensuring the Board has full and timely access to all relevant information in an insightful format.

The Chairman is responsible for setting the Board agenda and is assisted by the Chief Executive Officer and Company Secretary. The Board agenda is structured to ensure it covers strategic and forward looking items. The Chairman reviews the time allocation with the Company Secretary to ensure adequate time is allowed to discuss material matters. The Company Secretary keeps the Chairman informed of any agenda items requested by Non-Executive Directors. In order to carry out its work, a yearly planner is prepared by the Company Secretary to map out the flow of key items of business to the Board and to ensure that sufficient time at the meeting is provided for debate and challenge. Directors are sent papers for Board meetings up to five working days in advance of the meeting (whether they are able to attend or not) in order that they may have the time to consider the proposals put forward, seek clarification or, if required, request further information.

At each main meeting the Board discusses:

- the Chief Executive Officer's Report – including performance against the Strategic Plan, key developments in the external environment, the economic outlook and impacts for the Group, business performance, product and proposition developments, stakeholder engagement and investor relations matters, material regulatory issues, and key matters relating to people, cultural and organisational transformation and capability.
- the Chief Financial Officer's Report – including performance against the Financial Plan, Key Performance Indicators, capital, liquidity and funding matters.
- the Chief Operating Officer's Report – including delivery against customer service commitments, operational efficiency, performance against the Conduct Framework, and the status of major investment programmes.
- the Chief Risk Officer's Report – including the current and emerging risk profile, key risk issues and Risk Appetite Statement performance and trends.

How Board Meetings are Run

Prior to the start of a scheduled Board meeting the Senior Independent Director meets with Non-Executive Directors

(excluding the Chairman and then with the Chairman present) to discuss matters of concern or focus. Both the Chairman and the Senior Independent Director report to the Board on issues to be brought to the Board's attention at the commencement of each meeting and these are recorded in the Board minutes. The Chairman ensures Board meetings are structured to facilitate open discussion, debate and challenge with dissenting views of Directors being freely expressed and discussed within the decision making process, leading to Board decisions being made on a sound and well-informed basis. The Board makes full use of technology such as video conferencing and teleconferencing in its meeting arrangements.

All Directors are expected to attend each Board meeting and Committee meeting for which they are members, save for in exceptional circumstances. Reasons for non-attendance are generally unavoidable conflicts with prior business commitments, personal reasons or illness, and non-attendance must always be notified in advance to the Chairman, relevant Committee Chair or the Company Secretary. In the rare event of a Director being unable to attend a meeting, he/she has the opportunity to discuss with, or notify, the Chairman, relevant Committee Chair or the Company Secretary of any matters he/she wishes to raise and to follow up the decisions made at the meeting. The Chairman and Company Secretary, together with members of the Executive Leadership Team, are available to discuss issues relating to meetings or other matters with Directors.

During the year, the Chairman held a number of meetings with Non-Executive Directors without the Executive Directors being present.

Board Committees

The Board delegates certain clearly defined responsibilities to its four principal Board Committees, namely: the Governance & Nomination Committee; the Audit Committee; the Risk Committee; and the Remuneration Committee.

The Committee Chairs report to the Board on the activities of the Committees at each Board meeting. Each principal Committee comprises Non-Executive Directors only and is chaired by an experienced Chair. Committee memberships are spread between the Non-Executive Directors, drawing on each of their relevant skills and experience. Only members of the Committees are entitled to attend their meetings, but others may attend at the Committee's discretion.

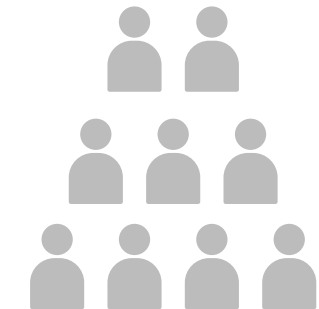
## BOARD FOCUS IN 2016



Chairman



Executive Directors



Independent Non-Executive Directors

### Effectiveness

#### Board Size and Composition

The Board comprises a Non-Executive Chairman, three Executive Directors and nine independent Non-Executive Directors. The size of the Board is considered to be suitable with the appropriate combination of Executive and Non-Executive Directors such that no individual or small group of individuals can dominate the Board's decision making. The names of the Directors together with their full biographical details, including the skills and experience they each bring to the Board, are on pages 62 to 67. Further details on the composition of the Board and independence of the Non-Executive Directors are provided in the Governance & Nomination Committee Report on pages 86 to 89.

#### Time Commitments

The Board recognises that it is vital that Directors should be able to dedicate sufficient time to the Company to effectively discharge their responsibilities. The time commitment is considered by the Board on appointment and kept under review. The letters of appointment of the Chairman and of each of the Non-Executive Directors set out the minimum time commitment for their roles and that they undertake to allocate sufficient time to the Company as is necessary for the effective discharge of their duties.

The Chairman is expected to commit at least 60 days per year on Company business, the Deputy Chairman 45 days per year and Non-Executive Directors at least 35 days. Time commitment increases for other Board roles such as the Senior Independent Director and Committee Chairs and for involvement in a Committee as a member.

As described within the relevant sections of this Corporate Governance Report, the Non-Executive Directors' preparation for and attendance at Board and Committee meetings is only part of their role.

The other significant commitments of the Chairman and Non-Executive Directors are disclosed to the Board before appointment, with an indication of time involved. During the year, the Governance & Nomination Committee kept under review the number of external directorships held by each Director and considered the limits on the number of directorships which Directors may hold as a result of PRA Rulebook 'General Organisational Requirements' 5.5 (having regard to General Organisational Requirements' 5.6) and FCA Handbook Senior Management Arrangements, Systems and Controls (SYSC) 4.3A.6R (having regard to SYSC 4.3A.7R). Details of the Chairman's other significant commitments are set out on page 62. Details of the Non-Executive Directors' other significant commitments are set out on pages 62 to 66. Any changes to the Non-Executive Directors' time commitments were reported by the Governance & Nomination Committee to the Board. The Board is satisfied that each Non-Executive Director is able to devote sufficient time to their role.

#### Board Changes

During the year, David Allvey, Non-Executive Director and Chair of the Audit Committee, Barbara Ridpath, Non-Executive Director and Chair of the Governance & Nomination Committee, Richard Sawers, Executive Director, and Alex Shapland, Non-Executive Director, retired from the Board.

During the year, David Bennett joined the Board as a Non-Executive Deputy Chairman on 22 October 2015 (and his appointment was approved at the Company's first AGM on 22 January 2016 prior to the IPO, when the sole shareholder was NAB). After the 2016 AGM, Clive Adamson, Paul Coby, Fiona MacLeod and Tim Wade joined the Board as Non-Executive Directors.



Further details about the appointment of new Directors and the Group's approach to succession planning can be found in the Governance & Nomination Committee Report on pages 88 to 89. Changes to Committee memberships are set out on pages 87, 91, 100 and 126.

### Board Independence

It is the Company's policy that at least half the Board should be independent Non-Executive Directors. The Board assesses the independence of Directors on an annual basis following a review by the Governance & Nomination Committee. The Board considers each of its current Non-Executive Directors to be independent in character and judgement. The Chairman was considered independent on appointment. Further information is given in the Governance & Nomination Committee Report on page 89.

### Conflicts of Interest

Pursuant to the Companies Act 2006, the Directors have a statutory duty to avoid situations in which they have or can have a direct or indirect interest in the Company, unless that interest is first authorised by the other Directors. This duty is in addition to the existing duty that a Director owes to the Company to disclose to the Board any transaction or arrangement under consideration by the Company. Prior to appointment, potential conflicts of interest are disclosed and assessed to ensure that there are no matters which would prevent the incoming Director from taking the appointment, and during their tenure Directors are asked to consult with the Company Secretary and the Chairman prior to taking up any external appointment or responsibilities. Any changes to the commitments of Directors are reported to the Governance & Nomination Committee and the Board. Directors are reminded, at each Board meeting, of their duty to report any actual or potential conflict as soon as they become aware of any such events. If any actual or potential conflict arises, the relevant Director will excuse himself/herself from any meeting or discussions where the potential conflicts are considered and all relevant material will be restricted including Board papers and minutes. A Director with a potential or actual conflict will not be permitted to form part of the quorum or vote upon the matter giving rise to the conflict. Directors do not participate in decisions concerning their own remuneration or interest. All potential conflicts authorised by the Board are recorded in a Register of Directors' Conflicts of Interests which is reviewed by the Board annually.

### Board Induction

The Company understands the importance of a well-focused induction plan to help a new Director get up to speed as quickly as possible and to enable them to contribute fully in Board and Committee meetings.

The Governance & Nomination Committee is responsible for ensuring that newly appointed Directors are provided with a full, formal and tailored induction plan and the Board Chairman maintains oversight to ensure the induction plan is appropriate and reflects a Director's skills, experience and Board role. Key stakeholders and the Director themselves provide input. The focus of the induction plan is designed to facilitate a Director's understanding of:

- the Group and its strategy;
- key business drivers of performance and the competitive environment and regulatory landscape in which it operates;
- major strategic and investment programmes and priorities;
- the key current and emerging risk issues and challenges for the business and risk appetite;
- the organisational culture and capabilities, the role of the Board and its Committees, and the Company's corporate governance practices; and
- to provide training on the role and responsibilities of a Director, including statutory duties.

The induction plan is arranged by the Company Secretary and is centred on a comprehensive programme of one-to-one briefings with current Directors, particularly the Senior Independent Director and Committee Chairs, members of the Executive Leadership Team, selected senior managers and other relevant internal and external stakeholders including the External Auditor. Directors joining the Board to perform a specific role or holding a Senior Management Function role, such as a Committee Chair, are provided with additional in-depth training. The induction plan commences as soon as possible after a Director has been recommended for appointment and, in practice, is part of a wider orientation plan with proactive input from the Director.

Non-Executive Directors are encouraged to identify any further information needs and to request additional meetings or visits to help familiarise themselves with the business, and generally these additional requirements become clearer as the induction plan is progressed and a Director identifies areas where they would like further insight.

## FIONA MACLEOD: OUTLINE INDUCTION PLAN

### Core components

- Strategic objectives and financial plan
- Operating environment
- Voice of customer
- Capital and funding position
- Talent, capabilities and people
- Governance model
- Risk Management Framework, Risk Appetite Statement and risk profile
- Directors' responsibilities
- Senior Managers and Certification Regimes prescribed responsibility and Conduct Rules

### One-to-one briefings

- Chairman, Senior Independent Director and Company Secretary
- Committee Chairs
- Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Risk Officer and members of the Executive Leadership Team

- Briefings on each business area
- Director of Internal Audit
- External Auditor

### Tailored programme

- The Chairman ensures the induction plan is tailored according to a Director's skills and experience. In the case of Fiona MacLeod additional briefings were arranged on UK retail banking relevant risks and the regulatory environment recognising that Fiona had not worked in UK financial services or retail banking previously.

### Briefing and Reading Materials

- Archive Board and Board Committee papers
- Most recent Annual Report & Financial Statements
- Corporate governance documents including Strategic Plan, ICAAP, ILAAP, Risk Appetite Statement, Delegation of Authority Framework, and Board and Committee Charters
- Prospectus for IPO

In addition to the programme of one-to-one briefings, Directors are provided with appropriate reading material, such as briefing notes previously provided to the Board, and archive Board and Board Committee papers.

Directors who take on or change role during the year participate in an induction plan tailored to their new role.

An outline of the induction plan of Fiona MacLeod as an example is set out above.

### Professional Development and Training

Continuing professional development is an important aspect of a Director's role. Skills and knowledge need to be kept up to date to ensure the effectiveness of the Board as a whole and allow every Director to contribute fully in Board and Committee meetings.

The Chairman leads the learning and development of Non-Executive Directors individually and of the Board as a whole and regularly reviews and agrees with each Director their training and development needs.

The Board level annual training and development programme includes briefings for all Directors on current and emerging business, regulatory or corporate governance issues, which are often led by industry experts and specialists. There is also a programme of 'deep dive' sessions on specific topics which give Directors the opportunity to engage with management in a more informal way outside of the structure of a Board meeting to gain insight on topics of interest or focus for the Board. Directors also undertake site visits to get closer to business operations, current issues and customer service in an operational environment. This provides insight into customer experiences and allows Directors to connect with management and employees alike.

## CORPORATE GOVERNANCE REPORT

### DEEP DIVES AND BOARD BRIEFINGS IN 2016



Directors also participate in Board dinner discussions, sometimes on a specific topic and facilitated by a member of the Executive Leadership Team, which provides the opportunity for Directors to learn and consider business issues outside their own direct area of expertise.

Management, customer and other stakeholder meetings are also undertaken.

During the year the Directors spent a considerable amount of training and development time preparing for the Company's listing on the LSE, and the ASX. This included a series of Board briefings on the listing process, the Listing Rules, and the continuing obligations and enhanced corporate governance framework requirements of a listed company.

The Company Secretary maintains a training and development log for each Director.

#### Board Performance Evaluation

The Board carried out an externally facilitated evaluation of its effectiveness in 2015 prior to the demerger and IPO.

The Board will carry out a thorough evaluation compliant with the Code provision B.6 in the financial year 2017 and will report on the outcomes of the evaluation in the 2017 Annual Report and Accounts.

#### Information and Support

The Board has processes in place to ensure that it is supplied in a timely manner with information in a form and of a quality to enable it to effectively discharge its duties. The Chairman, through the Company Secretary, is responsible for ensuring communication flows between the Board and its Committees with the support of the Executive Directors and management, and ensures that this information is of high quality in terms of its currency, clarity, accuracy, appropriateness and comprehensiveness. All Directors have access to the advice of the Company Secretary in relation to the discharge of their duties and matters of governance. Directors are able to seek clarification or further detail from management where necessary. The Company Secretary is also responsible for facilitating communications with shareholders, as appropriate, and ensuring due regard is paid to their interests. All Directors are provided with sufficient resources to undertake their duties. In appropriate circumstances, Directors may obtain independent professional advice where they judge it necessary to discharge their responsibilities as Directors at the Company's expense. The appointment and removal of the Company Secretary is a matter reserved for the Board as a whole.

#### Service Contracts and Letters of Appointment

Details of Executive Service Contracts and Letters of Appointment of the Board are set out on pages 112 to 114 of the Directors' Remuneration Report.

### Internal Control

#### Board Responsibility

The Board is responsible for the Group's systems of internal control. The internal control framework is designed to facilitate effective and efficient operations, ensure a high quality of internal and external reporting, and ensure compliance with applicable laws and regulations. The Directors and management are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. Owing to the limitations inherent in any internal control framework, the controls have been designed to manage, rather than eliminate, the risk of failure to achieve the Group's business objectives and can provide only reasonable, not absolute, assurance against material misstatement or loss. The Directors acknowledge their responsibilities in relation to the Group's risk management and internal control framework and for reviewing their effectiveness.

The Board confirms that throughout the year ended 30 September 2016 and up to the date of approval of this Annual Report and Accounts, there have been rigorous processes in place to identify, evaluate and manage the principal risks faced by the Group, including those that would threaten its business model, future performance, solvency or liquidity, the likelihood of a risk occurring and the costs of control in accordance with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published by the Financial Reporting Council (FRC).

In order to assist in the identification and management of the principal risks, the Board has established a risk management framework which is integrated into the Group's overall framework for risk governance, developed a system of regular reports from management and reserved specific matters for its decision. The Board has authorised the Risk Committee to oversee the Group's compliance with the Board's approved Risk Appetite Statements, Risk Management Framework and risk culture. Further details can be found in the Risk Report on pages 138 to 197.

#### Reviews by the Board

The effectiveness of the risk management and internal control systems is reviewed regularly by the Risk Committee and the Audit Committee, including an annual review. The Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future risk

exposures. The Audit Committee assists the Board in discharging its responsibilities with regard to external and internal audit activities and controls including reviewing audit reports, internal controls and risk management systems.

The Group's risk management and internal control systems are regularly reviewed by the Board and are consistent with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting issued by the FRC and compliant with the requirements of the Capital Requirements Directive IV (CRD IV). They have been in place for the year under review and up to the date of the approval of the Annual Report and Accounts.

#### Control Effectiveness Review

In addition, a Control Effectiveness Review was completed across the Group, providing an assessment and statement on the effectiveness of the Group's control environment. This provides assurance to the Risk Committee that no new material control issues have been identified and that robust management actions are in place to address specific known gaps.

#### Overall Assessment

Over the past year, the Group has refreshed the Risk Management Framework, simplifying and improving the risk categories and impact classification. The control environment remains stable with the 2016 Control Effectiveness Statement providing assurance that ineffective controls are escalated appropriately and have adequate action plans in place.

The Risk Committee, in conjunction with the Audit Committee, concluded that the Group's risk management and internal control framework in relation to the Group's risk profile and strategy was effective and adequate, and was recommended to and approved by the Board.

### Remuneration

The statement by the Chair of the Remuneration Committee, the Directors' Remuneration Policy and the Directors' Annual Report on Remuneration are set out on pages 104 to 130.



## Shareholder Relationships

The Board recognises the need for a programme of engagement which offers all shareholders opportunities to receive information from the Company and enables them to share their views with the Board. In addition, the Board regularly receives feedback on shareholder sentiment and sell side analyst views of the Group and the wider industry. In the short time the Company has been listed, the Chairman, Deputy Chairman and the Senior Independent Director have all met investors.

Following the demerger, approximately 75% of the Company's shares were distributed to existing NAB shareholders and 25% were sold by NAB via the IPO. Since the demerger and the IPO, the Company's share register composition has changed.

The notable changes to the share register since listing have seen the Company's UK institutional ownership decrease from 12% at listing to 10% at 30 September 2016. The level of Australian institutional ownership has increased over the same period from 40% to 61%. Institutional shareholders outside of the UK and Australia, as well as retail shareholders in Australia and New Zealand, commensurately lowered their level of ownership of the Company during this period.

The demerger also resulted in a considerable holding of the Company's securities in the form of CHESS Depository Interests (CDIs). Following the demerger, approximately 75% of the Company's securities were issued in the form of CDIs which trade on the ASX, and 25% of the Company's securities were issued in the form of ordinary shares which trade on the LSE. At 30 September 2016, the figures were 85% and 15% respectively.

### Relationships with Institutional Investors

During the year, a number of investors moved to greater than a 3% holding in the Company. Details are provided in the Directors' Report on page 135.

During the year the Executive Leadership Team was actively involved in marketing activities to support the demerger and the IPO. An investor roadshow was held following the interim results in the key geographic locations where our shareholders are based. The event in London provided a webcast facility for investors and analysts unable to attend in person.

In September 2016, the Company held a Capital Markets Day in London. A number of the Company's investors attended in person alongside a number of UK and Australian sell side analysts that cover the Company. The purpose of the day was to update the market with respect to management plans for the Company and to outline the additional opportunities the new management team had identified since the demerger. In addition, the Company also updated the market with revised and accelerated guidance targets. Further details on the Company's strategy have been included on pages 14 to 19.

The Board receives regular feedback on share price performance, investor and analysts news and changes to the shareholder register via regular monthly reports, a quarterly detailed investor relations update and ad hoc feedback.

### Governance and Executive Remuneration

A draft of the Directors' Remuneration Policy was developed and shared with the Company's largest shareholders. The consultation process set out the UK regulations applied by the PRA and described how the Company's framework operated within this regulation. The investors were invited to feed back on the Company's framework and the alignment with shareholder interest recognising the regulatory requirements. This feedback was considered by the Remuneration Committee before finalising the policy, which will be put to shareholders for approval at the forthcoming AGM.

### Relationships with Retail Shareholders

The Company Secretary oversees communication with retail shareholders and provides feedback to the Board and appropriate Committees to ensure the views of retail shareholders are received and considered.

The Group's Registrar, Computershare, provides a dedicated shareholder service at [www.investorcentre.co.uk](http://www.investorcentre.co.uk) in the UK and [www.investorcentre.com.au](http://www.investorcentre.com.au) in Australia through which shareholders can manage their shareholding online, receive Company communications and cast proxy votes for forthcoming general meetings.

During the year the Company has made specific contact with shareholders in relation to the demerger and the IPO. All new shareholders received a welcome pack.

## The Annual General Meeting

The Company held its first AGM on 22 January 2016 prior to the IPO, when the sole shareholder was NAB.

Shareholders are invited to attend the Company's 2017 AGM, to be held at 10.00am (Melbourne time – AEDT) on Tuesday 31 January 2017 at the Melbourne Convention and Exhibition Centre, 1 Convention Centre Place, South Wharf, Melbourne, Victoria 3006, Australia, when they will have the opportunity to engage directly with Directors, who will be available to answer any shareholder questions. Facilities are also available for shareholders to cast their votes electronically, or by post. All resolutions at the 2017 AGM will be voted on a poll. The procedure for voting on a poll follows best practice and allows the Company to count all votes rather than just those of the shareholders attending the meeting.

The resolutions to be proposed at the AGM, together with explanatory notes, are set out in a separate Notice of AGM which accompanies this Annual Report and Accounts and is on

the Company's website ([www.cybg.com](http://www.cybg.com)). The Notice of AGM is circulated to all shareholders at least 20 working days prior to such meetings and it is the Company's policy not to combine resolutions. As recommended by the Code, all resolutions to be proposed at the 2017 AGM will be voted separately and the voting results will include all votes cast for, against and those withheld, together with all proxies lodged prior to the meeting. A vote withheld will not be a vote in law and will not be used in calculating the votes for or against a resolution. Details of the proxy votes cast will be made available on the Company's website as soon as is reasonably practicable after the meeting, by means of an announcement on the securities exchanges to which the Company is listed and on the Company's website [www.cybg.com](http://www.cybg.com). In the opinion of the Board, where the situation arises that a significant proportion of votes have been cast against a resolution at any general meeting, the Company will explain, when announcing the results of voting, what action it intends to take to understand the reasons behind the result of the vote.



GOVERNANCE  
& NOMINATION  
COMMITTEE  
REPORT

Dear Shareholder,

I am pleased to present my first report as Chair of the Governance & Nomination Committee having succeeded Barbara Ridpath as Committee Chair on 29 April 2016 and I would like to thank her for her valuable contribution.

The Committee's role is to regularly review the structure, size and composition of the Board having regard to the balance of skills, experience, knowledge, independence and diversity on the Board, and to develop and maintain a formal, rigorous and transparent procedure for identifying and nominating for approval by the Board candidates to fill Board and Committee vacancies when they arise. The Committee also reviews the succession plans at Board and Executive level; leads the process for the periodic evaluation of the performance and effectiveness of the Board, Committees and individual Directors; and makes recommendations to the Board to ensure that the Group's corporate governance arrangements are consistent with best practice and good corporate governance standards.

During 2016, succession planning and the composition of the Board and its Committees was a key focus for the Governance & Nomination Committee. The Committee led a programme to review and refresh Board and Committee composition and recommended the appointment of five new independent Non-Executive Directors to complement the Board's existing knowledge, skills and experience, and increasing diversity, and to ensure the composition of the Board and Committees are appropriate for a listed company.

During the year, the Committee also considered Executive succession planning, oversaw the strengthening of the Executive Leadership Team and supported a number of high calibre Executive Leadership Team appointments.

The Committee also spent time considering progress against the actions arising from the externally facilitated evaluation of Board effectiveness undertaken in 2015 prior to the demerger and IPO. I am pleased to confirm that the majority of recommendations have been acted upon, leading to improvements in a number of areas including further strengthening the Board and enhancing the corporate governance framework in preparation for listing.

In the year ahead the Committee will continue to monitor the needs of the Board, its Committees and the longer term leadership of the business by ensuring that succession plans align to, and keep pace with, the strategic goals of the Group. The Committee will continue to oversee the effectiveness of the corporate governance arrangements and will lead a formal performance evaluation of the Board, its Committees and of individual Directors (including my role as Chairman) during 2017.

**Jim Pettigrew**  
Chair, Governance & Nomination Committee

Membership and Meetings

The current members of the Committee are:

- Jim Pettigrew, Chair
- David Bennett
- Richard Gregory

The Committee is chaired by the Chairman of the Board and the members of the Committee are independent Non-Executive Directors, in accordance with the provisions of the Code. If a matter were to concern the Chairman, then he would leave the meeting and the remaining members would elect one of their number to take the Chair, unless the Chairman had designated a member to do so.

The Chief Executive Officer attends meetings of the Committee at the invitation of the Committee. The Group Human Resources Director also attends meetings at the invitation of the Committee, particularly when the Committee is considering Executive succession planning matters.

Members of the Committee took no part in any discussions concerning their own membership of the Board or appointment as a Chair, or in the case of David Bennett interim Chair, of a Committee.

Committee Attendance

The core activities of the Committee were carried out in four scheduled meetings of the Committee. Five additional ad hoc meetings of the Committee were arranged when matters required to be brought to the Committee's attention or decisions were required outside scheduled meetings. The table below shows the Committee members during the year to 30 September 2016 and their attendance at scheduled Committee meetings:

	Number of scheduled Committee meetings eligible to attend	Number of scheduled Committee meetings attended
<b>Committee Chair</b>		
Jim Pettigrew <sup>(1)</sup>	2	2
<b>Committee Members</b>		
David Bennett <sup>(2)</sup>	4	4
Richard Gregory	4	4
<b>Former Committee Members</b>		
Barbara Ridpath <sup>(3)</sup>	2	2
Alex Shapland <sup>(4)</sup>	2	1 <sup>(5)</sup>

<sup>(1)</sup> Jim Pettigrew was appointed Chair of the Committee on 29 April 2016. Jim Pettigrew was not a member of the Committee prior to 29 April 2016 however regularly joined meetings as an attendee.  
<sup>(2)</sup> David Bennett was appointed as a Committee member on 23 November 2015.  
<sup>(3)</sup> Barbara Ridpath retired as Chair of the Committee on 28 April 2016.  
<sup>(4)</sup> Alex Shapland retired as Committee member on 20 May 2016.  
<sup>(5)</sup> The Directors were unable to attend meetings due to unavoidable prior business commitments.

Committee Purpose and Responsibilities

The purpose of the Committee is to keep the Board's composition, skills, experience, knowledge, independence, diversity and succession arrangements under review. The Committee makes recommendations to the Board to ensure that the Group's corporate governance arrangements are consistent with good corporate governance standards.

The Committee reports to the Board on how it discharges its responsibilities and makes recommendations to the Board, all of which were accepted during the year.

- The key role and responsibilities of the Committee are to:
- regularly review the structure, size and composition of the Board and to put in place plans for the orderly succession of appointees to the Board and senior executives;



- lead the process for identifying, and nominating for approval by the Board, candidates to fill Board and Committee vacancies when they arise;
- lead the process for the periodic evaluation of the performance and effectiveness of the Board, Committees and individual Directors, ensuring that the conclusions and recommendations are reported to the Board;
- lead the process for the periodic evaluation of the independence of Non-Executive Directors;
- ensure that the Company's Board and senior executives have the right skills, values and attitudes essential to success;
- oversee the application of policies and procedures of the Group adopted in accordance with the Committee's Charter throughout the Group; and
- oversee matters relating to developments in the law and practice of corporate governance insofar as these matters and developments affect the Board.

### Matters Considered by the Committee in 2015/16

#### Board and Executive Succession

During the year the Committee:

- reviewed the composition of the Board and led a process of strengthening the skills, experience and knowledge of the Board by selecting and recommending to the Board the appointment of David Bennett as an independent Non-Executive Director and Deputy Chairman and Clive Adamson, Paul Coby, Fiona MacLeod and Tim Wade as independent Non-Executive Directors. Details of their experience are set out on pages 62 to 66;
- kept the composition of the Committees under review and recommended the appointment of David Bennett as a member of the Audit, Governance & Nomination, Remuneration and Risk Committees; and Clive Adamson and Tim Wade as members of the Audit and Risk Committees. As announced on 26 October 2016 the Committee recommended the appointment of Fiona MacLeod as a member of the Governance & Nomination Committee and Risk Committee, and Paul Coby as a member of the Risk Committee with effect from 30 December 2016;
- recommended the appointment of Jim Pettigrew as Chair of the Governance & Nomination Committee to succeed Barbara Ridpath;

- recommended to the Board an interim arrangement for David Bennett to be appointed Chair of the Audit Committee while the selection of a permanent successor progressed, and subsequently guided the Board on the recommended timing of transition arrangements;
- led the process for selecting and recommending Tim Wade as a permanent successor for David Allvey as Chair of the Audit Committee with effect from 23 November 2016;
- as part of its work on Executive succession planning, reviewed and supported the appointment of Gavin Opperman as Customer Banking Director and of Fergus Murphy as Products Director, who joined the business in November 2015 and January 2016 respectively; of Kate Guthrie as Group Human Resources Director, who joined the Group in January 2016; and finally of Mark Thundercliffe as Chief Risk Officer, who joined the Group in September 2016;
- considered the longer term succession of Board and Committee members, and of the Executive Leadership Team roles, including the tenure, mix and diversity of skills and experience of current Directors and Executives relative to future requirements in the context of the Group's strategy, which will be an area of continued focus for the Committee going forward. The approach for Non-Executive Director succession planning takes into account the need to periodically refresh the Board to bring new and fresh perspectives to the Board and its decision making. Work is underway to develop a skills matrix to support and enhance longer term succession planning.

When considering the recruitment of a new Director, the Committee adopts a formal, rigorous and transparent procedure with due regard to diversity, including gender. Prior to commencing the recruitment process, the Committee evaluates the balance of skills, knowledge, experience, independence and diversity on the Board and, in light of this evaluation, prepares a description of the role and capabilities required. In identifying suitable candidates, the Committee:

- uses open advertising or the services of external advisers to facilitate the search;
- considers candidates from different genders and a wide range of backgrounds;
- considers candidates on merit and against objective criteria ensuring that appointees have sufficient time to devote to the position, in light of other potential significant positions; and

- engages from time to time with the Group's major shareholders in future skills requirements and ideas for potential candidates.

Where the Committee appoints external advisers to facilitate the Director search process, it ensures that the firm has a specialism in financial services appointments and has no other connection with the Company.

#### Recruitment of Chair of Audit Committee

It was intimated in the Company's IPO Prospectus published in February 2016 that David Allvey had indicated his intention to retire from the Board and that this was expected to be during the first half of 2016. In expectation of David's retirement the Committee commenced the process for the appointment of a successor. A comprehensive and rigorous search process commenced and the Committee agreed a description of the role and capabilities required. Korn Ferry, an external search firm with no other connection to the Company, was engaged to assist with the selection process. Korn Ferry undertook a search for candidates and an initial competency assessment and interview of all potential candidates. A longlist of candidates was prepared. The longlist of candidates was reviewed by Committee members and the Chairman of the Board. A shortlist of suitable, qualified candidates was agreed and a number of interviews and meetings with shortlisted candidates were held with Committee members, the Chairman of the Board and the Chief Executive Officer. Following the interview process, Tim Wade was selected as the preferred candidate as he fully met the criteria required for the role and was therefore recommended to the Board for approval. Under the PRA and FCA Senior Managers and Certification Regimes, the Chair of the Audit Committee role is a Senior Management Function (SMF 11) thereby also requiring, and receiving, the approval of the PRA.

#### Composition, Skills and Independence

The Committee is responsible for the ongoing assessment of the independence of the Non-Executive Directors. In assessing independence, the Committee had regard to both the Code requirements on independence and factors such as length of tenure and the ability of the Non-Executive Directors to objectively challenge the Executive, free from relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement. It also took account of any relationships that had been disclosed and

authorised by the Board. The Code suggests that length of tenure is a factor to consider when determining the independence of Directors. This year when reviewing independence in preparation for listing, and in considering whether the Group's corporate governance framework was aligned with the Code, the Committee took account of the fact that Richard Gregory had served over the Code's nine year provision on the Board of a Group company as at 8 February 2016, the listing date. The Board considered the matter carefully and was of the opinion that Richard Gregory continues to demonstrate the qualities of independence in character and judgement in carrying out his role and provides a strong non-executive presence on the Board.

Based on the assessment for 2016, the Committee is satisfied that, throughout the year (or the period of their appointment), all Non-Executive Directors remained independent as to both character and judgement and that Jim Pettigrew was considered independent on his appointment. Accordingly, at least half the Board is comprised of independent Non-Executive Directors.

The Committee recommends the election and re-election of all Directors, as at the date of this report.

#### Diversity

The Board recognises the value of achieving diversity on the Board and throughout the Group. Although new appointments are based on merit, careful consideration is given to the benefits of improving and complementing the diversity, skills, experience and knowledge of the Board. The Board recognises and is committed to creating the conditions that foster talent for women to achieve their full potential by building strong female representation at Board level, Executive Leadership Team level and throughout the Group. The Board's commitment is set out in the Board Composition and Renewal Policy. A separate Diversity at Work Standard applies to all colleagues across the Group. In 2016 the Board continued to focus on improving diversity and will continue to do so. The percentage of female representation on the Board at the date of this report is 23% (based on three female Directors and 10 male Directors), slightly short of the recommendation of Lord Davies for 25% female representation by 2015.



## AUDIT COMMITTEE REPORT

Dear Shareholder,

I became the Interim Chair of the Audit Committee on 1 April 2016 upon the retirement of David Allvey, having been appointed to the Committee in November 2015. The Committee was strengthened with the appointment of Clive Adamson in July 2016 and, as announced in September 2016, Tim Wade will become Chair of the Audit Committee with effect from 23 November 2016 and I wish him every success for the future. I would like to thank David Allvey my predecessor as Chair, the members of the Committee and the Executive Leadership Team for their invaluable support during my tenure as interim Chair.

During the year, the Audit Committee has fulfilled its responsibilities and met its key objectives. The Committee reviewed a number of key accounting judgements relevant to the financial statements, including a focus on impairment provisioning, capitalisation of intangible assets, provisioning for PPI and other conduct matters and deferred tax.

A key addition to the 2016 Annual Report and Accounts is the inclusion of a Viability Statement as required by the Code, which is assessed and challenged by both the Audit and Risk Committees. Details can be found within the Risk Overview section on pages 32 to 39.

In preparation for our demerger and IPO, a formal competitive tender for external audit services was undertaken. The Committee oversaw the tender process, which involved a thorough and robust assessment of the firms involved, including the incumbent firm Ernst & Young LLP (EY), details of which are set out on page 97.

After careful consideration of the strength of each proposal, the Board approved the recommendation from the Committee to retain EY as external auditor for the year ended 30 September 2016.

The Committee also reviewed management and Internal Audit's assessment of the Group's internal controls, which covers all aspects of external statutory and regulatory reporting, and concluded that the Group's internal controls were appropriately designed and operating effectively during the year.

Finally, the Committee engaged Deloitte LLP to undertake a review of the activity, role and effectiveness of the Internal Audit function and I am pleased to report that based on Deloitte LLP's report, the Committee concluded that the function generally conformed with the high standards set by the Chartered Institute of Internal Auditors (CIIA) 2013 Guidance, "Effective internal audit in the financial services sector". Observations raised in the assessment to further enhance the function are being progressed by the Director of Internal Audit and they will be monitored by the Committee.

David Bennett  
Interim Chair, Audit Committee

## Membership and Meetings

The current members of the Committee are:

David Bennett, Interim Chair  
Clive Adamson  
David Browne  
Richard Gregory  
Dr Teresa Robson-Capps  
Tim Wade

The Committee comprises six independent Non-Executive Directors. David Bennett, Interim Chair, has recent and relevant accounting and audit experience for the purposes of the Code having held a number of senior finance roles (details of which are on page 62). The other Committee members

have significant current or recent experience in the financial services and banking industries. This depth of experience enables the Committee to deal effectively with the matters within its remit and to challenge management when required. In addition to the Committee members, the Chairman, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Company Secretary, Deputy Chief Financial Officer, General Counsel, Director of Internal Audit and the external auditor are invited to attend Committee meetings. The Interim Chair is also a member of the Risk Committee.

The Committee meets at least twice a year with the external auditor and Director of Internal Audit, without management present, to discuss any matters relating to their remit and any matters arising from external and internal audit.

## Committee attendance

The core activities of the Committee were carried out in seven scheduled meetings of the Committee. One additional ad hoc meeting of the Committee was arranged when matters required to be brought to the Committee's attention or decisions were required outside scheduled meetings. The table below shows the Committee members during the year to 30 September 2016 and their attendance at scheduled Committee meetings:

	Number of scheduled Committee meetings eligible to attend	Number of scheduled Committee meetings attended
<b>Committee Chair</b>		
David Bennett (Interim Chair) <sup>(1)</sup>	5	5
<b>Committee Members</b>		
Clive Adamson <sup>(2)</sup>	2	1 <sup>(5)</sup>
David Browne	7	7
Richard Gregory	7	7
Dr Teresa Robson-Capps	7	7
Tim Wade <sup>(3)</sup>	2	1 <sup>(5)</sup>
<b>Former Committee Members</b>		
David Allvey <sup>(4)</sup>	4	4

<sup>(1)</sup> David Bennett was appointed as a Committee member on 23 November 2015 and Interim Chair on 1 April 2016.  
<sup>(2)</sup> Clive Adamson was appointed as a Committee member on 1 July 2016.  
<sup>(3)</sup> Tim Wade was appointed as a Committee member on 12 September 2016.  
<sup>(4)</sup> David Allvey retired as Committee Chair on 31 March 2016.  
<sup>(5)</sup> The Directors were unable to attend meetings due to unavoidable prior business commitments.



Committee Purpose and Responsibilities

The Committee acts independently of management to ensure that the interests of shareholders are properly protected in relation to financial reporting, maintaining an appropriate relationship with the external auditor, and the effectiveness of the Group's system of internal control and risk management. The key responsibilities of the Committee are to:

- monitor the integrity of the accounting, financial statements (including annual and half-yearly reports) and financial reporting processes of the Group;
- review and challenge, where necessary, the judgements and estimates of management taking into account the views of the external auditor in relation to the Company's financial statements, including the going concern assumption;
- ensure that the Group complies with all necessary regulatory reporting including reviewing arrangements for complying with regulatory financial reporting and best practice requirements;
- monitor the adequacy and effectiveness of the Group's internal controls over financial reporting and risk management systems;
- approve the Internal Audit plan and monitor the role and effectiveness of the Internal Audit function;
- agree the scope of the external auditor's annual plan and output;
- oversee the Company's relationship with the external auditor including approving the terms of engagement, making recommendations to the Board on their remuneration (including fees for audit and non-audit services), and reviewing on an annual basis their independence and the effectiveness of the audit process taking into account relevant UK professional and regulatory requirements;
- develop and implement a policy on the supply of non-audit services by the external auditor taking into account any relevant ethical guidance on the matter;
- consider and make recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor;
- monitor the effectiveness of the Group's whistleblowing, fraud and anti-money laundering procedures; and
- oversee the application of Group policies and procedures adopted in accordance with the Committee's Charter throughout the Group.

Matters Considered by the Committee

2015/16

During the year, the Committee considered, amongst other matters, the following:

- whether the Finance and Internal Audit functions were sufficiently resourced and skilled to operate as a standalone entity;
- the integrity of the Pillar 3 Disclosures, Interim Financial Report, the Preliminary Results announcement and the Annual Report and Accounts;
- changes to financial reporting requirements following the demerger and IPO and how those changes would be built into future reporting;
- provisions in respect of legacy conduct (including PPI) matters;
- the effectiveness of the Group's Whistleblower Programme;
- the effectiveness of the Internal Audit function including the role of Director of Internal Audit; and
- the performance, objectivity and independence of the external auditor, the audit tender process and external audit fees.

Financial Reporting

A key responsibility of the Committee is to review the content of the Interim Financial Report, Annual Report and Accounts, and related Preliminary Results Announcements. In doing so, the Committee has:

- understood the process for the production of the reports under the remit of the Chief Financial Officer and the level of involvement of cross functional subject matter experts, including monitoring the procedures in place to ensure that all contributors attested to the completeness, accuracy and appropriateness of the disclosures provided;
- reviewed the reports to ensure that, taken as a whole, based on the information supplied to it and challenged by the Committee, they were fair, balanced and understandable, and advised the Board to that effect;
- reviewed and challenged the going concern and viability assessment undertaken by management;
- considered, where necessary, the actions, estimates and judgements of management; and
- reviewed the critical accounting policies, disclosure obligations and changes in accounting requirements.

Details of the significant issues and areas of judgement considered are set out on pages 94 to 95.

Internal Control & Risk Management

Details of the internal controls and risk management systems for the Group's financial reporting process are provided within the Corporate Governance Report on page 83 and in the Risk Report on pages 140-145. During 2016, the Committee has:

- reviewed the effectiveness of the Group's internal control and risk management systems;
- overseen and challenged the enterprise wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools;
- considered the results of Internal Audit's work and its periodic reporting;
- considered the findings of the external auditor;
- considered, and where necessary challenged, the outputs

of the Group's attestation framework over internal control and financial reporting;

- considered the outcome of the work of Reporting Assurance;
- considered periodic whistleblower framework reporting; and
- considered any instances in which control weaknesses, fraud or misconduct were highlighted and management's response in conjunction with any associated control deficiencies.

As a result, the Committee is assured that internal controls for financial reporting and risk management systems were appropriate and fit for purpose throughout the year.

CORPORATE  
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Key Issues/Judgements

During 2016, the Committee considered the following key financial issues and judgements in relation to the Group's financial statements and disclosures which were made by management, with input from the external auditor:

Key issues/judgements in financial reporting	Audit Committee review and conclusions
<p><b>Impairment provisions on credit exposures</b></p> <p>The calculation of loan impairment provisions is management's best estimate of losses incurred in the Group's portfolios at the balance sheet date. This judgement includes estimates of future expected cashflows both from the customer and security held. Accordingly, determining the appropriateness of impairment provisions is inherently judgemental and requires the use of assumptions.</p>	<ul style="list-style-type: none"><li>- Management has presented regular reports to the Committee in relation to impairment provisioning, with the key focus being on collective provisioning for SME lending where the judgemental element is most significant.</li><li>- The Committee reviewed and challenged the inputs and resulting output of the collective provisioning models, with a particular focus on probabilities of default, emergence periods and the impact of factors that may not have been adequately captured in modelling based on historic data, such as the impact of economic conditions on the oil and gas sector and the impact of the vote to leave the European Union.</li><li>- The Committee agreed that the judgements were appropriate at 30 September 2016. The disclosures relating to impairment provisions are set out in note 17 to the financial statements and in the Risk Report from page 165.</li></ul>
<p><b>PPI and other conduct related provisioning</b></p> <p>The level of provisions required for both redress and administration in relation to past conduct related matters requires assumptions to be made that are based upon a combination of historical data and management judgement. These judgements are inherently complex as they involve making estimates based on multiple factors that incorporate expectations of future customer behaviour, the impact of regulatory rule making and the application of precedent from the Financial Ombudsman Service.</p>	<ul style="list-style-type: none"><li>- The Committee has reviewed and challenged the assumptions made by management when determining the level of provisions required for PPI and other conduct related matters.</li><li>- During the year, the Committee reviewed in detail a number of PPI scenarios presented by management which reflected alternative potential outcomes before concluding on the £450m provision increase recorded in March 2016.</li><li>- In relation to PPI, the Committee also considered the impact of CP 15/39 and Plevin together with the latest consultations (CP16/20) and in particular the impact of the proposed time bar. Based upon the most recent information the Committee concluded that the assumptions used by management were supportable and that the provisions recorded at 30 September 2016 were appropriate.</li><li>- Other conduct related provisioning requirements were reviewed by the Committee on a regular basis during the year. This included a review of requirements for both redress and administration, together with an assessment of the ability to claim from NAB under the terms of the Conduct Indemnity which materially mitigates the impact of provision increases on the Group, including for PPI, but does not reduce the level of judgement required in the provision itself. Where appropriate, claims have been submitted to NAB and the Committee has reviewed and agreed the subsequent accounting treatment.</li><li>- The disclosures relating to provisions for conduct matters and the impact of the Conduct Indemnity from NAB are set out in note 27.</li></ul>
<p><b>Recoverability of deferred tax assets</b></p> <p>The largest elements of the Group's deferred tax asset are historic losses and capital allowances. Recognition requires consideration of the future levels of taxable profits in the Group. During the year further changes in tax rules occurred, with the most significant being a restriction on the use of historic losses of banks to 25% which became effective in September 2016.</p>	<ul style="list-style-type: none"><li>- The Committee has reviewed the recoverability of deferred tax assets throughout the year.</li><li>- Changes in tax legislation and the impact on the deferred tax asset have been considered and resulted in material derecognition as set out in the related disclosures in note 23.</li><li>- The Committee also considered the shortening of the time horizon over which the use of tax losses was foreseeable in light of the continuing and progressively tightening restrictions on their use and concluded that this was appropriate and that recognition of a deferred tax asset of £183m at 30 September 2016 was appropriate.</li></ul>

Equity Investments

Unlisted available for sale investments are held at fair value and require valuation techniques which incorporate management judgements.

- As a result of sale offers in relation to the two principal equity investments, judgement has been required in relation to the timing and recognition of valuation changes during the year and the measurement of residual interests at 30 September 2016.
- The Committee reviewed and agreed management proposals and note 13 provides additional detail in relation to the position at 30 September 2016.

Carrying value of intangible assets

As part of its ongoing operations, the Group makes significant investment in its systems and processes to address resilience and currency, regulatory change and to support product development and deliver the infrastructure required to provide customers with an effective omni-channel experience. Software assets are capitalised when they are considered to provide a future benefit to the Group and its customers.

The portfolio of capitalised software assets is reviewed on a regular basis to assess whether any are impaired, whether by changes in use, replacement, or customer behaviour, and to confirm that amortisation periods are appropriate.

- During 2015 and 2016 there has been significant investment in digital capability, principally relating to the development and implementation of B.
- The Committee has considered the accounting recognition of the digital development activity and also considered management's review of indicators of impairment across the wider portfolio of software assets, in particular those where proposed efficiency initiatives may impact on the existing assets. The Committee agreed with management's view around the capitalisation of the relevant assets and the recognition of impairment charges for assets that are being superseded and for elements of the investment that replace existing capability.
- The movements in intangible assets including the £45m of impairment recognised are disclosed in note 22.

Retirement benefit obligations

The valuation of the defined benefit pension obligation incorporates significant judgements on future financial and demographic outcomes, with the key elements being discount rate, inflation and mortality.

- In line with most UK defined benefit pension schemes, the market impact of the UK vote to leave the European Union has been detrimental to IAS 19 funding levels. The Committee has reviewed the discount and inflation rate assumptions proposed by management as at 30 September 2016 and concurred with these key assumptions which are disclosed in note 29.
- The mortality assumptions are consistent with the prior year and will be reviewed in detail over the next 12 months as part of the scheduled Triennial Review process which will be referenced to 30 September 2016.

A number of other judgements are included within the financial statements although these are not considered to be as significant by the Committee.

- The Committee considered these other issues and judgements, including accounting for equity based compensation and the use of the Effective Interest Rate method of accounting. The Committee concurred with the approach adopted by management.



## Assessment of the Fair, Balanced and Understandable Statement

At the request of the Board, the Committee considered whether the 2016 Annual Report and Accounts was fair, balanced and understandable and whether it provided the necessary information for shareholders to assess the Group's performance, business model and strategy. The process enabling the Committee to reach this conclusion included:

- the production of the 2016 Annual Report and Accounts which was managed by the Chief Financial Officer, with overall governance and co-ordination provided by a cross-functional team of senior management led by the Deputy Chief Financial Officer;
- cross-functional support to drafting the 2016 Annual Report and Accounts, which included input from Finance, Risk, Governance, Investor Relations, HR and the wider business;
- there was a robust review process of inputs into the 2016 Annual Report and Accounts by all contributors to ensure disclosures were balanced, accurate and verified, and further comprehensive reviews were conducted by senior management;
- the Company Secretary reviewed all Board and Committee minutes to ensure all significant matters discussed at meetings were appropriately disclosed in the 2016 Annual Report and Accounts as required;
- a formal review was undertaken by the Committee of the draft 2016 Annual Report and Accounts in advance of final sign-off; and
- a final review was performed by the Board of Directors.

After careful review and consideration of all relevant information, the Committee was satisfied that, taken as a whole, the Annual Report and Accounts is fair, balanced and understandable and has affirmed that view to the Board.

## Internal Audit

Internal Audit plays a key role in the Risk Management Framework by providing independent assurance and challenge over governance, risk management and internal control practices across the Group. In monitoring the role and effectiveness of the Internal Audit function, the Committee:

- approved the Internal Audit Charter, which sets out the role and responsibilities of the function;
- assessed the effectiveness of the Internal Audit function, including the commissioning of an independent external quality assessment, carried out by Deloitte LLP, which

concluded that the function generally conforms with the Standards and Code of Ethics issued by the Chartered Institute of Internal Auditors (CIIA). Deloitte LLP also concluded that the function generally conforms with the higher standards set by the CIIA's 2013 Guidance, "Effective internal audit in the financial services sector". Observations raised in the assessment to further enhance the function are being progressed by the Director of Internal Audit;

- approved the audit plan and monitored progress to deliver the plan and material changes to it on a quarterly basis;
- reviewed the outcomes of Internal Audit's work, the actions agreed with management to address any issues raised and the status of previously agreed actions; and
- monitored the adequacy of Internal Audit resources, including the financial budget and capability to draw on external specialists when appropriate.

There were regular interactions with the Director of Internal Audit during the year, including private Committee sessions and specific workshops with Internal Audit and senior management to discuss audit planning and priorities.

## Whistleblowing

The Committee considered reports from Internal Audit covering the Group's whistleblowing arrangements, including the outcome from a benchmarking review of the whistleblowing framework conducted by EY. As part of this review, the Committee considered the PRA and FCA policy statement (PS15/24) on whistleblowing published in October 2015.

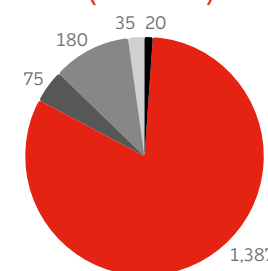
The Chair of the Committee has been appointed as the Whistleblowing Champion and actions have been undertaken to ensure compliance with the new regulatory rules.

## External Audit

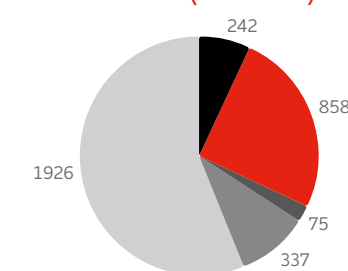
The Committee is responsible for overseeing the relationship with the external auditor. The Committee undertook the following activities during the year in order to fulfil its obligations:

- approved the annual audit plan, approved the engagement letter and agreed the auditor's remuneration;
- reviewed the findings of the external audit including key judgements and the level of challenge provided by the external auditor;
- reviewed management's responses to control weaknesses, non-compliance and any other weaknesses identified by external audit;

2016 (£'000)



2015 (£'000)



- Audit of the Company's Financial Statements
- Audits of the Company's subsidiaries including Clydesdale Bank PLC
- Audit of the Group pension scheme
- Audit related assurance
- Other assurance services

- considered the continued effectiveness of the audit process and the external auditor's performance, including qualifications, expertise, resources and effectiveness, through an annual effectiveness review which was integrated within the tender process;
- considered the objectivity and independence of the external auditor during the year; and
- reviewed and approved the Group's External Auditor Independence Policy, which included details regarding the provision of non-audit services by the external auditor.

## Audit Tenure

EY has been the external auditor for Clydesdale Bank PLC and other Group entities since 31 January 2005. EY was appointed as the Company's external auditor on 14 January 2016, prior to the Company becoming the holding company of the Group.

## External Audit Tender

The Committee took the decision in early 2015 to tender the audit of the Group in order to meet the requirements applying to external auditor appointments under the Competition & Market Authority's 2014 Order. The process commenced in May 2015 and was conducted as follows:

- five firms were initially invited to participate in the tender process, with EY, PricewaterhouseCoopers LLP and Deloitte LLP progressing beyond the preliminary stage. One firm selected to progress to the next stage withdrew from the process as they were unable to accept the appointment before 1 October 2017. Consequently, the firm was eliminated from the selection process;
- the participant firms submitted written service proposal documents which were assessed against the criteria set by management and the Committee. Suitable alternatives

from the challenging firms were presented against EY as incumbent auditor. The performance of EY as auditor in the previous year was also assessed. Given the level of change facing the Group at the time, the Committee concluded that there were clear benefits in retaining EY as auditor to provide a continuous and consistent service and a robust level of challenge that comes from knowing our business; and

- following careful consideration, the Board accepted the recommendation from the Committee to appoint EY as auditor for the initial period post the demerger and IPO but recommended that this be kept under review.

The Committee continues to follow developments in the reform of the external audit regulations and the UK and European requirements on publicly listed banking groups.

The Committee confirms that the Group has complied during the period of financial review and to the date of this report with The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

## Audit Independence and Remuneration for Non-Audit Services

Both the Board and the external auditor have safeguards in place to protect the independence and objectivity of the external auditor. The Committee has in place a comprehensive External Auditor Independence Policy to regulate the use of the external auditor for the provision of non-audit services. This policy is reviewed at least annually and was refreshed during 2016 to take account of the latest changes in auditor regulations and to reflect the demerger and IPO.

## CORPORATE GOVERNANCE REPORT

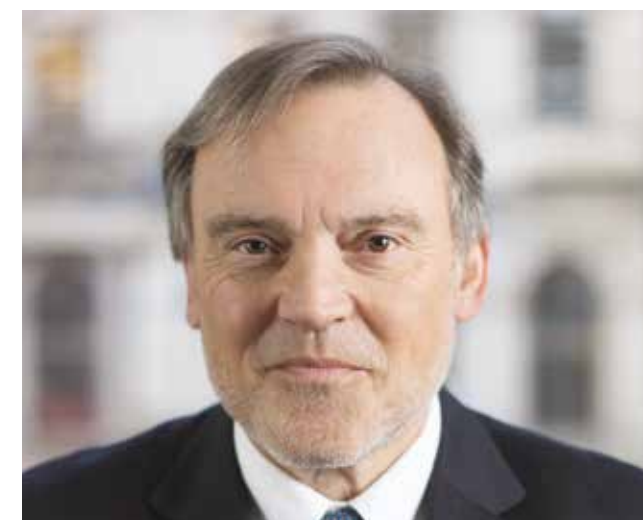
This policy specifies the nature of work that the external auditor may not undertake, including but not restricted to financial information system design and implementation, accounting or other services relating to the Group's financial statements or legal services.

In certain cases, the external auditor may be selected over another service provider due to their detailed knowledge and understanding of the Group's operations. Any allowable non-audit service with a value above £250,000 requires approval from the Chair of the Committee.

The total amount paid to the external auditor in 2016 was £1,697k (2015: £3,438k). Payments by the Group for both audit and non-audit services provided in 2016 and 2015 are further detailed in note 7 to the financial statements.

### Alignment with Risk Committee

The Committee recognises the common interest in issues relevant to both the Risk Committee and Audit Committee and in particular the responsibilities of both in relation to the effectiveness of internal control. To support the co-ordination of information between the Committees, the Chairs of each of the Audit and Risk Committees are members of both Committees. The Audit Committee and Risk Committee also hold at least one joint meeting per year. The most recent meeting took place on 28 September 2016 and considered assurance plans from the three lines of defence and the Viability Statement.



## RISK COMMITTEE REPORT

Dear Shareholder,

As Chair of the Risk Committee, I am pleased to present the report from the Committee for the year ending 30 September 2016. During the year, I have been particularly pleased to witness the further strengthening of the Committee's oversight of risk management practices across the Group through its first year as a standalone listed entity. The Committee has benefited from the excellent insight and challenging inputs of its existing and new members and as Chair, I would like to thank them all for their contributions.

The Committee has worked to ensure that an appropriate risk culture is embedded within the Group and that the adopted culture supports the delivery of the Group's Strategic Plan in line with the Group's Risk Appetite.

During the year, I met regularly with members of the Executive Leadership Team, the Risk Leadership Team and the heads of business units to discuss business performance, market conditions and the impact of key risk indicators on the Group's performance. I also met with the Group's regulators, the FCA and PRA, to keep them apprised of key risks and to discuss with them the regulatory agenda and any other pertinent matters. Throughout the period a number of important risk matters were considered by the Committee, both in the current risk profile of the Group and in relation to emerging risks due to changes in the internal activities of the Group and within the wider environment in which the Group operates. The internal activities of the Group presented new and changing risks for the Committee to consider including: the move to standalone listed status; the development of an omni-channel strategy including the launch of the new B proposition; and the further evolution of the Group's Conduct Risk journey. In terms of emerging risks within the wider environment in which the Group operates, the Committee

considered: the outcome of the European Union referendum; uncertainty in the UK housing market; the impact of new tax rules for BTL investors; the challenges experienced in the oil & gas and agriculture industries; the rising threat of cybercrime; legal and industry developments in the treatment of PPI complaint cases; and various regulatory developments such as the EU's Payment Accounts Directive.

The Committee has been rigorous in its challenge to management to satisfy itself that robust controls are in place over key risks. The Committee has overseen the operation of Conduct Risk management controls to be confident that our customers receive the right outcomes and that our business continues to operate with the high standards of governance that our shareholders and other stakeholders expect.

The following report sets out some of the specific key risks the Committee evaluated over the year. More details on the wider risk profile and the Risk Management Framework that the Committee oversees can be found in the Risk Overview within the Strategic Report on pages 32 to 39 and in the Risk Report on pages 138 to 197. Looking ahead, areas of emerging risk that the Committee will continue to monitor are outlined in the Risk Overview on pages 36 to 37.

**Richard Gregory**  
Chair, Risk Committee



Membership and Meetings

The current members of the Committee are:

Richard Gregory, Chair  
Clive Adamson  
David Bennett  
David Browne  
Tim Wade

Committee have a deep understanding of risk management and bring extensive experience and a broader perspective to the oversight of risk management. In addition to the Committee members, the Chairman, Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Risk Officer, Company Secretary, General Counsel, Director of Internal Audit and the Head of Regulatory & Compliance Risk are invited to attend Committee meetings. The Chair is also a member of the Audit Committee.

The Committee comprises five independent Non-Executive Directors who have a variety of industry backgrounds, including banking and financial services. The members of the

Committee Attendance

The core activities of the Committee were carried out in six scheduled meetings of the Committee. One additional ad hoc meeting of the Committee was arranged when matters required to be brought to the Committee's attention or decisions were required outside scheduled meetings. The table below shows the Committee members during the year to 30 September 2016 and their attendance at scheduled Committee meetings:

	Number of scheduled Committee meetings eligible to attend	Number of scheduled Committee meetings attended
Committee Chair		
Richard Gregory	6	6
Committee Members		
Clive Adamson <sup>(1)</sup>	2	1 <sup>(6)</sup>
David Bennett <sup>(2)</sup>	6	5 <sup>(6)</sup>
David Browne	6	6
Tim Wade <sup>(3)</sup>	2	2
Former Committee Members		
David Allvey <sup>(4)</sup>	3	2 <sup>(6)</sup>
Barbara Ridpath <sup>(5)</sup>	3	2 <sup>(6)</sup>
Alex Shapland <sup>(5)</sup>	3	2 <sup>(6)</sup>

<sup>(1)</sup> Clive Adamson was appointed Committee member on 1 July 2016.  
<sup>(2)</sup> David Bennett was appointed Committee member on 23 November 2015.  
<sup>(3)</sup> Tim Wade was appointed Committee member on 12 September 2016.  
<sup>(4)</sup> David Alley retired as a Committee member on 31 March 2016.  
<sup>(5)</sup> Barbara Ridpath and Alex Shapland retired as Committee members on 20 May 2016.  
<sup>(6)</sup> The Directors were unable to attend meetings due to unavoidable prior business commitments.

Committee Purpose and Responsibilities

The purpose of the Committee is to review and challenge the risk culture of the Group and ensure that the risk culture is fully embedded and supports the Group's agreed risk appetite. The key responsibilities of the Committee are to:

- make recommendations to the Board on high level risk matters such as risk appetite, tolerance and particular risks, including Conduct Risk, as well as risk management practices and Prudential Risk;
- monitor and challenge strategic and business change;
- oversee the development, implementation and maintenance of the overall risk management framework and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice;
- review and advise the Board on the current risk exposures of the Group and review management's plans for mitigation of the material risks faced;
- oversee the implementation and review of risk management and internal compliance and control systems;
- review the procedures for preventing and detecting fraud across the Group and to assess the adequacy and effectiveness of the Group's anti-money laundering and compliance processes;
- oversee the management of pension risk;
- assist the Board in promoting awareness of a risk based culture and the achievement of a balance between risk and reward for risks accepted;
- consider and make recommendations to the Board regarding the appointment or removal of the Chief Risk Officer;
- oversee and review the ICAAP and ILAAP, Recovery and Resolution planning process and Risk Assurance plans;
- review and challenge changes to the Group's product portfolio;
- maintain close lines of communication with the Audit Committee and refer any relevant matters which have come to the Committee's attention to the Audit Committee; and
- take a forward looking perspective, anticipating changes in business conditions, risk appetite and tolerance, and regulatory requirements.

Matters Considered by the Committee

2015/16

During the year, the Committee reviewed, approved and maintained oversight of the Group's management of known and emerging risks and the frameworks and policies in place to support risk management. The Committee reviewed and recommended approval by the Board of the setting of the Group's risk appetite, promoted the embedding of a strong risk culture, oversaw the design and application of a robust Risk Management Framework, and assessed the management of the Group's risk profile on an ongoing basis. In addition, the Committee considered a range of specific risks, assessing the potential impact on the Group's operations, and confirmed that adequate controls were in place to manage those risks within appetite.

Risk Appetite

- The Committee reviewed and approved the Group's risk appetite and in particular:
- conducted regular reviews of the Risk Appetite Statement (RAS) taking consideration of the strategic objectives and target business model of the Group as well as the environment in which it operates;
  - reviewed regular reports of performance against each RAS measure, and assessed and confirmed the adequacy of management actions in relation to actual or potential breaches of Red and Amber RAS thresholds;
  - fully refreshed the statements of appetite and limit settings for the material sources of risk during the year and challenged a potential over-reliance on quantitative measures, resulting in the adoption of more qualitative statements of risk; and
  - requested and reviewed deep-dive analysis on a variety of risk matters highlighted through the ongoing assessment of risk performance against appetite.

Risk Culture

The Committee is responsible for promoting awareness of, and ensuring that all employees operate in line with, the Group's risk focused culture, continually considering and assessing the balance between risk and reward.

At the heart of the Group's risk culture is the concept of personal accountability for risk management. During the year, the Committee:

- continually assessed risk culture, including considering risk events and undertaking root cause analysis; and
- reviewed the three lines of defence framework, including endorsement of changes to the 1st and 2nd Lines of Defence.

**Risk Framework**

The Committee oversees and reviews the application of the Group's risk management, compliance and control systems. During the year, the Committee:

- reviewed and approved an updated Risk Management Framework created to support the standalone nature of the Group; and
- reviewed and approved an updated Policy Governance Framework which provides the overarching principles and minimum control requirements that operate across the Group to mitigate risks to within the Group's risk appetite.

**Risk Management**

The Committee plays a pivotal role in overseeing the risk profile and risk management of the Group within the Board approved RAS. During the year, the Committee:

- reviewed and challenged regular reports from the Chief Risk Officer that escalated any matters of concern on the material sources of current and emerging risk to the Group and outlined the remedial activities initiated to ensure that the risk was brought within risk appetite;
- reviewed and challenged regular reports from the Chief Financial Officer to ensure the risks related to the Funding, Liquidity and Capital Risks were managed within appetite;
- approved the annual 3 Lines of Defence Oversight and Assurance Plans and received regular updates on the adequacy and effectiveness of the application of the risk and control framework; and
- alongside other risk categories, the Committee oversaw Conduct Risk and Customer Redress Programmes ensuring that they deliver the right outcomes for our customers.

Further details on the Group's approach to risk appetite, risk culture, and the Risk Management Framework can be found in the Risk Report beginning on page 138.

**Other Committee Activities**

During the year the Committee also:

- monitored the effective operation of controls over the risks which had been identified as part of the demerger;
- reviewed the key risks identified for the Group as a standalone organisation and ensured that a robust assessment was undertaken to confirm that the risks were within appetite;
- reviewed and monitored the capital, funding and liquidity profile to ensure adequacy, including endorsing the ICAAP and ILAAP for Board approval;
- monitored performance against objectives in relation to remediation of the PPI programme;
- oversaw the development and implementation of an enhanced 1st Line assurance model;
- obtained assurance from the Internal Audit function that internal control processes for risk management were adequate in accordance with tolerance levels and strategy;
- worked with the Governance & Nomination Committee regarding the appointment of the new Chief Risk Officer;
- worked with the Remuneration Committee to develop financial risk metrics and appropriate risk adjustments in respect of remuneration;
- reviewed and approved the Cyber Security Strategy; and
- monitored people-related risks relative to the internal control framework.

**Bribery and Corruption**

In compliance with the Bribery Act 2010, the Group has in place risk assessments, policies and guidelines on interacting with customers, suppliers and agents, including specific policies for gifts and hospitality. Senior Managers are required to complete an evaluation of relevant risk areas as part of the risk assessment process. Formal Anti-Bribery and Corruption training is required for all employees, the Executive Leadership Team and Directors.

**Significant Risks considered by the Committee**

In addition to the specific activities outlined above, detail on the significant risks encountered by the Group and the corresponding actions that the Committee maintained oversight of during the year can be found in the Risk Overview on pages 32 to 39. In summary, these were:

Significant Risks	Examples of Risk Committee consideration
Credit Risk	The Committee regularly reviewed the performance of the credit risk portfolio, including segmentations to ensure that concentration risks were minimised. An area of particular focus and attention is the Group's mortgage portfolio spread and the level of concentration of mortgage lending.
Balance Sheet and Prudential Regulation Risks	The Committee closely monitors the Group's funding position giving due consideration to any additional risks arising from increased market uncertainty following the European Union referendum outcome and other environmental factors. At each meeting, the Committee considered a report from the Treasurer that provided an update on the Group's exposure to balance sheet and prudential regulation risks.
Regulatory and Compliance Risk	The Committee obtained frequent briefings from management on forthcoming regulatory developments and upstream risk, to allow members to consider and oversee the implications of these on the Group's strategic objectives and operations, systems and controls.
Conduct Risk	The Committee was kept informed of progress to remediate key legacy conduct issues throughout the year, and received regular updates on the implementation and effective execution of the Group Conduct Strategy.
Operational Risk	The Committee reviewed the current and target approaches to change management to ensure that the Operational Risk elements inherent in the Group's strategic plans were being effectively mitigated. This included the oversight of the effectiveness of actions being taken to exit TSAs with NAB.
Financial Crime Risk	The Committee maintained oversight of the implementation of phase two of an Automated Transaction Screening system which has improved the Group's ability to monitor and detect potentially fraudulent activity on customers' accounts. The Committee also considered reports on the strength of the Group's cyber crime defence strategy.
Strategic, Business and Financial Performance Risk	The Committee reviewed the risk implications to the Group from the European Union referendum outcome and initiated additional monitoring activities around deposit flows, lending patterns and general external intelligence to ensure that adequate resources and procedures were in place to take any remediating actions swiftly and effectively if required.
People Risk	The ability to manage change, availability of management resources against plan and succession planning all featured amongst the risks overseen by the Committee.

In addition, the Committee considered a range of emerging risks that may impact the Group's operations, arising from the environment in which it operates. These are listed in more detail in the Risk Overview section.





## DIRECTORS' REMUNERATION REPORT

Dear Shareholder,

As Chair of the Remuneration Committee, I am pleased to present the Group's first Directors' Remuneration Report, which includes:

- The proposed Directors' Remuneration Policy for three years from the 2017 AGM. This is subject to a binding shareholder vote at this year's AGM.
- The Annual Report on Remuneration, which sets out payments and awards made to the Directors and details the link between Group's performance and Directors' remuneration for the year ended 30 September 2016. The Annual Report on Remuneration is subject to an advisory shareholder vote at the AGM in January 2017.

### Decisions and activity

In preparation for the demerger and IPO, the Committee defined the post demerger remuneration policies which were set out in the Prospectus and Scheme booklet.

Following demerger, the Committee undertook a consultation with shareholders prior to submitting our remuneration policy for approval. This consultation included the policy on shareholding requirements for Executive Directors and the measures to be used for future Long Term Incentive Plan (LTIP) awards.

In addition the Committee undertook the following activities:

- developed the Remuneration Committee's charter;
- approved the level of demerger awards to Executive Directors and members of the Executive Leadership Team based on the approach approved by NAB;
- introduced the CYBG PLC share plans;

- determined the level of the 2015 bonus pool and awards to Executive Directors and members of the Executive Leadership Team; and
- revised Executive Directors' contracts prior to the demerger.

### Remuneration philosophy

Our remuneration philosophy is designed to support our business strategy, with remuneration linked to an individual's performance and behaviours, business results, shareholder outcomes and fair customer outcomes. Remuneration arrangements are fully compliant with all regulatory requirements and the PRA's Remuneration Code. The remuneration approach is intended to:

- provide competitive, transparent and fair rewards, benefits and conditions;
- reward achievement of short and long term individual objectives and business strategy;
- align the interests of employees and shareholders through employee share ownership;
- deliver outcomes over short and long term horizons with appropriate performance and risk adjustments, ensuring performance assurance principles are applied;
- support the risk management framework and have regard to the risk appetite of the Group; and
- attract, recognise, motivate and retain high performers.

In order to incentivise management to deliver the performance set out in the strategic plan and aligned to shareholders' interests, the annual bonus and long term incentive plans reflect a balance of financial and non-financial metrics.

### Highlights for 2016

Overall 2016 has been a very strong year, including the completion of the demerger from NAB followed by the successful IPO and listing on the UK and Australian Stock Exchanges on 8 February 2016. As the Group has delivered on its strategic priorities over the course of the year, the Group's share price has increased strongly from the original listing price of 180p.

The Executive Leadership Team has been strengthened with five new additions and is making good progress in delivering the strategy and creating a robust and sustainable PLC. Underlying profit is up 39% year on year and 15% ahead of the target (£190m). CIR has declined by 1% from 75% to 74% notwithstanding the additional costs associated with being a standalone company.

Overall underlying costs for the year at £729m were £33m or 4% better than our original targets as set out at the time of the IPO. Balance sheet growth continued based on a prudent risk appetite, with customer loans increasing by 4.7% as mortgage balances increased by 6.5% and Core SME balances grew by 6.1%.

Employee Engagement has risen to 79 percentage points, an increase of 6 percentage points year on year and 2 percentage points ahead of the UK Financial Services norm. This is clear evidence of the strong leadership provided by the Executive Leadership Team during a period of significant change.

As set out above and detailed in the Annual Report on Remuneration, the substantial majority of both financial and non-financial targets set by the Committee for 2016 bonuses were exceeded. The bank has also devoted significant effort into building its credibility and relationships with key external stakeholders across the business, regulatory and Government spectrum.

In addition, significant progress has also been made in setting out a revised long term strategy for the business, including consideration of Brexit implications, as outlined at our Capital Markets Day in September 2016. This included the acceleration of the delivery target for double digit shareholders returns by one year to 2019 and an improved target in respect of CIR from below 60% by FY2020 to 55-58% by 2019. The Committee therefore determined that a bonus of 80% of salary was to be paid to the CEO, CFO and COO.

This report has been prepared in accordance with Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended in 2013, the provisions of the UK Corporate Governance Code (the 'Code') and the Listing Rules. Directors' remuneration figures for 2015 have been included for comparative purposes. These reflect the remuneration received by the Directors, as Directors of CYB Investments Limited and Clydesdale Bank PLC during 2015.

On behalf of the Board

Adrian Grace, Chair, Remuneration Committee  
21 November 2016

### Considerations for the year ahead

The Committee will focus on ensuring the remuneration policy remains in line with the market and compliant with regulatory requirements. Our continuing strategy will align the interests of the Executive Directors and shareholders. Given the anticipated exit of the UK from the EU and low interest rates, the Committee will also focus on ensuring the Group is able to attract, retain and motivate key talent at all levels of the organisation, in a challenging market.

The structure and quantum of the remuneration arrangements for the Executive Directors and MRTs will be in line with the 2:1 cap on variable to pay, as set out in the PRA Remuneration Code. The increase to a ratio of 2:1 was approved by the NAB Board in 2015, as the sole shareholder prior to the demerger.

The Committee is seeking shareholder approval to remove the maximum individual limit on awards that may be granted under the Deferred Equity Plan (DEP) and LTIP rules in order to increase flexibility in balancing the fixed and variable components of remuneration. This will not change the overall amount of variable remuneration which the Group may award an individual, as the Group will continue to comply with the maximum ratio of variable to fixed remuneration of 2:1. The changes proposed do not alter the underlying remuneration structure set out in the Prospectus at listing.

### Consideration of shareholders' views

As part of finalising the proposed Directors' Remuneration Policy, I contacted a number of our major shareholders to set out our proposed approach and in particular the measures being proposed for the LTIP. Following the Capital Markets Day in September, the Committee and I reviewed the feedback received before engaging further with our major shareholders during October in order to finalise the policy on which we are seeking shareholder approval at the AGM in January 2017.

Adrian Grace  
Chair, Remuneration Committee

DIRECTORS' REMUNERATION REPORT

Directors' Remuneration Policy

Policy and Principles

Within this section, we have set out our forward looking policy, which has been refreshed from the policy previously in place at the time of the demerger and IPO and is aligned with the strategy of CYBG PLC. The policy is intended to apply for three years following the January 2017 AGM, subject to shareholder approval.

The Committee will consider the remuneration policy annually to ensure that it remains aligned with business needs and is appropriately positioned relative to the market. However, there is no intention to revise the policy more frequently than every three years.

We use target performance to estimate total potential rewards and benchmark against a peer group of other banks and wider financial services firms of a comparable size. This is to ensure our package remains competitive and we are able to attract and retain key talent.

Our remuneration philosophy is designed to support our desired culture and our business strategy, with remuneration linked to the individual's performance and behaviours, business results, shareholder outcomes and fair customer outcomes. Remuneration arrangements are fully compliant with, and will be operated in line with, all regulatory requirements, including the PRA Remuneration Code.

The remuneration approach is intended to:

- provide competitive, transparent and fair rewards, benefits and conditions;
- reward achievement of short and long term individual objectives and business strategy;
- align the interests of employees and shareholders through employee share ownership;
- deliver outcomes over short and long term horizons with appropriate performance and risk adjustments, ensuring performance assurance principles are applied;
- support the risk management framework with regard for the risk appetite of the Group; and
- attract, recognise, motivate and retain high performers.

When awarding variable pay CYBG PLC operates a balanced scorecard approach for all employees, with individual objectives aligned to business strategy. Employees are required to meet both the balanced scorecard objectives and a number of compliance hurdles to qualify for variable pay.

Our peer group companies

The CYBG comparator peer group was reviewed by the Committee and is defined as other UK-based banks and wider financial services firms of a comparable size, divisional heads in larger UK banks and other FTSE companies reflecting our market capitalisation.

Elements of package – Fixed Remuneration

The policy in relation to each element of Executive Directors' remuneration is set out in the following tables:

Base salary	
Purpose and link to strategy	Recruit, reward, retain and recognise leadership position and responsibility for delivering strategy.
Operation	Base salaries are paid in twelve equal monthly instalments during the year and are reviewed annually. Any changes are effective from 1 January. When determining and reviewing base salaries, the Committee considers: <ul style="list-style-type: none"><li>- Group and individual performance;</li><li>- The skills, experience and responsibilities of the Executive Director and their market value;</li><li>- The scope and size of the role;</li><li>- Base salary increases for colleagues throughout the Group; and</li><li>- External benchmarks data for peer banks, the divisional heads of larger UK banks and FTSE data reflecting our market capitalisation.</li></ul>
Maximum potential	The Committee will seek to limit pay increases for Executive Directors, where there is no change in role, to those applied to employees generally across the Group. However, where an Executive Director is relatively new in role the Committee reserves flexibility to provide increases that are greater than those applied across the Group to bring the individual's salary into line with the market and reflect the gaining of experience.
Other employees	The approach takes into account affordability, economic factors, external market data, and business and personal performance.
Pension	
Purpose and link to strategy	Recruit, reward, retain key talent and contribute towards individuals' funding for retirement.
Operation	Executive Directors are entitled to participate in the Group defined contribution pension scheme or may receive a cash allowance in lieu of some, or all, of the employer pension contribution. The Group's defined benefit pension scheme is only available to existing members.
Maximum potential	The maximum cash allowance for Executive Directors will be set at 20% of an Executive Director's base salary. Contributions to the Group's defined benefit pension scheme are capped by reference to the scheme earnings cap.
Other employees	All new employees are automatically enrolled in the Group's defined contribution pension scheme. The defined benefit scheme closed to new entrants in 2004.
Benefits	
Purpose and link to strategy	To provide benefits consistent with role.
Operation	The Group provides a range of benefits which can include private medical insurance, health assessments, life assurance and car allowance/car. The Committee retains the discretion to provide additional benefits as may be reasonably required. These may include relocation benefits such as (but not limited to) accommodation, family relocation support and taxable travel.  The Executive Directors are entitled to a maximum of 30 days' holiday in addition to applicable bank/public holidays.
Maximum potential	The CEO has a cap of £250,000 on his benefits, including pension contributions and any cash allowance in lieu of pension contributions. For the other Executive Directors, the maximum value of benefits is set by the nature of the benefits and the cost of providing them.
Other employees	The Group provides a range of benefits based on employees' roles, which include private medical insurance, health assessments, life assurance and car allowance/car. Employees receive between 25 and 30 days holiday annually depending on their role.



DIRECTORS' REMUNERATION REPORT

Elements of Package – Variable Remuneration

Bonus	
Purpose and link to strategy	The annual bonus is designed to reward Group and personal performance in line with strategic objectives.
Operation	<p>Annual bonuses are discretionary and are based on Group and individual performance within the year. The measures, their weighting and targets are set annually, with awards determined by the Committee at the end of the financial year.</p> <p>The annual bonus may be delivered in cash and shares, which, in combination with the LTIP awards and any relevant awards under the all-employee SIP, will be structured in line with the requirements on the deferral of variable pay under the PRA Remuneration Code.</p> <p>The equity based element of the award will be made as rights to CYBG shares or other instruments, which are released at the end of the required holding period. The mechanism for making these awards will be the Deferred Equity Plan (DEP). The amount and deferral period for bonus will be determined in line with regulatory requirements and to the extent that the LTIP award does not fully meet the deferral requirements.</p> <p>Dividends or dividend equivalents accrued on deferred annual bonus shares are paid on vesting, subject to the extent permitted under the relevant remuneration regulations.</p> <p>Discretion may be exercised by the Committee to ensure that the bonus outcomes are a fair and accurate reflection of the business and individual performance and consider any risk-related issues (but may not exceed the maximum opportunity). The Group can, in specific circumstances, apply malus and/or clawback to all or part of any bonus award.</p>
Maximum potential	Taken together with the LTIP awards, total variable remuneration is limited by the 2:1 ratio of variable pay to fixed pay, subject to the LTIP award being at least half of the total variable pay award.
Performance conditions	<p>Performance measures are set by the Committee each year and are set out in the Annual Report on Remuneration, normally this would be:</p> <ul style="list-style-type: none"><li>- 80% of the annual bonus opportunity for Executive Directors is based on performance of the Group against key financial and non-financial measures; and</li><li>- 20% is based on personal performance and behaviours.</li></ul> <p>When determining the outcome of the performance measures, the Remuneration Committee will seek the advice of the Risk Committee to ensure all relevant risk factors are identified and the bonus pool and/or individual awards adjusted accordingly.</p> <p>Specific measures, targets and weightings will be set by the Remuneration Committee annually and disclosed on a retrospective basis.</p>
Other employees	<p>Following a review of bonus arrangements, all employees within the Group are in a single Group wide scheme with target opportunities ranging from 8% to 50% of base salary depending on role.</p> <p>Awards will be funded from a bonus pool reflecting the same financial and non-financial measures, that apply to Executive Directors. When determining the outcome of the performance measures, the Remuneration Committee will seek the advice of the Risk Committee to ensure all relevant risk factors are identified and the bonus pool and/or individual awards are adjusted accordingly.</p>

Long Term Incentive Plan (LTIP)							
Purpose and link to strategy	Delivery of the Group's strategy and growth in shareholder value.						
Operation	<p>Awards are based on a three-year performance period reflecting a basket of business and shareholder measures aligned with strategic goals. Awards will vest a minimum of three years after being awarded, or longer, for example where required by the PRA Remuneration Code. Where a period of deferral extends beyond three years, awards will only be subject to service requirements for the first three years; thereafter awards will only be subject to forfeiture for reasons of gross misconduct or malus. The value of awards for the purposes of determining total variable remuneration will be in line with the rules set by the regulator.</p> <p>The Committee, in its absolute discretion, will determine the level of the LTIP awards made under the LTIP after taking account of the Executive Directors' individual performance and business performance. Any LTIP award, when combined with any deferred element of the annual bonus, will meet the deferral requirements under the PRA Remuneration Code. Malus and clawback also apply to the whole of the LTIP award in line with the requirements of the PRA Remuneration Code.</p> <p>Awards are made as conditional rights to CYBG shares, or other instruments, which will be released at the end of the holding period or later where required under the PRA's remuneration code. Dividends or dividend equivalents accrue on the LTIP awards and, to the extent that the award vests, are paid on vesting, subject to the extent permitted under the relevant financial services remuneration regulations.</p>						
Maximum potential	Taken together with the bonus award, the total variable remuneration is limited by the agreed 2:1 ratio of variable pay to fixed pay, subject to the LTIP award being at least half of the total variable pay award.						
Performance conditions	<p>Service and performance conditions must be met over a three-year period.</p> <p>Measures aligned with strategic goals are proposed for future LTIP awards, including the 2016 awards to be made following the AGM:</p> <ul style="list-style-type: none"><li>- Sustainable Customer Growth;</li><li>- Efficiency;</li><li>- Capital Optimisation; and</li><li>- Prudent Risk Management and Governance.</li></ul> <p>The weighting of metrics will be determined before each award and those for the 2016 award are set out in the Annual Report on Remuneration, with 25% of the maximum vesting for each measure for threshold performance. The measures reflect a balanced approach between financial and non-financial. The Committee has discretion to vary the weighting of performance metrics, or to substitute the metrics over the life of this Director's Remuneration Policy. Shareholders will be consulted should the metrics themselves be varied.</p> <p>In determining the outcome, the Remuneration Committee will seek the advice of the Risk Committee to ensure all relevant risk factors are identified and the level of vesting adjusted accordingly.</p>						
Other employees	Members of the Executive Leadership Team and other senior managers are eligible to participate in the LTIP, with awards made solely at the discretion of the Committee.						
Shareholding Requirement							
Purpose and link to strategy	To align Executive Directors' interests with those of shareholders.						
Operation Executive Director	<p>Executive Directors are expected to build up a holding of CYBG shares equivalent to a percentage of salary. 60% of the shares vesting (after settling tax and NIC liabilities) from CYBG share plans must be retained until the shareholding requirement is met.</p> <table><tr><th>Executive Director</th><th>Shareholding requirement (% of salary)</th></tr><tr><td>CEO</td><td>200%</td></tr><tr><td>CFO and COO</td><td>150%</td></tr></table> <p>When assessing an Executive Director's shareholding against the requirement, vested awards which are held as rights rather than shares will be included based on the anticipated net number of shares which would be released to the Executive Director at the end of the holding period.</p>	Executive Director	Shareholding requirement (% of salary)	CEO	200%	CFO and COO	150%
Executive Director	Shareholding requirement (% of salary)						
CEO	200%						
CFO and COO	150%						
Other employees	Additionally, members of the Executive Leadership Team are expected to build up a holding of CYBG shares equivalent to 100% of salary. 50% of the shares vesting (after settling tax and NIC liabilities) from CYBG share plans must be retained until the shareholding requirement is met.						

## DIRECTORS' REMUNERATION REPORT

### Bonus and LTIP flexibility

The Committee operates within its policy at all times. It will also operate the Bonus and LTIP according to the rules of each respective plan and consistently with normal market practice and the Listing Rules, including flexibility in a number of areas. This includes how to deal with a change of control, restructuring or any other corporate event of the Group; how and whether an award or its performance conditions may be adjusted in certain circumstances (e.g. change of accounting policy); and the choice of (and adjustment of) performance measures, weightings and targets for each incentive plan from year to year in accordance with the remuneration policy. Any use of the above discretions would, where relevant, be explained in the Annual Report on Remuneration.

### Performance measures

The Committee selected the performance measures to ensure an appropriate balance between short and long term strategic goals and aligning the interests of Executive Directors with shareholders. Targets are set each year having regard to the strategic plan and consensus forecasts. Measures and targets for both the bonus plan and LTIP are aligned to the strategic plan and have been approved by the Board.

The Committee may apply discretion, in exceptional circumstances (for example, if there is a major corporate event), to amend targets and measures if these are no longer appropriate to ensure alignment with strategy and any risks within the business.

The Committee retains discretion to adjust outcomes to ensure these are consistent with corporate performance. The Committee proposes to use the measures described in the Policy Table for the 2016 LTIP award to be made after

the AGM and future awards, but will reassess these annually based on the Group's performance and strategy. In determining the measures, the Committee consulted with major shareholders.

The Committee has discretion to vary the weighting of performance metrics, or to substitute the metrics over the life of this Director's Remuneration Policy, but will consult with shareholders in advance of any change to performance metrics.

### Other CYBG share plans

The Executive Directors are also eligible to participate in the CYBG Share Incentive Plan (SIP). This provides for the purchase of shares on a monthly basis from gross pay and also allows awards of free or matching shares. Each Executive Director received 256 free shares following the demerger. None of the Executive Directors currently participates in the monthly purchase of shares through the SIP.

If operated in the future, Executive Directors will also be eligible to participate in all employee share plans operated by the Group.

### Legacy arrangements

Awards granted under the NAB Share Plans were retained by employees of the Group following the demerger and IPO on 8 February 2016. Awards remain subject to their existing terms and performance conditions, with service requirements based on employment by CB PLC.

Detailed below are the rights under the NAB LTIP held by the COO. Neither the CEO nor the CFO received any NAB LTIP awards.

Debbie Crosbie's NAB LTIP awards	Vesting date	Release date <sup>(1)</sup>	Performance period (if applicable)	Number of NAB Performance rights
2012 LTIP	19 Dec 16	19 Jun 17	1 Jan 13 to 30 Sep 16	4,928 <sup>(2)</sup>
2013 LTIP	20 Dec 17	20 Jun 18	11 Nov 13 to 11 Nov 17 <sup>(3)</sup>	10,161
2014 LTIP	21 Dec 18	21 Jun 19	10 Nov 14 to 10 Nov 18 <sup>(3)</sup>	13,380

<sup>(1)</sup> Reflects the end of the six months post vesting holding period.

<sup>(2)</sup> The COO will also receive a cash amount of up to £70,000 based on the level of vesting which will be determined by the NAB Board in December 2016.

<sup>(3)</sup> Awards which do not vest at the end of the first performance period will be retested after 12 months.

The level of vesting for these awards will be determined by the NAB Board, in line with the following performance conditions:

- The 2012 NAB LTIP award to be released in June 2017 is based on the performance of the UK business, with half of the award based on Cash Earnings and Return on Equity and the other half on Economic Profit.
- The 2013 and 2014 LTIP awards to be released in June 2018 and June 2019 respectively are based on NAB's relative TSR performance, with half measured against the S&P/ASX Top 50 Index peer group and half against a selection of financial companies in the ASX Top 200 peer group. Awards which do not vest at the end of the first performance period will be retested after 12 months.

The final decision on the level of vesting will be taken by the NAB Board, with value at the date of vesting included in the Directors' single table figure in the year they vest.

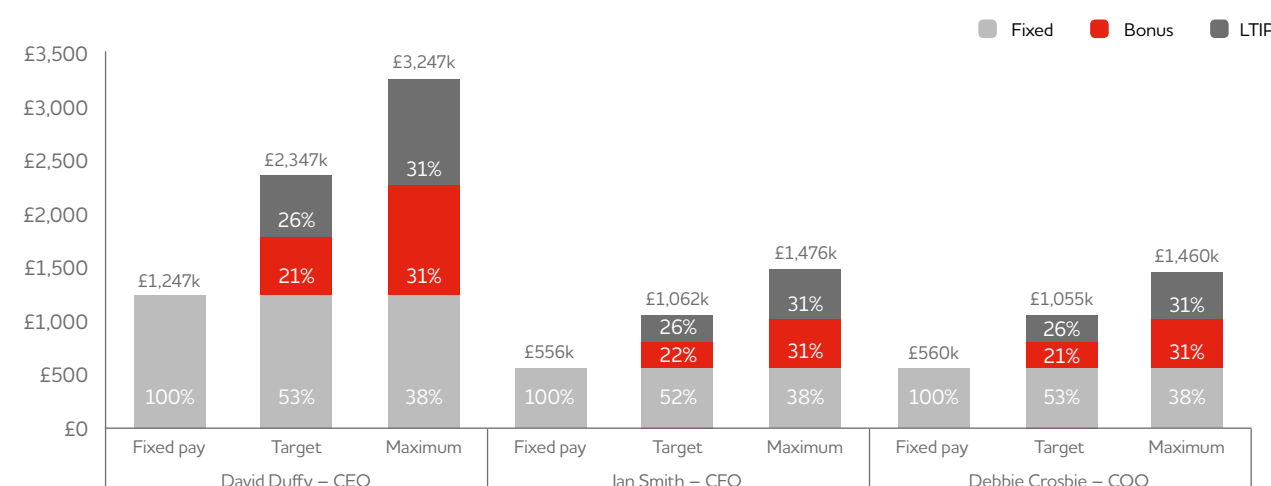
### Illustration of the application of Remuneration Policy

The chart below illustrates the potential remuneration of the Executive Directors based on the proposed policy in the following three scenarios:

- Minimum remuneration based on fixed elements of package only (salary, pension, benefits).
- Target outcome assumes the actual bonus award is 50% of the maximum opportunity with 60% of the LTIP vesting.
- Maximum outcome which assumes the actual bonus award is 100% of the maximum opportunity and 100% vesting of the LTIP.

The amounts do not allow for share price appreciation and do not include dividends or payments in lieu of dividends. Salary figures are as at 1 October 2016 and assume the implementation of proposed LTIP policy, with the maximum bonus and LTIP awards being 100% of salary.

### Potential 2017 Remuneration Outcomes





DIRECTORS' REMUNERATION REPORT

Approach to recruitment remuneration

The Remuneration Policy will be applied to any new hires; when considering Executive Director appointments, the Committee will consider the skills and experience of the candidates in relation to external data and the quantum of package required to attract the individual. The Committee will seek advice from its independent advisers when considering the level of package to be offered.

to match the expected value of the award through granting awards which will vest over a similar timeframe with similar conditions. The Committee will also consider the relative stretch of any performance conditions compared to those awards being forfeited and will determine the value of the grant accordingly.

The other elements of the package would be in line with the Directors' Remuneration Policy:

Where it is necessary to compensate an individual for awards forfeited from an existing employer, the Committee will seek

Element	Maximum
Base salary	-
Pension	Up to 20% of base salary
Benefits	Depending on circumstances
Variable Pay (Bonus & LTIP)	Two times fixed remuneration

Service contracts and policy on payments for loss of office

Standard provision	Policy	Details
Election	All Executive Directors are subject to annual re-election.	
Notice periods within Executive Directors' service contracts	12 months' notice from Company. 12 months' notice from Executive Directors.	Executive Directors may be required to work during the notice period, unless determined otherwise.
Confidentiality	Six month post-termination restrictive covenants.	Executive Directors are subject to a confidentiality undertaking without limitation in time, as well as to six month post-termination restrictive covenants covering non-competition, non-solicitation of and non-dealing with clients, non-interference with suppliers or contractors and non-solicitation of employees.
Compensation for loss of office	Payment in lieu of notice of no more than 12 months' salary.	Payable monthly and subject to an obligation on the Executive Director to mitigate their loss such that payments will either reduce or cease completely if the Executive Director obtains alternative employment. In the event of redundancy, the Executive Director shall be entitled to receive statutory redundancy pay, together with outplacement and legal support.
Treatment of annual bonus on termination	With the exception of good leavers, where participants leave before 1 December they will not be eligible for an award.	The Committee has discretion to reduce the entitlement of a 'good leaver' in line with performance and the reason for leaving.

Treatment of unvested deferred bonus on termination	With the exception of good leavers, awards lapse where participants leave in the three years following the award being made.	Awards to good leavers will be retained in full, with no change to vesting or release dates. With the exception of gross misconduct and malus, service provisions end three years from the date of award.
Treatment of unvested LTIP awards on termination	With the exception of good leavers, awards lapse where participants leave in the three years following the award being made.	Awards to good leavers will be prorated, unless the Committee decides otherwise, to reflect the period worked in the three years following the award. The award will vest, unless the Committee decides otherwise, on the normal vesting date to the extent that any performance condition has been met. With the exception of gross misconduct and malus, service provisions end three years from the date of award.
Outside appointments	Executive Directors may accept outside appointments in other listed companies with Executive Directors retaining any fees received.	The Chair is required to approve appointments in advance.

The Committee retains the discretion to determine if an Executive Director is to be treated as a good leaver. Unless determined otherwise, an Executive Director will be treated as a good leaver in cases where their employment ends due to death, retirement, injury, ill-health, disability, redundancy, retirement, or company being transferred out of the CYBG group and any other reason (except for dishonesty, fraud,

misconduct or dismissal). The Committee reserves the right to make additional payments where such payments are made in good faith and are required to discharge legal obligations or are due to the breach of such obligations.

The notice periods and dates of their service contracts are shown below.

Executive Directors	Notice Period	Date of Service Contract
Debbie Crosbie	12 Months	24 November 2015
David Duffy	12 Months	25 November 2015
Ian Smith	12 Months	3 December 2015

Chairman and Non-Executive Directors

The table below sets out the Directors' Remuneration Policy which will apply, subject to shareholder approval, to the Chairman and Non-Executive Directors from the date of the AGM.

Non-Executive Directors are engaged through letters of appointment which are for an initial period of three years,

subject to three months' notice by the Non-Executive Directors or the Group. The Chairman has six months' notice. All Non-Executive Directors are subject to annual re-election by shareholders at each AGM and are subject to early termination without compensation if he or she is not re-appointed at a meeting of shareholders.

# DIRECTORS' REMUNERATION REPORT

## Non-Executive Directors Packages

Purpose and link to strategy	To ensure the Group is able to engage and retain highly skilled and experienced individuals.
Operation	<p>Fees paid to the Chairman are determined by the Remuneration Committee, whilst the fees paid to the Non-Executive Directors are set by the Board annually. The fees reflect a base fee with additional fees payable for being members of, or chairing, Board Committees, and a separate fee is payable to the Senior Independent Director and Deputy Chairman.</p> <p>Non-Executive Directors are appointed for an initial three-year term and will normally serve two terms, exceptionally three.</p> <p>The fees are set at a rate that reflects the value to the Group and expected time commitment given the added regulatory complexity within the financial services sector. In exceptional circumstances, incremental fees may be paid for additional duties and time commitment, to reflect increased workload.</p> <p>From time to time, new Board Committees may be established and/or responsibilities distributed between Committees, at which point fees for Committee membership and Chair may be reviewed.</p> <p>The Chairman and Non-Executive Directors are reimbursed for expenses incurred in performing their duties and any tax arising on such reimbursed expenses is paid by CYBG PLC. For individuals based outside of the UK this will include travel to and from the UK. Non-Executive Directors and the Chairman do not participate in any variable remuneration or benefits arrangements.</p>
Maximum potential	The maximum aggregate value of fees payable to the Chairman and the Non-Executive Directors is capped at £2.5m under the Articles of Association.
Performance conditions	There are no performance conditions attached to the fees payable to the Chairman or Non-Executive Directors.

The dates of Non-Executive Directors' letters of appointment are shown below.

### Non-Executive Directors'

Clive Adamson	19 May 2016
David Bennett	23 November 2015
David Browne	11 November 2015
Paul Coby	19 May 2016
Adrian Grace	11 November 2015
Richard Gregory	11 November 2015
Fiona MacLeod	8 September 2016
Jim Pettigrew	11 November 2015
Teresa Robson-Capps	11 November 2015
Tim Wade	8 September 2016

### Risk adjustments, malus and clawback

For MRTs, which includes the Executive Directors, bonus and LTIP awards may be reduced before they are released (malus) or may be subject to clawback where the Committee determines that an adjustment should apply. Clawback may be applied up to seven years from the award date, or ten years for those holding a senior management function where an investigation has commenced.

Malus may be applied where there is evidence of employee misbehaviour, misconduct, material error, they participated in conduct which resulted in losses for the Group or they failed to meet appropriate standards; any material failure of risk management at a Group, business area, division or business unit level; if the financial results at a Group, division or business unit level are restated; if the financial results for a given year do not support the level of variable remuneration awarded; or any other circumstances where the Committee consider adjustments should be made.

Clawback may be applicable where there is reasonable evidence of employee misbehaviour or material error; or there is material failure of risk management at a Group, business area, division or business unit level.

### Change of control

In the event of a takeover or other major corporate event (but not an internal reorganisation of the Group), all outstanding LTIP awards granted under the Group's share plans would vest early on a prorated basis, unless determined otherwise by the Committee and to the extent the Committee determines that the performance conditions have been met. Any deferred bonus awards will normally be retained in full and not vest early, unless determined otherwise by the Committee.

### Considerations of Employment Conditions elsewhere in the Group

During the year the Committee considered the following in relation to employees below the Executive Directors:

- remuneration packages of Executive Leadership Team members;
- design of the annual bonus plan for Executive Leadership Team and all employees;
- measures and targets for the 2016 annual bonus pool;
- salary for all employees;
- policy in relation to pension plans and the impact of changes to the tax rules on pension contributions;
- policy for LTIP awards to members of the Executive Leadership Team; and
- commencement and termination payments made to MRTs.

The Committee does not specifically invite employees to comment on the Directors' Remuneration Policy, but any comments made by employees are taken into account. Consideration is given to feedback provided by employees through the annual engagement survey.

### Statement of consideration of shareholder views

During September and October 2016, the Chair of the Committee engaged with key shareholders on the Directors' Remuneration Policy and specifically the measures in relation to the LTIP awards. The CEO also undertook discussions with key stakeholders on the strategic plan with the outputs used to determine the performance measures that apply to the LTIP.



DIRECTORS' REMUNERATION REPORT

Annual Report on Remuneration

Executive Directors – Single Total Figure Of Remuneration (Audited)

The table below sets out the single total figure of remuneration and breakdown for each Executive Director in respect of the financial year to 30 September 2016.

	David Duffy <sup>(1)</sup>		Ian Smith <sup>(2)</sup>		Debbie Crosbie	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Salary	1,000	318	460	253	450	367
Benefits and allowances	67	21	9	5	10	53
Pension & Pension allowance <sup>(3)</sup>	180	57	87	48	100	81
Total Fixed Remuneration	1,247	396	556	306	560	501
Annual Bonus <sup>(4)</sup>	800	450	368	253	360	450
LTIP vesting in year <sup>(5)</sup>	-	-	-	-	-	-
Other awards <sup>(6) (7)</sup>	1	500	1	-	1	-
Total Remuneration	2,048	1,346	925	559	921	951

<sup>(1)</sup> David Duffy was appointed as an Executive Director of CYBI on 5 June 2015.  
<sup>(2)</sup> Ian Smith was appointed as an Executive Director of CYBI on 11 March 2015.  
<sup>(3)</sup> David Duffy and Ian Smith have both opted out of the Group's defined contribution pension scheme and received a cash allowance in lieu of the Group's pension contributions. Debbie Crosbie is a member of the defined benefit plan and the figure reflects the HMRC method as outlined below, with the figure restated for 2015 on the same basis.  
<sup>(4)</sup> Includes the cash, upfront retained and deferred bonus elements.  
<sup>(5)</sup> No CYBG PLC LTIP awards or legacy NAB LTIP awards vested during 2015 or 2016.  
<sup>(6)</sup> David Duffy received a commencement award following his appointment in 2015. The award is over NAB shares and vests over a three year period.  
<sup>(7)</sup> Each of the Executive Directors also received £500 of freeshares in February 2016.

Former Executive Directors (Audited)

Richard Sawers resigned as an Executive Director on 2 February 2016 when CYBG PLC demerged from NAB and no additional remuneration or fees were paid by the Group or NAB for his services to the Group. The Directors believe it would be appropriate to apportion AS249,000 (2015: AS930,000) of his remuneration as being in respect of his duties to the Group to 8 February 2016.

Executive Directors payments to past Directors (Audited)

No additional payments were made to Richard Sawers on retiring from the Board.

Executive Directors payments for loss of office (Audited)

No payments were made during the year.

Total pension entitlements (Audited)

David Duffy and Ian Smith have both opted out of the Group's defined contribution pension plans and receive cash allowances in lieu of pension contributions. Debbie Crosbie participates in the Group's defined benefit scheme based on her salary up to the earnings cap (£149,400 from October 2015 to April 2016 and £150,600 from April 2016 to September 2016). In addition Debbie Crosbie receives a cash allowance of 17.6% of her salary above the earnings cap.

Details of the pension accrued in the Group's defined benefit pension scheme by Debbie Crosbie in respect of qualifying services are shown below. The value of the pension is calculated using the HMRC Method. The remainder of the pension value is delivered as a cash allowance.

Values relating to DB Scheme	Accrued pension at year end £'000	Normal retirement date	Additional value of pension on early retirement £'000	Pension value in the year from DB Scheme £'000	Pension value in year from cash allowance £'000	Total £'000
Debbie Crosbie	38	30 March 2035	-	45	55	100

Taxable benefits (Audited)

- Executive Directors receive private medical cover, health assessment and life assurance.
- The CEO receives a car cash allowance of £30,000 p.a. and the other Executive Directors receive an allowance of £6,840 p.a.
- To support the CEO's relocation from Ireland to Glasgow, the CEO receives an allowance of £35,000 p.a. which is payable until May 2017.

Annual Bonus (Audited)

The following annual bonus awards were made in respect of the 2016 financial year; these were agreed by the Committee having reviewed the Group's results. Details of the targets used to determine annual bonus in respect of the 2016 financial year and the extent to which they were satisfied are shown in the table below. These figures are included in the single figure table above.

2016 saw a strong performance from the Group, with significant change as a result of the demerger and a focus on building a high performing, customer centric organisation with strong productivity and efficiency. In our first year as CYBG we have demonstrated good progress in delivering against the key performance measures set by the Committee:

- underlying profit before tax up by 39% on last year and 15% ahead of target;
- underlying RoTE increased to 5.2%;
- underlying CIR reduced by 1% from 75% to 74%;
- engagement score 2% ahead of industry norm;
- successful delivery of the demerger and IPO;
- significant progress against our five year strategic plan with CIR and RoTE targets to be delivered 1 year early; and
- while customer NPS for CB and YB were below target, CB's Brand Reputation rose to 11% with the peer group scoring 8% and YB Brand Reputation continues to be ahead of peers at 43% (peer score of 25%).

## DIRECTORS' REMUNERATION REPORT

The table below sets out the performance of the Group element for determining Executive Directors' bonus awards:

Executive Directors Underlying Performance measures		Weighting	Threshold	Target	Maximum	Actual	Award as % Salary
Sustainable Returns	Profit Before Tax (PBT)	16.67%	£133m	£190m	£247m	£219m <sup>(1)</sup>	<b>13%</b>
	Returns (RoTE)	16.67%	2.99%	4.27%	5.51%	5.2%	<b>15%</b>
	CIR	16.67%	81%	74%	67%	74%	<b>8%</b>
Customer	CB NPS <sup>(2)</sup>	2.5%	7%	10%	13%	2%	<b>-</b>
	YB NPS <sup>(2)</sup>	2.5%	7%	10%	13%	7%	<b>1%</b>
People	Employee engagement	5%	67%	77%	87%	79%	<b>3%</b>
Strategy	Strategic delivery	20%	Qualitative assessment by the Committee				<b>20%</b>
		80%	Outcome				<b>60%</b>

<sup>(1)</sup> The PBT outcome excludes exceptional items which have reduced the Statutory PBT by £144m. The bulk of this reduction is driven by a combination of legacy conduct issues in respect of PPI, other conduct matters, impairment of intangible assets and restructuring expenses. The PBT outcome was adjusted by the incremental year on year change in the Prudent Valuation Adjustment figure of £2m.

<sup>(2)</sup> Measured on performance relative to peers.

The Committee determined that performance against strategic goals was ahead of target in each area, and taking into account the highly successful execution of the demerger in difficult market conditions concluded that the maximum payment should be made under the strategic element. Performance was

assessed against the five categories shown below. The categories and targets were not formulaically weighted but were judged by the Remuneration Committee in the round based on overall performance and taking into account the relative significance of the achievements in each category.

Area	Targets and attainment
IPO and demerger	<ul style="list-style-type: none"> <li>- Executed successful IPO and demerger on 8 February</li> <li>- Listed on UK and Australian stock markets</li> <li>- Strong share price performance post IPO</li> </ul>
Strategic planning	<ul style="list-style-type: none"> <li>- Strong execution on strategic plan</li> <li>- Established strong executive team with 5 key appointments</li> <li>- Development of post-Brexit strategy communicated at Capital Markets Day in September</li> </ul>
Improving proposition for customers	<ul style="list-style-type: none"> <li>- Launched a range of improved digital services and Apps</li> <li>- Rise in brand reputation relative to peers</li> </ul>
Sustainable growth	<ul style="list-style-type: none"> <li>- Growth in Customer Loans of 4.7%</li> <li>- Mortgage Balances up 6.5%</li> <li>- Core SME balances up 6.1%</li> </ul>
Capital	<ul style="list-style-type: none"> <li>- Strong capital position maintained with CET1 ratio of 12.6%</li> </ul>

In assessing the Group's performance the Committee reviewed a report from the Chair of the Risk Committee on any risk issues within the business and determined that no adjustments were required to the bonus pool.

The Committee determined the personal award for each Executive Director as set out below. This reflects the Committee's assessment of a strong performance against every category of their scorecard and the demonstration of the required behaviours for their role, together with the pivotal role the Executive Directors played in the successful delivery of the demerger:

Executive Director	Personal Award % Salary	Group Award % Salary	Total Award % Salary	Total award
David Duffy	20%	60%	80%	<b>£800,000</b>
Ian Smith	20%	60%	80%	<b>£368,000</b>
Debbie Crosbie	20%	60%	80%	<b>£360,000</b>

### Deferral of Bonus

In line with regulatory requirements, a portion of the bonus award is subject to deferral to the extent to which the required deferral is not fully met by the LTIP award. Half of the upfront and deferred elements are also subject to a six month retention period. As such the Executive Directors awards were made as follows:

	David Duffy	Ian Smith	Debbie Crosbie
Upfront cash	£295,850	£136,000	£133,050
Upfront shares <sup>(1)</sup>	£295,850	£136,000	£133,050
Deferred shares <sup>(2)</sup>	£208,300	£96,000	£93,900
<b>Total</b>	<b>£800,000</b>	<b>£368,000</b>	<b>£360,000</b>

<sup>(1)</sup> Awarded as conditional rights to CYBG PLC shares which will be released at the end of the six month retention period.

<sup>(2)</sup> Awarded as conditional rights to CYBG PLC shares or other instruments with vesting after twelve months in line with regulatory requirements after taking account of the LTIP award. Half will be released on vesting with half subject to an additional six month retention period.

### Demerger LTIP Award (Audited)

Prior to the demerger, the NAB Remuneration Committee approved the grant of awards on demerger, in lieu of granting awards under a NAB share plan in respect of the 2015 performance year and to recognise the Executive Director's contribution to the success of the demerger. Awards were granted on 11 February 2016, and vesting is subject to the achievement of a target based on cumulative underlying

profit before tax (on a management basis) over the three years to September 2018.

Details of the PBT targets will be disclosed after the end of the performance period once these are no longer commercially sensitive. The PBT outcome will be adjusted by the incremental year on year change in the Prudent Valuation Adjustment figure during this period.

2015 Demerger LTIP	Percentage of salary <sup>(1)</sup>	Face value of award	Number of shares awarded <sup>(2)</sup>	Type of interest awarded	End of performance period	Percentage receivable for below target performance	Percentage receivable for target performance
David Duffy	150%	£1,500,000	768,560	Conditional rights to CYBG PLC Shares	30 September 2018	0%	100%
Ian Smith	100%	£450,000	230,568				
Debbie Crosbie	100%	£450,000	230,568				

<sup>(1)</sup> The award was based on a multiple of salary as at 30 September 2015.

<sup>(2)</sup> The award price of £1.9517 was calculated based on the average middle market share price over the three days before grant.



# DIRECTORS' REMUNERATION REPORT

## 2016 LTIP Awards

Subject to the approval of the Remuneration Policy at the AGM, the following are proposed under the Group's LTIP. These awards are designed to align the interests of Executive Directors with shareholders' interests and the growth of the Group.

## 2016 LTIP Awards

	Percentage of salary <sup>(1)</sup>	Face value of award	Type of interest awarded	End of performance period	Percentage receivable for threshold performance <sup>(2)</sup>	Percentage receivable for target performance <sup>(3)</sup>
David Duffy	100%	£1,000,000	Conditional rights to CYBG PLC Shares	30 September 2019	20%	68%
Ian Smith	100%	£460,000				
Debbie Crosbie	100%	£450,000				

<sup>(1)</sup> The award is based on a percentage of salary as at 30 September 2016.  
<sup>(2)</sup> 20% reflects 80% of the measures vesting at 25% for threshold performance and 20% vesting at 0%.  
<sup>(3)</sup> 68% reflects 80% of the measures vesting at 60% for target performance and 20% vesting at 100% for target performance.

Performance over the period will be assessed against the following measures which have been set in line with the strategic plan outlined to investors at the Capital Markets Day in September 2016 and following a consultation process with major shareholders.

The objectives are designed to deliver sustainable growth over the next three years and as such deliver returns to shareholders. Outcomes will be disclosed on a retrospective basis at the end of the performance period.

## 2016 LTIP Measures

		Weighting	Threshold	Target	Maximum
Sustainable Customer Growth	Clydesdale & Yorkshire Bank NPS	10%	22.5%	25%	27.5%
	Digital Adoption	10%	45%	50%	55%
Efficiency	CIR <sup>(2)</sup>	25%	60%	57.5%	55%
Capital Optimisation	CET1 Ratio <sup>(1) (2)</sup>	10%	n/a	> 12%	n/a
	RoTE <sup>(2)</sup>	30%	8%	9%	10%
	IRB Accreditation for mortgage book <sup>(1)</sup>	5%	n/a	Achieved	n/a
Prudent Risk Management and Governance	Bad and Doubtful Debt/Average Loans <sup>(1) (3)</sup>	5%	n/a	< 25bps	n/a
	Cumulative Operational Risk Losses <sup>(4)</sup>	5%	<£25m	<£20m	<£15m

<sup>(1)</sup> CET1 Ratio, IRB Accreditation for mortgage book and Bad and Doubtful Debt / Average Loans are all or nothing measures with 100% vesting if achieved for these elements.  
<sup>(2)</sup> CIR and RoTE are targeted on an underlying basis.  
<sup>(3)</sup> Three year average.  
<sup>(4)</sup> Cumulative figure for 2017, 2018 and 2019.

## Non-Executive Directors (Audited)

The table below sets out the single total figure of remuneration and breakdown for each Non-Executive Director for the year ending 30 September 2016

	Fees		Benefits		Total	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Clive Adamson <sup>(1)</sup>	23	-	-	-	23	-
David Allvey <sup>(2)</sup>	95	92	-	-	95	92
David Bennett <sup>(3)</sup>	183	-	-	-	183	-
David Browne <sup>(4)</sup>	137	80	-	-	137	80
Paul Coby <sup>(5)</sup>	23	-	-	-	23	-
Adrian Grace <sup>(6)</sup>	118	47	-	-	118	47
Richard Gregory OBE <sup>(7)</sup>	225	140	-	-	225	140
Fiona MacLeod <sup>(8)</sup>	4	-	-	-	4	-
Jim Pettigrew <sup>(9)</sup>	495	300	-	-	495	300
Barbara Ridpath <sup>(10)</sup>	75	70	-	-	75	70
Dr Teresa Robson-Capps <sup>(11)</sup>	102	67	-	-	102	67
Alexander Shapland <sup>(12)</sup>	76	70	-	-	76	70
Timothy Wade <sup>(13)</sup>	5	-	-	-	5	-
<b>Total</b>	<b>1,561</b>	<b>866</b>	<b>-</b>	<b>-</b>	<b>1,561</b>	<b>866</b>

<sup>(1)</sup> Clive Adamson joined the Board on 1 July 2016.  
<sup>(2)</sup> David Allvey retired from the Board on 31 March 2016. Fees include £46,000 in relation to increased duties during the demerger.  
<sup>(3)</sup> David Bennett (Deputy Chairman) joined the Board on 22 October 2015. Fees include £20,625 in relation to increased duties during the demerger.  
<sup>(4)</sup> David Browne's fees include £40,000 in relation to increased duties during the demerger.  
<sup>(5)</sup> Paul Coby joined the Board on 1 June 2016.  
<sup>(6)</sup> Adrian Grace's fees include £23,500 in relation to increased duties during the demerger.  
<sup>(7)</sup> Richard Gregory's (Senior Independent Non-Executive Director) Fees include £70,000 in relation to increased duties during the demerger and a fee of £17,500 pa. for his ambassadorial role as Yorkshire Bank Chair.  
<sup>(8)</sup> Fiona MacLeod joined the Board on 12 September 2016.  
<sup>(9)</sup> Jim Pettigrew's (Chairman) fees include £150,000 in relation to increased duties during the demerger.  
<sup>(10)</sup> Barbara Ridpath retired from the Board on 20 May 2016. Fees include £26,250 in relation to increased duties during the demerger.  
<sup>(11)</sup> Dr Teresa Robson-Capps's fees include £25,125 in relation to increased duties during the demerger.  
<sup>(12)</sup> Alexander Shapland retired from the Board on 20 May 2016. Fees include £26,250 in relation to increased duties during the demerger.  
<sup>(13)</sup> Timothy Wade joined the Board on 12 September 2016.

## Non-Executive Directors annual fees

The following fees are payable to Non-Executive Directors in line with the 2016 rates approved by the Board in November 2015. The Non-Executive Directors are reimbursed for expenses they incur in performing their duties. Any tax arising on such reimbursed expenses is paid by CYBG PLC:

Non-Executive Director	£70,000
Chair Audit Committee	£30,000
Member Audit Committee	£10,000
Chair Risk Committee	£30,000
Member Risk Committee	£10,000
Chair Remuneration Committee	£30,000
Member Remuneration Committee	£10,000
Chair Governance & Nomination Committee	£5,000
Member Governance & Nomination Committee	£5,000
Chairman	£350,000
Deputy Chairman	£60,000
Senior Independent Director	£30,000

DIRECTORS' REMUNERATION REPORT

Non-Executive Directors payments for loss of office (Audited)

No payments were made during the year.

retain 60% of the net shares received from variable pay awards after the payment of tax and National Insurance until the shareholding requirement is met.

Statement of Directors' shareholding and share interests (Audited)

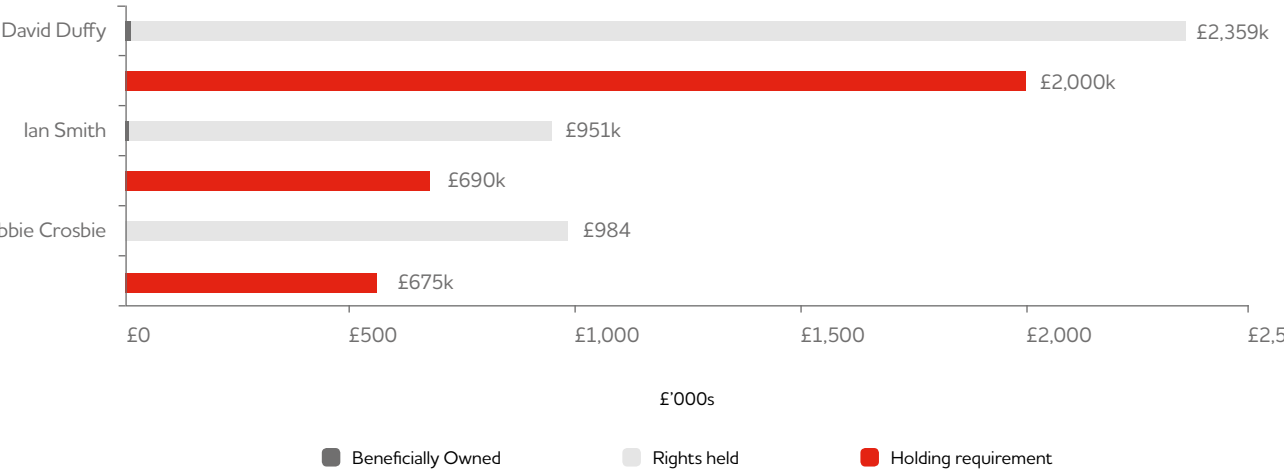
Executive Directors are required to build up a holding of the Group's shares of the value of 150% of base salary (200% for the CEO). To support this, Executive Directors are required to

Detailed below are the current beneficial holdings of ordinary shares for each Executive Director, together with details of their vested and unvested awards under the CYBG PLC share plans.

Director	Ordinary Shares <sup>(1)</sup>	Vested Awards <sup>(2)</sup>	Unvested Awards <sup>(3)</sup>	Vested LTIP Awards <sup>(2)</sup>	Unvested LTIP Awards <sup>(4)</sup>	Maximum Total Shares & Awards	Expected value pre tax <sup>(5)</sup> £'000s	Expected value net of tax <sup>(6)</sup> £'000s
David Duffy	4,336	115,284	-	-	768,560	888,180	2,359	1,256
Ian Smith	4,758	88,325	34,408	-	230,568	358,059	951	510
Debbie Crosbie	1,477	92,227	46,113	-	230,568	370,385	984	523

<sup>(1)</sup> Ordinary shares beneficially owned including any shares held via the CYBG PLC Share Incentive Plan and holdings of connected persons.  
<sup>(2)</sup> Gross number of conditional rights awards which have vested but not yet been released as shares.  
<sup>(3)</sup> Unvested awards are subject to continued employment with no business performance conditions.  
<sup>(4)</sup> Unvested awards are subject to continued employment and the achievement of business performance conditions. This applies to the gross number of shares under the 2015 Demerger LTIP award which have not yet vested and are subject to business performance conditions and continued employment.  
<sup>(5)</sup> The unvested 2015 Demerger LTIP awards have been included at 100% of their face value in line with current accounting assumptions. Values are based on the 30 September 2016 closing price of 265.6 pence.  
<sup>(6)</sup> Assumes 47% is deducted from vested and unvested rights to reflect the tax and national insurance due on the release of shares.

The chart below shows the Executive Director's current share holdings and net number of shares they would receive if all the unreleased rights (vested and unvested) shown above vested in full against their shareholding requirements applicable for Executive Directors:



For the purpose of assessing the Executive Directors, holdings against the shareholding requirements at 30 September 2016 unvested awards are excluded:

Director	Base salary £'000s	Requirement as % of base salary	Shares & vested rights <sup>(1)</sup>	Expected value net of tax <sup>(2)</sup> £'000s	Shareholding requirement met?
David Duffy	1,000	200%	119,620	173	No
Ian Smith	460	150%	93,083	136	No
Debbie Crosbie	450	150%	93,704	133	No

<sup>(1)</sup> Includes vested awards over CYBG PLC shares which have not yet been released.  
<sup>(2)</sup> Values are based on the 30 September 2016 closing price of 265.6 pence, with 47% deducted from vested rights to reflect the tax and national insurance due on the release of shares.

None of the Executive Directors, or their connected persons, bought or sold shares between 30 September 2016 and the date of this report, nor were any share plan awards made or released.

Non-Executive Directors' Shareholding (Audited)

The beneficial interests of the Non-Executive Directors and their connected persons who held office at 30 September 2016 in the shares of the Group and as at that date and 1 October 2015 are shown below.

Non-Executive Directors	Ordinary shares beneficially owned at date of listing (8 February 2016) or date of appointment if later	Ordinary shares beneficially owned at 30 September 2016 (or date of cessation if earlier)
Clive Adamson <sup>(1)</sup>	-	-
David Bennett <sup>(2)</sup>	-	16,334
David Browne	-	5,000
Paul Coby <sup>(3)</sup>	-	-
Adrian Grace	-	16,220
Richard Gregory OBE	-	-
Fiona MacLeod <sup>(4)</sup>	-	-
Jim Pettigrew	-	50,000
Dr Teresa Robson-Capps	-	-
Tim Wade <sup>(5)</sup>	-	-

<sup>(1)</sup> Clive Adamson was appointed as a Director on 1 July 2016.  
<sup>(2)</sup> David Bennett was appointed as a Director on 22 October 2015.  
<sup>(3)</sup> Paul Coby was appointed as a Director on 1 June 2016.  
<sup>(4)</sup> Fiona MacLeod was appointed as a Director on 12 September 2016.  
<sup>(5)</sup> Tim Wade was appointed as a Director on 12 September 2016.

None of the Non-Executive Directors hold any awards under the CYBG PLC share plans.

None of the Executive Directors, or their connected persons, bought or sold shares between 30 September 2016 and the date of this report



## DIRECTORS' REMUNERATION REPORT

### Executive Directors' shareholdings under each of the Group's Share Plans

The Group operates four shares plans, which were approved prior to the demerger:

- Deferred Equity Plan (DEP)
- Long Term Incentive Plan (LTIP)
- Share Incentive Plan (SIP)
- Save As You Earn (SAYE)

As CYBG PLC is no longer part of the NAB Group, no details of outstanding NAB awards are included within this section.

### Deferred Equity Plan (DEP)

Awards were made to Executive Directors under the DEP following the demerger.

DEP Awards	Start of year	Awarded during the year	Vested during the year <sup>(1)</sup>	Lapsed during the year	Unvested at year end <sup>(2)</sup>	Date of grant	Market value at date of grant <sup>(3)</sup> £000s	Notes
David Duffy	-	115,284	115,284	-	-	11-Feb-16	£225	Upfront Retained Bonus
	-	768,560	-	-	768,560	11-Feb-16	£1,500	Demerger LTIP
Ian Smith	-	88,325	88,325	-	-	11-Feb-16	£173	Upfront Retained Bonus
	-	34,408	-	-	34,408	11-Feb-16	£67	Deferred Bonus
	-	230,568	-	-	230,568	11-Feb-16	£450	Demerger LTIP
Debbie Crosbie	-	92,227	92,227	-	-	11-Feb-16	£180	Upfront Retained Bonus
	-	46,113	-	-	46,113	11-Feb-16	£90	Deferred Bonus
	-	230,568	-	-	230,568	11-Feb-16	£450	Demerger LTIP

<sup>(1)</sup> The upfront retained bonus award vested on 11 February 2016 when granted.

<sup>(2)</sup> None of the unvested awards are due to vest prior to the AGM in January 2017.

<sup>(3)</sup> The value of awards granted under the DEP on 11 February 2016 were based on the three day mid-market closing price over the preceding three days being 195.17 pence.

### Long Term Incentive Plan (LTIP)

No awards have been made under the 2016 LTIP plan.

### Share Incentive Plan (SIP)

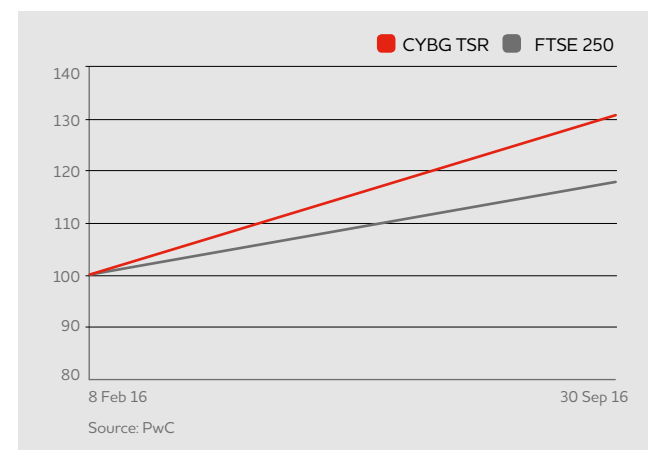
Each of the Executive Directors received 256 CYBG PLC shares under the Demerger Freeshares offer made to all employees through the CYBG PLC SIP. The award was made in March 2016 based on a share price of 194.67 pence with shares placed into the SIP Trust.

### Save As You Earn plan (SAYE)

No offers under the CYBG PLC SAYE Plan have been made.

### Total Shareholder Return (TSR) performance

The graph below shows the value of £100 invested in the Group's shares since listing compared with the FTSE 250 Index. The graph shows the Total Shareholder Return generated by both the movement in share value and the reinvestment over the same period of dividend income. The Committee considers the FTSE 250 as representative of the current market capitalisation of the Group.



### CEO historic remuneration

The table below sets out the total remuneration delivered to the Chief Executive Officer over 2016.

Chief Executive Officer	2016
Total Single Figure (£000s)	2,048
Annual short term incentive payment level achieved (% of maximum opportunity)	80%
Long term incentive vesting level achieved (% of maximum opportunity) <sup>(1)</sup>	-

<sup>(1)</sup> No CYBG LTIP awards vested during 2016.

### Relative importance of spend on pay

The table below sets out the relative importance of spend on pay in the 2016 financial year.

Overall spend	Disbursements from profit in 2016 financial year (£m)
Dividend <sup>(1)</sup>	-
Overall spend on pay including Executive Directors <sup>(2)</sup>	280

<sup>(1)</sup> No dividend has been declared or paid in 2016, in line with the Group's dividend policy.

<sup>(2)</sup> As per note 7 of the consolidated financial statements.

### Change in the CEO's remuneration compared with employees

The table below shows the percentage change in remuneration for the CEO between 2015 and 2016 compared with the percentage change in the average remuneration of employees.

Remuneration compared with employees	Salary 2015 to 2016	Benefits <sup>(3)</sup> 2015 to 2016	Bonus 2015 to 2016
CEO <sup>(1)</sup>	0%	0%	78%
Employees <sup>(2)</sup>	3%	0%	11%

<sup>(1)</sup> Reflects annual salary at 30 September and bonus awards of 80% of annual salary for 2016, compared to 45% of annual salary for 2015.

<sup>(2)</sup> Reflects average annual FTE salary of employees employed at both 30 September 2015 and 2016 and average bonus award 2016.

<sup>(3)</sup> Taxable benefits and other allowances excluding employer pension contributions.

### Implementation of remuneration policy in the next financial year 2017

The Remuneration Policy will be operated as set out above in 2017. In particular:

- No salary changes are proposed for Executive Directors in 2017.
- The targets for the 2017 annual bonus are considered to be commercially sensitive at this time but will be disclosed along with measures and weightings on a retrospective basis.
- Details of the proposed LTIP award for 2016 are set out in the Annual Report on Remuneration.
- The annual bonus for Executive Directors for the performance year 2017 will be capped at 100% of base salary.
- The Executive Directors' LTIP for the performance year 2017 will be capped at 100% of base salary.
- Non-Executive Directors' fees in 2017 may be reviewed as the Group progresses with its strategic priorities and to reflect any changes in the nature of a Non-Executive Director's role and responsibilities.

DIRECTORS' REMUNERATION REPORT

Remuneration Committee

Activities during the year

In preparation for the separation from NAB, the Committee was formally established by the Board on 11 November 2015. In advance of this, a subset of the Board met to commence work on the establishment of the demerger remuneration policies of CYBG PLC and the Remuneration Committee's Charter.

Prior to the demerger, Lynda Dean (NAB Head of Workplace Performance) was appointed by NAB as their representative on the CYBG PLC Remuneration Committee. All other

members of the Committee were independent Non-Executive Directors who serve on the Committee for a minimum three-year term and a maximum of six years.

Prior to the demerger in February 2016, final approval was given by the NAB Remuneration Committee in relation to Executive Directors' remuneration, Demerger awards and the 2015 bonus pool.

The Committee is chaired by Adrian Grace and it held five scheduled meetings during the financial year as well as six ad hoc meetings.

The Committee receives assistance from the Human Resources Director and Head of Reward and Pensions, who will attend meetings by invitation, except when issues relating to their own remuneration are being discussed. The Chief Executive Officer (CEO), Chief Financial Officer (CFO), and other members of the Executive Leadership Team attend by invitation on occasions.

Matters considered by the Committee

2015/16

During the year, the Committee considered, amongst other matters, the following:

- the pre demerger Committee Charter and operating schedule;
- the remuneration disclosures in the Prospectus and Scheme Booklet;
- revised Executive Directors' contracts;
- shareholding requirements for Executive Directors;
- the annual salary budget for employees and increases for Executive Directors and members of the Executive Leadership Team;
- performance outcome of the 2015 bonus plan, level of risk adjustment and individual awards for the Executive Directors and members of the Executive Leadership Team;
- the Demerger LTIP awards proposed by NAB;
- policy in relation to commencement awards and termination payments;
- benchmarking data for Executive Directors and members of the Executive Leadership Team;
- Chairman's fees;
- introduction of the new CYBG Share Plans;
- remuneration arrangements for new members of the Executive Leadership Team;
- list of MRTs and any commencement awards and termination payments to MRTs;
- 2016 bonus arrangements and established measures for Executive Directors, members of the Executive Leadership Team and all employees;

- remuneration policy in relation to pensions and commencement awards;
- Directors' Remuneration Policy and 2016 LTIP design and measures;
- approval of the Directors' Remuneration Report disclosures;
- interim performance of the Group, Executive Directors and members of the Executive Leadership;
- risk adjustment process for variable pay awards; and
- regulatory developments.

Advisors to the Committee

Following a selection process carried out by the Remuneration Committee prior to the IPO of the Group, the Committee engaged the services of PwC as independent remuneration advisor. During the financial year, PwC advised the Committee on all aspects of the Directors' Remuneration Policy for members of the Executive Leadership Team. PwC also provide professional services in the ordinary course of business including assurance, advisory, tax and legal advice. The Committee is notified of other remuneration work that is undertaken by PwC. In addition, there are processes in place to ensure no conflict of interest exists in the provisions of these services.

PwC is a member of the Remuneration Consultants Group, whose voluntary code of conduct is designed to ensure objective and independent advice is given to remuneration committees. Fees of £93,000 excluding VAT (2015: £Nil) based on the time spent working on CYBG remuneration matters were provided to PwC during the year in respect of remuneration advice received.

Statement of voting at General Meeting

The Group held its first AGM on 22 January 2016 prior to the IPO when the sole shareholder was NAB, and no resolutions on Directors' remuneration matters were considered. There is therefore no historic voting information.

The table below shows the Committee members during the year to 30 September 2016 and their attendance at scheduled Committee meetings.

	Number of scheduled Committee meetings eligible to attend	Number of scheduled Committee meetings attended
Committee Chair		
Adrian Grace	5	5
Committee Members		
David Bennett <sup>(1)</sup>	5	4 <sup>(2)</sup>
David Browne	5	5
Jim Pettigrew	5	4 <sup>(3)</sup>
Former Committee Members		
Lynda Dean <sup>(4)</sup>	2	2

<sup>(1)</sup> David Bennett was appointed as a Committee member on 23 November 2015.

<sup>(2)</sup> The Board schedule was set before the Director joined the Board and as a result he was unable to attend meetings due to unavoidable prior business commitments.

<sup>(3)</sup> Jim Pettigrew was unable to attend due to unavoidable prior business commitments.

<sup>(4)</sup> Lynda Dean retired as a Committee member on 2 February 2016 prior to the demerger.

Roles and Responsibilities

The Committee is responsible for overseeing the Directors' Remuneration Policy ensuring that the Group complies with its regulatory requirements and is able to recruit, retain and motivate its senior employees and reward their individual contribution to the Group in line with the Group's risk appetite. Under the Committee's Charter the key roles and responsibilities of the Committee are to:

- develop the Group's remuneration strategy and policy for all colleagues, including Executive Directors, for approval by the Board;
- ensure the Directors' Remuneration Policy has regard to the risk appetite of the Group and aligns with its long term success;
- ensure there are measures in place to avoid potential conflicts of interest in the design of incentive arrangements to ensure the interests of customers, employees, shareholders and other stakeholders are aligned;

- submit the Directors' Remuneration Policy, at least every three years, to a binding vote of the Group's shareholders, consider and, where appropriate, respond to feedback received from shareholders through that process;
- determine the overall parameters for variable pay arrangements for employees, members of the Executive Leadership Team and Executive Directors;
- determine the remuneration in respect of the Chairman and members of the Executive Leadership Team;
- consider, and approve, the list of MRTs;
- monitor the remuneration arrangements of all MRTs in line with the PRA Remuneration Code; and
- approve annually the formal Group's PRA Remuneration Policy Statement (RPS) required under the PRA Remuneration Code.



## DIRECTORS' REMUNERATION REPORT

### Other Remuneration Disclosures

#### Our remuneration policy for all employees

The remuneration policy supports our strategy and is designed to promote the delivery of our long term strategy in line with our business, values and risk appetite. The remuneration policy applies the same principles to all MRTs and reflects regulatory requirements. The key elements are set out below:

Element	Objective	Operation
Base salary	Recruit, reward, retain and recognise scope of role.	Base salaries are reviewed annually and reflect Group and individual performance, skills, experience and the scope of the role.
Benefits	To provide benefits consistent with role.	The Group provides access to a range of benefits.
Pension	To provide benefits consistent with role.	The Group operates a defined contribution pension scheme for all employees. The defined benefit scheme closed to new entrants in 2004.
Bonus	The annual bonus is designed to reward Group and personal performance in line with strategic objectives.	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.  For MRTs, deferral is applied in line with PRA Remuneration Code. Where that does not apply, employees who have a bonus award of £14,000 or more will have part of the award deferred for 12 months.
LTIP	Delivery of the Group's strategy and growth in shareholder value.	Awards are based on a three-year performance period reflecting a basket of business and shareholder measures aligned with strategic goals. Awards will vest a minimum of three years after being awarded, or longer where required by the PRA Remuneration Code. Awards may be subject to a discount in determining total variable remuneration under the rules set by the European Banking Authority.
Other share plans	Offers opportunity to acquire shares in CYBG PLC.	As well as the DEP and LTIP, the Group operates: - a SIP under which employees may purchase Partnership Shares and the Group may offer free shares; and - the Group may in the future offer a SAYE plan.
Commencement, retention and guaranteed awards	Buy-out of unvested equity from a previous employer	The amount, timing and performance hurdles are based on those being forfeited and satisfactory evidence. Guaranteed incentives or bonus are not provided to existing employees.

Total reward consists of both fixed and variable components:

- fixed remuneration provided as cash and benefits (including employer pension); and
- variable remuneration reflects both individual and business performance.

The mix of fixed and variable reward is balanced to ensure that fixed remuneration provides a sufficient level of remuneration so that the variable reward components can

be fully flexible, including the possibility of paying no variable reward. The remuneration mix at target is based on market information and practices. In any year, the actual mix may vary from target, given the overlay of business performance and individual performance.

All variable pay awards to MRTs are subject to malus and clawback in line with regulatory requirements.

#### Control functions

Employees engaged in control functions (i.e. Risk, Internal Audit and Compliance employees) are critical to effective management of risk across the Group. Independence from the business for these employees is assured through:

- setting the reward mix so that variable reward is not significant enough to encourage inappropriate behaviours while remaining competitive with the external market
- scorecards which are specific to the function.

The Committee reviews remuneration structures for control function employees.

#### Risk adjustment

In addition to the Committee's review of risks which impact on the level of the bonus pool and the application of malus and clawback as outlined above, individual bonus awards are also subject to meeting all compliance requirements and awards made can be reduced to nil where these are not met, or where employees are subject to disciplinary sanction.

#### Deferral arrangements

Variable rewards (bonus, LTIP and retention awards) are subject to deferral and retention for all MRTs in line with UK regulation:

- At least 60% of total variable reward will be deferred over three years where the total variable reward is £500,000 or more; and
- At least 40% of total variable reward will be deferred over three years where the MRT does not meet de minimis conditions.

#### Remuneration of MRTs for 2016

This section discloses the remuneration awards made by the Group to 149 MRTs (2015: 65) in respect of the 2016 performance year. Additional information summarising the Group's decision-making policies for remuneration are also provided. These disclosures deliver the requirements of Capital Requirements Regulation (CRR) Article 450.

The following groups of individuals have been identified as meeting the criteria for MRTs including those who may have a material impact on the Group's risk profile:

- Senior Management, Executive Board Directors, members of the Executive Leadership Team
- Non-Executive Directors
- Other individuals whose activities could have an impact on the Group's risk profile

Aggregate Remuneration of MRTs by business area	Banking <sup>(1)</sup>	Independent Control Functions <sup>(2)</sup>	Corporate Functions <sup>(3)</sup>	Total
Number of MRTs	33	84	32	149
Total fixed remuneration (£m)	6.5	13.9	10.6	31.0

<sup>(1)</sup> Includes all employees in the Customer Banking Division and the Customer Banking Director.

<sup>(2)</sup> Includes Executive Directors, Non-Executive Directors and employees within Risk, Internal Audit and Compliance functions.

<sup>(3)</sup> Includes Human Resources, Finance, Marketing, Products and other corporate functions.

Total value of MRTs remuneration awards	Senior Management (£m) <sup>(1)</sup>	Other MRTs (£m) <sup>(2)</sup>	Total (£m)
Number of MRTs	31	118	149
Fixed remuneration <sup>(3)</sup>	6.8	12.2	19.0
Variable remuneration (cash)	1.3	2.0	3.3
Deferred remuneration (cash) <sup>(4)</sup>	-	-	-
Deferred remuneration (shares) <sup>(5)</sup>	1.6	1.0	2.6
Long term incentive (shares) <sup>(5, 6)</sup>	4.7	1.4	6.1
Total variable remuneration <sup>(7)</sup>	7.6	4.4	12.0
Total remuneration	14.4	16.6	31.0

<sup>(1)</sup> Includes the Executive Directors, members of the Executive Leadership team and those holding a Senior Management function under the Senior Managers Regime.

<sup>(2)</sup> Includes Non-Executive Directors, employees identified as MRTs under the FCA/PRA criteria and any employees who the Group consider to have responsibility and accountability for activities that could have a material impact on the Group's business risk profile or credit exposure and employees in independent Risk Management, Compliance or Internal Audit function roles.

<sup>(3)</sup> Excludes termination awards made under the Group redundancy policy together with PILON and any pension augmentation.

<sup>(4)</sup> Deferred bonuses awarded in cash.

<sup>(5)</sup> All awards are made as conditional rights to the Group's shares.

<sup>(6)</sup> Reflects the face value of the 2016 LTIP award to be made, subject to approval at the AGM.

<sup>(7)</sup> Includes current year commencement awards awarded in 2016.

# DIRECTORS' REMUNERATION REPORT

Deferred remuneration	Senior Management (£m)	Other MRTs (£m)	Total (£m)
Deferred remuneration at 30 September 2015 <sup>(1)</sup>			
Outstanding Vested	11	0.1	1.2
Outstanding Unvested	5.7	2.5	8.2
Awarded during the financial year <sup>(2)</sup>	4.9	2.5	7.4
Released / paid during the financial year <sup>(3)</sup>	0.6	0.9	1.5
Reduced through performance adjustments <sup>(4)</sup>	-	-	-

<sup>(1)</sup> Value at date of award. Figures including legacy NAB deferred bonus / LTIP awards.  
<sup>(2)</sup> Includes 2015 deferred bonus awards, 2015 Demerger LTIP awards and commencement awards.  
<sup>(3)</sup> Reflects deferred element of 2014 and 2013 bonuses.  
<sup>(4)</sup> This figure does not include the adjusted value of awards which were forfeited by employees upon leaving the Group.

Other remuneration	Senior Management (£m)	Other MRTs (£m)	2016 Total (£m)
Commencement awards <sup>(1)</sup>	0.1	0.4	0.5
Number of beneficiaries	1	3	4
Highest award to single beneficiary	0.1	0.3	n/a
Termination awards <sup>(2)</sup>	1.7	2.2	3.9
Number of beneficiaries	4	9	13
Highest award to single beneficiary	0.7	0.4	n/a

<sup>(1)</sup> Current year commencement awards and prior year buyout awards granted in 2016.  
<sup>(2)</sup> Awards made under the Group redundancy policy together with PILON and any pension augmentation.

Remuneration band <sup>(1)</sup>	Senior Management	Other MRTs	2016 Total
More than €4.0m	-	-	-
€3.5m - €4.0m	1	-	1
€3.0m - €3.5m	-	-	-
€2.5m - €3.0m	-	-	-
€2.0m - €2.5m	-	-	-
€1.5m - €2.0m	2	-	2
€1m - €1.5m	3	-	3
Less than €1m	25	118	143

<sup>(1)</sup> Total remuneration has been calculated including fixed remuneration, allowances, variable remuneration (including 2016 LTIP at face value) in relation to the performance year, and fees for Non-Executive Directors. Variable remuneration includes the annual short term incentive award in respect of the 2016 financial year. Bands have been converted using a rate of 1 GBP = 1.1741 EUR, consistent with the European Commission's currency converter for September 2016.

# GOVERNANCE

# DIRECTORS' REPORT



Corporate Governance Report

The Corporate Governance Report, found on pages 58 to 137, together with this report of which it forms part, fulfils the requirements of the Corporate Governance Statement for the purpose of the FCA's Disclosure and Transparency Rules (DTR).

Company Background

The Company was incorporated in England and Wales on 18 May 2015 as a public company limited by shares under the Companies Act 2006 with the name Pianodove PLC. Pianodove PLC changed its name to CYBG PLC on 1 October 2015. The registered office of the Company is at 20 Merrion Way, Leeds, West Yorkshire, LS2 8NZ with the head office and principal place of business of the Company being 30 St Vincent Place, Glasgow, G1 2HL.

Board Composition Changes

Changes to the composition of the Board since 1 October 2015, and up to the date of this report, are shown in the table below. Further details of Board changes can be found on page 79 of the Corporate Governance Report and on page 87 of the Governance & Nomination Committee Report.

Name	Role	Date of Appointment	Date of Retirement
David Bennett	Non-Executive Director	22 October 2015	
Richard Sawers	Executive Director		2 February 2016
David Allvey	Non-Executive Director		31 March 2016
Barbara Ridpath	Non-Executive Director		20 May 2016
Alex Shapland	Non-Executive Director		20 May 2016
Paul Coby	Non-Executive Director	1 June 2016	
Clive Adamson	Non-Executive Director	1 July 2016	
Fiona MacLeod	Non-Executive Director	12 September 2016	
Tim Wade	Non-Executive Director	12 September 2016	

Directors

The current Directors of the Company and their biographical details are shown on pages 62 to 67. As previously announced, David Allvey, Non-Executive Director and Chair of the Audit Committee, retired from the Board on 31 March 2016 and Barbara Ridpath, Non-Executive Director and Chair of the Governance & Nomination Committee, and Alex Shapland, Non-Executive Director, retired from the Board on 20 May 2016.

Particulars of Directors' emoluments and interests in shares in the Company are given on pages 116 to 125 of the Directors' Remuneration Report.

During the year, no Director had a material interest in any contract of significance to which the Company or a subsidiary undertaking was a party.

Annual General Meeting

The Company's 2017 AGM will be held at 10.00am (Melbourne time - AEDT) on Tuesday 31 January 2017 at the Melbourne Convention and Exhibition Centre, 1 Convention Centre Place, South Wharf, Melbourne, Victoria 3006, Australia. Details of the meeting venue and the resolutions to be proposed, together with explanatory notes, are set out in a separate Notice of AGM which accompanies this Annual Report and Accounts and is published on the Company's website ([www.cybg.com](http://www.cybg.com)).

The AGM will be webcast live at 10.00am (Melbourne time - AEDT) on Tuesday 31 January 2017 on the Company's website [www.cybg.com](http://www.cybg.com) and a recording will also be available shortly after the conclusion of the AGM. Please note that viewing the live webcast does not enable shareholders to ask questions or vote during the AGM.

The webcast may include a question and answer session with shareholders present at the AGM in addition to background shots of those in attendance. Photographs may also be taken at the AGM and used in future CYBG Group publications. If you attend the AGM in person, you may be included in the webcast, recording and/or photographs.

Election and Re-election of Directors at the forthcoming AGM

The Company's Articles of Association provide that each Director is subject to election at the first AGM following their appointment; Non-Executive Directors, Clive Adamson, Paul Coby, Fiona MacLeod and Tim Wade will be seeking election as Directors at the 2017 AGM. Following recommendations from the Governance & Nomination Committee, the Board considers all Directors continue to be effective, committed to their roles and have sufficient time available to discharge their duties.

In accordance with the Code all other Directors will retire and seek re-election at the 2017 AGM.

Directors' Indemnities

The Directors have each entered into individual deeds of access, insurance and indemnity with the Group which, amongst other things and subject to certain exceptions, indemnify the Directors to the maximum extent permitted by law and regulation against liabilities to a person other than the Company or an associated company that they may incur as an officer of the Company and any other subsidiary of the Group. Each such provision constitutes a "third party indemnity provision" and a "qualifying indemnity provision" for the purposes of section 234 to 236 of the Companies Act 2006. These provisions are in force for the benefit of the Directors at the date of this report, and were in force when this report was approved and during the financial year to which this report relates. Such deeds are available for inspection at the Company's registered office.

The Group has an insurance policy in place for the benefit of all trustees, employees, Directors, officers, members and partners of the Company whilst acting in the capacity of a trustee or administrator of employee benefit or pension plans. This policy therefore indemnifies the Directors of Yorkshire and Clydesdale Bank Pension Trustee Limited and YCB DC Trustee Limited (each a "Trustee Company"), the trustees of two occupational pension schemes operated by the Group, against liability incurred by them in connection with the management and administration of the pension schemes. This insurance policy constitutes a "pension scheme indemnity provision" and a "qualifying indemnity provision" for the purposes of section 235 to 236 of the Companies Act 2006. These provisions are in force for the benefit of the Directors of Trustee Companies at the date of this report, and were in force when this report was approved and during the financial year to which this report relates. Such policy is available for inspection at the Company's registered office.

In addition, the Group had appropriate Directors' and Officers' Liability Insurance cover in place throughout the financial year.

Profits and Appropriations

The Group profit before tax for the year ended 30 September 2016 amounted to £77m (2015: loss of £285m). The loss attributable to the ordinary shareholders for the year ended 30 September 2016 amounted to £206m (2015: loss of £247m). No dividends were paid on the ordinary shares during the year ended 30 September 2016 (2015: £nil). The Directors do not recommend the payment of a dividend in respect of this financial year (2015: £Nil).

CORPORATE  
GOVERNANCE REPORT

Amendment to the Articles of Association

The Company may only amend its Articles of Association if its shareholders pass a special resolution to that effect.

Share Capital, Control and Directors' Powers

Shares in the Company are listed on both the LSE and the ASX (in the form of CHESS Depositary Interests (CDIs)) and therefore, the Company is required to comply with the disclosure requirements of both listing regimes.

Details of the movements in allotted share capital during the year, together with the rights and obligations attaching to the Company's shares, are shown in note 31 to the consolidated financial statements.

There are no restrictions on voting rights of securities in the Company. The Notice of AGM specifies deadlines for determining attendance and voting entitlements at the AGM.

Where participants in an employee share incentive plan operated by the Company are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised at the discretion of participants.

With the exception of restrictions on the transfer of ordinary shares under the Company's share incentive plans, whilst the shares are subject to the rules of the plan, there are no restrictions which exist on the transfer or holdings of securities in the Company under its Articles of Association and there are no shares carrying special rights with regards to the control of the Company.

Subject to the Articles of Association and provisions of relevant statutes, the Board may exercise all powers of the Company.

Acquisition of Own Shares

At the first AGM of the Company held on 22 January 2016 prior to the IPO when the sole shareholder was NAB, a resolution was passed that with effect on and from the earlier of (i) UK Admission; and (ii) Australian Admission, the Directors were authorised to purchase up to a maximum of 87,931,525 ordinary shares representing approximately 10% of the issued ordinary share capital of the Company immediately following the demerger. This authority remains in place until the AGM on 31 January 2017 when it is intended to seek a renewal up to a limit of 88,153,180 ordinary shares. Further information is set out in the Notice of AGM.

Political Donations

The Group did not give any money for political purposes nor did it make any political donations to political parties or other political organisations, or to any independent election candidates, or incur any political expenditure during the year.

Financial Risk Management Objectives and Policies

Information about internal controls and financial risk management systems in relation to financial reporting and Board review can be found on page 83 of the Corporate Governance Report.

Information about financial risk management objectives and policies in relation to the use of financial instruments can be found in the Risk Report on pages 138 to 197.

Post Balance Sheet Events

On 25 October 2016, the Group announced that it has engaged in discussions with The Royal Bank of Scotland Group plc (RBS) and has made a preliminary non-binding proposal to RBS in relation to its Williams & Glyn operations. This engagement is ongoing and there can be no certainty that any transaction will occur, nor as to the terms on which any transaction might be concluded.

Information included in Strategic Report

The following information that would otherwise be required to be disclosed in this report and which is incorporated into this report by reference can be found on the following pages of the Strategic Report:

Subject matter	Page reference
Future developments	13
Employment of disabled persons	24
Colleague engagement	23-24
Emissions reporting	29-31

Substantial Shareholdings

Information provided to the Company by substantial shareholders pursuant to the DTRs is published via a Regulatory Information Service.

As at 30 September 2016, the Company had been notified by its substantial shareholders under Rule 5 of the DTR of the following interests representing 3% or more of the issued share capital of the Company:

	Total number of shares	% of issued capital with rights to vote in all circumstances at general meetings <sup>(1)</sup>
Perpetual Limited and subsidiaries	64,650,581	7.33%
JCP Investment Partners Ltd	63,439,056	7.20%
AMP Life Limited, AMP Capital Investors Limited, Ipac Asset Management Limited, AMP Capital Investors (NZ) Limited	61,322,129	6.95%
Cooper Investors Pty Ltd	52,888,470	6.00%
Investors Mutual Limited	36,401,370	5.17%
Westpac Banking Corporation	27,570,287	3.13%

(1) Percentage correct at time of notification

On 11 October 2016 the Company was notified by AMP Life Limited, AMP Capital Investors Limited, ipac Asset Management Limited, AMP Capital Investors (NZ) Limited of a holding of 52,466,092 shares (5.95%).

On 20 October 2016 the Company was notified by Schroders plc of a holding of 44,572,459 shares (5.06%).



Going Concern

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

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

Disclosure of information under Listing Rule (LR) 9.8.4R

Additional information required to be disclosed by LR9.8.4R, where applicable to the Group, can be found in the following sections of this report:

Subject matter	Page reference
Publication of unaudited financial information	The disclosures within the Risk Report (pages 138 to 197) are unaudited unless otherwise stated.
Allotment of equity securities	266
Significant contracts	237

Research and Development Activities

The Group does not undertake formal research and development activities although it does invest in new platforms and products in each of its business lines in the ordinary course of business. In addition to new products and services the Group also invests in internally generated intangible assets including software and computer systems. Further details can be found in note 22 of the Group's consolidated financial statements.

Change of Control

The Group is not party to any significant agreements that are subject to change of control provisions in the event of a takeover bid, other than the following:

- A Conduct Indemnity Deed with NAB under which NAB has agreed, subject to certain limitations, to provide CYBG with a capped indemnity in respect of certain historic liabilities relating to Relevant Conduct Matters (as defined therein). The capped indemnity will not automatically cease to apply nor will it automatically terminate upon any takeover. However, prior to any

Viability Statement

The viability statement is contained in the Risk Overview section on page 38 and is incorporated into this report by reference.

change of control, the parties must cooperate in good faith to facilitate an assessment by the PRA to determine whether the capped indemnity should continue in the then amount or whether it should be terminated in whole or part. Any such assessment will be at the sole discretion of the PRA.

There are a very small number of senior employees who are entitled to an enhanced redundancy payment if redundancy arises within the initial period of employment and is a result of a change of control. The Group has share schemes under which change of control may apply albeit this is not considered to be significant.

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, they are required to prepare the Group financial statements in

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

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

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

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

On behalf of the Board:



Lorna McMillan  
21 November 2016  
Company Secretary

CYBG PLC. Registered No. 09595911

Responsibility Statement of the Directors in respect of the Annual Report and Accounts

The Directors confirm that to the best of our 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 Group and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the Group, together with a description of the principal risks and uncertainties that they face.

The Directors consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's and Group's position and performance, business model and strategy.

Independent Auditor and Audit Information

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

The Directors who were members of the Board at the time of approving the Report of the Directors are listed on page 61. Having made enquiries of fellow Directors and of the Group's auditor, each of these Directors confirms that:

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





# RISK REPORT



“Effective management of risk is a core capability for a successful financial services provider and is fundamental to the Group’s strategy. Board oversight of risk management is facilitated by the Boards’ Risk and Audit Committees; the Board approves the Group’s overall governance, risk and control frameworks and risk appetite.”

### The Group’s Approach To Risk

Risk exists in every aspect of the Group’s business throughout its operating environment, and is a core consideration within the Strategic Plan. The Group’s approach to risk management is based on a principle that risk management capability must be embedded within the businesses’ front line teams to be effective. This overriding principle embodies the following concepts:

- Commercial decisions are made on the basis of proactive consideration of risk and the impact on customers;
- Business managers use the Risk Management Framework (RMF), which assists in the appropriate balancing of both the risk and reward components; and
- Employees are responsible for risk management in their day to day activities.

### Risk Strategy

The Group has a clearly defined strategy in order to manage and mitigate risk in the daily course of its business. The strategy consists of:

- Ensuring all principal and emerging risks are identified and assessed;
- A clearly articulated risk appetite which influences the Group’s strategic plan;
- A clearly defined risk culture which emphasises risk management throughout all areas of the business whilst maintaining independent oversight;
- Ongoing analysis of the environment in which the Group operates to proactively address potential risk issues as they arise; and
- Supporting commercial decisions and people with appropriate risk processes, systems and controls.

### Risk Appetite Statement (RAS)

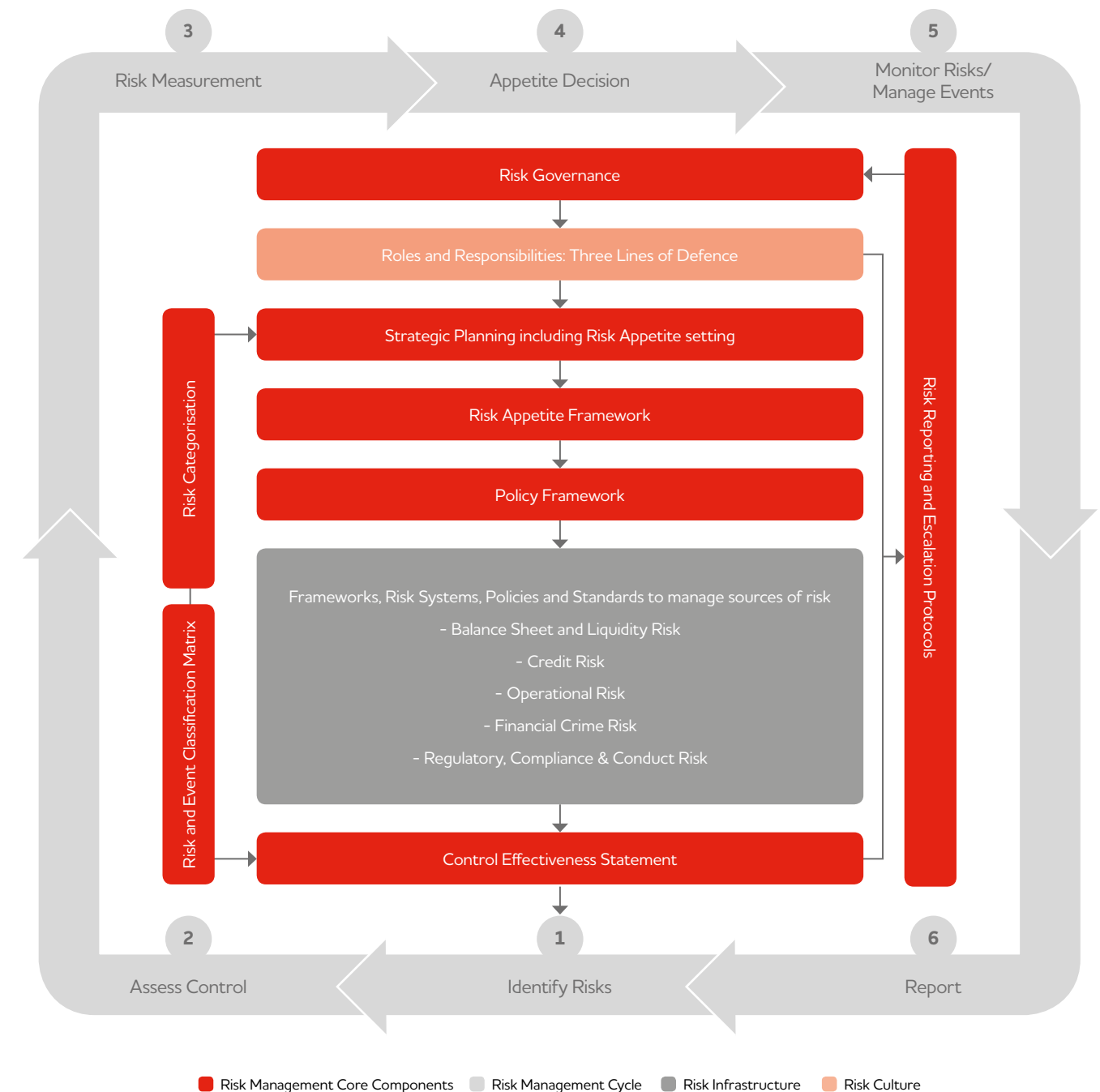
‘Risk Appetite’ is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity, to achieve its strategic objectives. The RAS articulates the Group’s risk appetite and helps communicate it to stakeholders. This is important as it provides the definitive view on the broad direction of risk taking activity the Board is comfortable that the Group undertakes and allows decision makers (including those with delegated authority and also those providing oversight) to exercise judgement with greater confidence and speed.

The RAS aligns to the risks identified and defined in the RMF. The design and structure of the RAS has taken into consideration best practice recently articulated by the European Central Bank which is aimed at ensuring Boards should be strongly involved in the validation process and monitoring of the RAS.

The Group’s RAS is prepared by the CRO with consideration of the strategic objectives and business model of the Group as well as the environment in which it operates. Monthly reporting to Executive Committees and Board includes details of performance against relevant RAS settings, breaches and trends.

### Risk Management Framework

The Group identifies and manages risk using the RMF (see diagram below), which is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, control, mitigate, monitor and report all internal and external sources of material risk.



## Risk Culture

Central to the Group's risk culture is the fair treatment of customers and meeting obligations to stakeholders, including shareholders and employees. The Board and senior management are responsible for setting and clearly communicating a strong risk culture through their actions and words, and proactively addressing any identified areas of weakness or concern.

Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships.

Initiatives that support appropriate risk culture include: the performance management framework; escalation procedures encouraging employees to raise concerns; and messaging from the CEO and members of the Executive Leadership Team emphasising the importance of risk identification, management and mitigation.

Underpinning the RMF and at the heart of the Group's risk culture is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model and a formal delegation framework through which employees are able to make risk based decisions.

## Risk Management

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy. Board oversight of risk management is facilitated by the Boards' Risk and Audit Committees; the Board approves the Group's overall governance, risk and control frameworks and risk appetite.

## Risk Policies and Procedures

The Policy Framework is a key component of the Group's RMF providing structure and governance for the consistent, effective management of Policies. In developing the Policy framework the Group aims to set a tone that demonstrates the risk culture expected across the organisation. This aligns with the behavioural expectations for all employees, which form a core part of our performance management approach. Policies and supporting standards define the minimum control requirements which must be observed across the Group to manage material sources of risk within risk appetite.

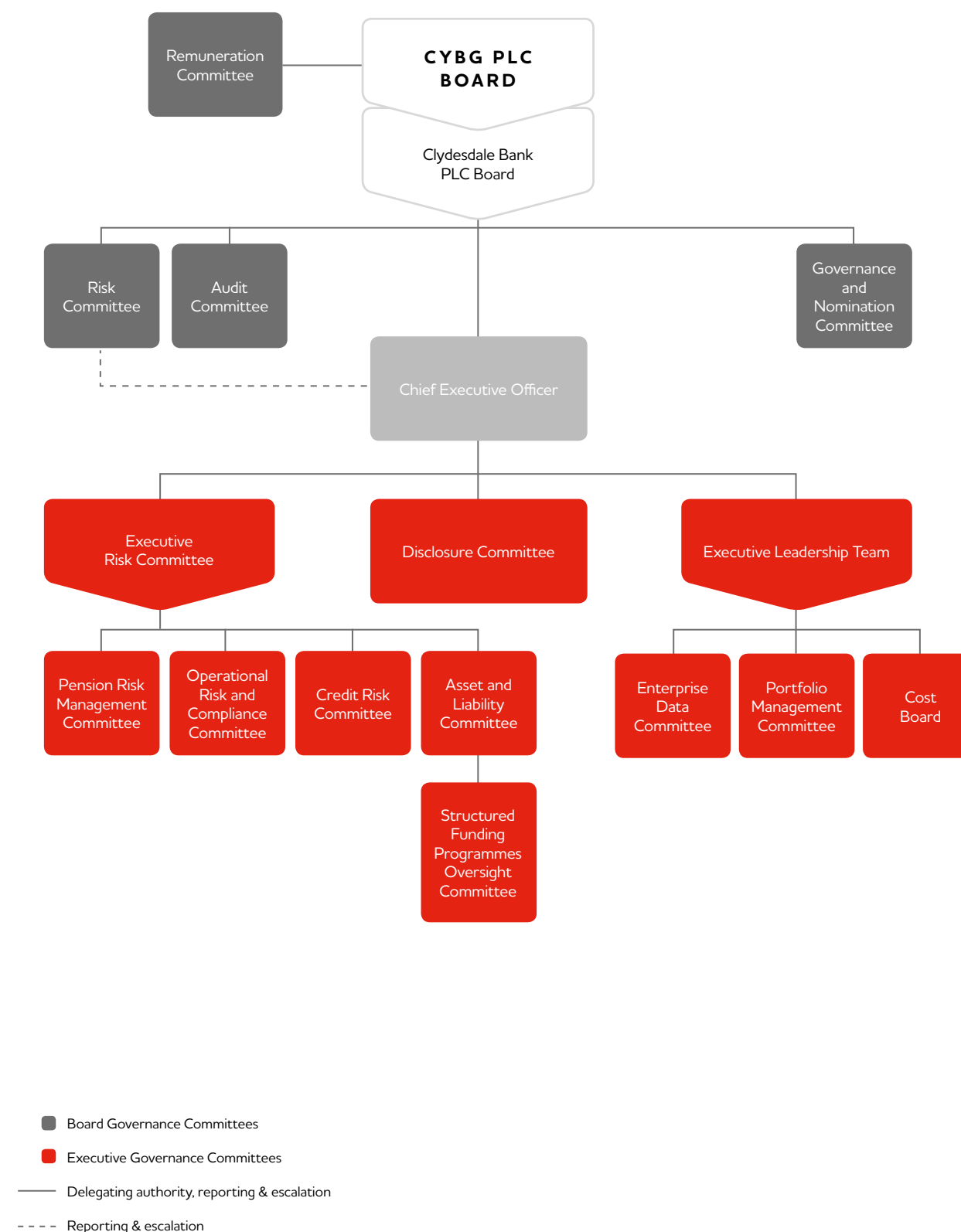
## Principal Risks

See pages 34 to 35 in the Strategic Report for details on the Group's principal risks.

## Risk Governance and Oversight

The Group's risk governance structure strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner. Refer to the Group's website ([www.cybg.com](http://www.cybg.com)) for further information on Board committees.

The Group's risk management is governed via a series of committees, as represented within the diagram which follows.





## RISK REPORT

The following Executive level Committees have been established under the authority of the Chief Executive Officer:

Committees	Risk Focus
<b>Executive Leadership Team</b>	The Executive Leadership Team supports the CEO to lead the Group to be a strong, customer focused bank for its communities by focusing on three business priorities: Sustainable Growth; Efficiency; and Capital Optimisation.
<b>Executive Risk Committee</b>	The Executive Risk Committee supports the CEO in respect of risk and control accountabilities and serves to provide leadership focus on key risk issues including: <ul style="list-style-type: none"> <li>- Endorsing the RAS for approval by the Board;</li> <li>- Overseeing and challenging the enterprise wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools;</li> <li>- Monitoring the status of regulatory relationships, the reputation of the Group in relation to its regulators and the changing state of the regulatory landscape including the impacts for and readiness of the Group;</li> <li>- Monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and</li> <li>- Reviewing and endorsing risk policies, frameworks and tools for use across the Group.</li> </ul>
<b>Disclosure Committee</b>	The Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations for the exchange(s) on which it has equity and debt securities listed.
<b>The Executive Risk Committee is supported by the following Committees:</b>	
<b>Pension Risk Management Committee</b>	The Pension Risk Management Committee is responsible for overseeing pension risk management and strategy. This committee also oversees the interaction with the pension scheme trustees in relation to the risks within the Scheme.
<b>Credit Risk Committee</b>	The Credit Risk Committee is responsible for ensuring that the Credit Risk Management Framework and associated policies remain effective. The committee has oversight of the quality, composition and concentrations of the credit risk portfolio and recommends strategies to adjust the portfolio to react to changes in market conditions.
<b>Operational Risk and Compliance Committee</b>	The Operational Risk and Compliance Committee is responsible for ensuring that the RMF and associated policies and standards are fit for purpose and implemented effectively.
<b>Asset and Liability Committee</b>	The Asset and Liability Committee (ALCO) is responsible for monitoring the performance of the Group against the Board approved Capital and Funding Plans. The committee focuses on the Group's non-traded market risks including capital, funding, liquidity and interest rate risk to ensure that the Group's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives. The impact of Pension Risk on Capital is also assessed by ALCO.
<b>Structured Funding Programmes Oversight Committee</b>	The Structured Funding Programmes Oversight Committee is responsible for supporting the Asset and Liability Committee in relation to its risk monitoring and oversight responsibilities for all secured funding programmes and supporting the CFO and Treasurer in relation to the compliance of the Regulated Covered Bond (RCB) Programme with FCA regulations and the RCB Sourcebook.
<b>The Executive Leadership Team is supported by the following Committees:</b>	
<b>Enterprise Data Committee</b>	The Enterprise Data Committee is responsible for providing direction and oversight of information and data practices, including oversight of management's resolution of data issues.
<b>Portfolio Management Committee</b>	The Portfolio Management Committee is responsible for the oversight and management of capital allocation and funding decisions for the product portfolio, related to pricing and sustainable returns.
<b>Cost Board</b>	The Cost Board is the primary forum for the management of costs across the Group. Its primary responsibilities are to approve expenditure within agreed delegated authorities, to oversee business unit expenditure and expense performance and to support the development of a strong expense control culture within the Group.

## Three Lines of Defence

Effective operation of a Three Lines of Defence model is integral to the Group's approach to risk management and is based on an overriding principle that risk capability must be embedded within the First Line of Defence teams to be effective. This principle embodies the following concepts:

- Commercial decisions are made on the basis of proactive consideration of risk and the impact on customers;
- Risk management activities are focused on enhancing sustainable business performance;
- Management must use the RMF, to support decision making involving risk and reward trade offs;

- Regular assessments are undertaken to confirm the effectiveness of the risk and control frameworks in relation to both the current and emerging risk profile; and
- Risk management responsibilities are clearly understood by all employees when carrying out their day to day activities.

Control is exercised through a clearly defined delegation of authority, with communication and escalation channels throughout the Group.



## STRESS TESTING

Stress testing is an important and recognised risk management tool, used to assess the vulnerability of financial institutions through the modelling of adverse scenarios. The Group undertakes stress testing, following the Basel Committee principles, aimed at understanding potential impacts arising from adverse conditions relevant to its business and to aid the development and understanding of potential management actions and contingency plans.

Stress testing forms an integral part of the overall governance and risk management culture. Involvement from the Board and senior management in the stress testing programme is essential for its effective operation.

### Methodology

Stress testing at the Group complies with regulatory requirements and is subject to a rigorous review and challenge process. The Group's approach ensures that a clear link exists between the economic scenarios and stress testing outputs, supported by a structured review and sign off process.

While the stress testing process is underpinned by models, it is also reliant on judgements made by senior management and key personnel across the Group including, but not limited to:

- Finance, who manage the macroeconomic scenario process and prepare and review stressed business plans;
- Credit Risk, who prepare and review Credit stress outputs, including impairment charges, RWAs and write-offs;
- Treasury, who provide funding and liquidity impacts and construct capital plans based on the outcomes of stress testing; and
- Products and Customer Banking, who guide on potential management actions in response to stress scenario mitigation.

### Reverse Stress Testing

Reverse stress testing requires a different approach. It starts from an outcome of business failure and identifies instances where this might occur. Severe but plausible scenarios with an unacceptably high risk are used to inform business planning to prevent or mitigate specific business risks. Reverse stress tests are also utilised as the start point for recovery and resolution planning scenarios and are recognised as a required risk management tool in the form of an early warning indicator framework.

### Stress testing within the Group's risk governance and capital framework

Stress testing outputs are used to inform the strategic planning process and the RAS. The plan is subjected to sensitivity analysis, forming a key element of the planning process from an overall risk assessment perspective, and provides the Board with further detail when looking to approve the plan.

Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP. The Group runs a number of adverse macroeconomic stresses in order to determine the impacts on the Group's financial and capital position, taking account of changes to impairments, margins, volumes and costs relative to the base case plan, and considers the actions which the Group may choose to deploy in response to such events materialising.

Stress testing is also a key feature of the ILAAP where stress testing scenarios are modelled regularly to provide insight into potential vulnerabilities in the Group's funding and liquidity strategies. Stress testing results of liquidity are also reported to ALCO on a monthly basis.

The Executive Leadership Team and Board engages at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to the selection and development of scenarios and thereafter; considers how the results are integrated into future strategic decision making, contingency planning, capital and business planning, and risk appetite.

Prior to Board submission, ALCO reviews the scenarios, assumptions and results of liquidity and capital stress testing and provides initial review and challenge of outputs.

## RISK CLASSES

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CREDIT  
RISK

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BALANCE SHEET  
& PRUDENTIAL  
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REGULATORY,  
COMPLIANCE &  
CONDUCT RISK

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OPERATIONAL  
RISK

(INCLUDING STRATEGIC, BUSINESS,  
FINANCIAL PERFORMANCE &  
PEOPLE RISKS)

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FINANCIAL  
CRIME RISK



STRONGLY PERFORMING CREDIT PORTFOLIOS,  
WELL POSITIONED FOR GROWTH

Close monitoring, robust policies and a well controlled framework support the credit operations of the Group, maintaining strongly performing portfolios.

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument.

Credit risk manifests itself in the financial instruments and/or products that the Group offers, and those in which the Group invests (including, among others, loans, guarantees, credit-related commitments, letters of credit, acceptances, inter-bank transactions, foreign exchange transactions, swaps and bonds). credit risk can be found both on and off balance sheet.

Risk Appetite

The Group controls the levels of credit risk it takes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical, product and industry segments. The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions, regular asset quality analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group.

Credit Strategies and Policies

Credit risks associated with lending are managed through the application of detailed lending policies and standards which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Group maintains a dynamic approach to credit management and aims to take necessary steps if individual issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to borrower, economic or sector specific weaknesses.

Roles and responsibilities for the management, monitoring and mitigation of credit risk within the Group are clearly defined in line with the Group's RMF.

Significant credit risk strategies and policies are approved, and reviewed annually, by the Credit Risk Committee. For complex credit products and services, the Chief Credit Officer (CCO) and Credit Risk Committee provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management, with appropriate oversight through governance committees.

Exposures

Credit risk exposures are categorised as retail (secured and unsecured) and SME.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to customers. To ensure appropriate credit limits exist, especially for SME lending, a single large exposure policy is in place within the Group and forms part of the risk appetite measures which are monitored and reported on a monthly basis. The overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

Exposures are also managed in accordance with the Large Exposure reporting requirements of the CRR.

Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

Measurement

The Group uses statistical models to measure credit risk exposures. Models are supported by both internal and external data.

The 'probability of default' (PD) (that borrowers will not meet their contractual obligations), current exposures, and the likely loss ratio on defaulted obligations are calculated to measure and mitigate credit risk.

Portfolios are assessed using segmentation for measurement, reporting and monitoring purposes.

Subject to regulatory approval, the Group is progressing toward attaining permission to use IRB models to measure the credit risk of loans and advances to customers. Meantime, all exposures are measured under the standardised approach for regulatory capital.

Details of the Group's approach to the impairment of financial assets can be found in note 2.

## CREDIT RISK

### Key Credit Metrics (audited)

	2016	2015
<b>Impairment charge on credit exposures (£m)</b>		
SME lending (including lease finance)	31	45
Retail lending	8	33
	39	78
Of which		
Specific charge for impairment losses	25	73
Collective charge for impairment losses	14	5
	39	78
<b>Impairment provisions held on credit exposures (£m)</b>		
SME lending (including lease finance)	157	168
Retail lending	58	62
	215	230
Of which		
Specific provision	64	92
Collective provision	151	138
	215	230
<b>Credit risk adjustments held on loans at fair value (£m)</b>		
SME lending	24	38
Of which		
Individually assessed credit risk adjustments	8	11
Collectively assessed credit risk adjustments	16	27
	24	38
Impairment charge / (credits) on loans held at fair value	(11)	(18)
<b>Past Due and impaired assets (£m)</b>		
90+ DPD assets	150	143
Impaired assets <sup>(1)</sup>	233	263
<b>Asset Quality measures (%)</b>		
90+ DPD plus impaired assets to customer loans	1.27%	1.41%
Specific provision to impaired assets <sup>(2)</sup>	30.8%	39.2%
Net write-offs to customer loans <sup>(3)</sup>	0.18%	0.35%
Total provision to customer loans <sup>(4)</sup>	0.79%	0.93%
Total impairment charge to average customer loans <sup>(5)</sup>	0.09%	0.21%

<sup>(1)</sup> Impaired assets for September 2016 and September 2015 includes £19m and £25m of impaired fair value loans respectively.

<sup>(2)</sup> Total specific provision includes the individually assessed credit risk adjustments on loans at fair value.

<sup>(3)</sup> Net write-offs includes loans at fair value.

<sup>(4)</sup> Total provision to customer loans includes the credit risk adjustments on loans at fair value through profit and loss.

<sup>(5)</sup> Total impairment charge to average customer loans includes loans held at fair value through profit and loss.

The Group's strategy to target selective areas for balance sheet growth particularly through mortgage origination has influenced the low impairment charge. High underwriting standards and a controlled risk appetite have resulted in a portfolio with strong asset quality which has, in turn, led to a low impairment charge to average customer loans ratio across all portfolios. Most asset quality measures improved in the period as the influence of a strong customer focused culture, prudent risk management and a stable UK economy took effect. Some downward pressure on the oil & gas and agriculture sectors has had a softening effect on the portfolios, evidenced by an increased level of collective provisioning. While the portfolio remains sensitive to economic shocks, broader based negative effects from Brexit have yet to be observed, and prolonged economic stability underpinned by low interest rates and higher employment has supported customer confidence.

Retail asset quality remains strong with lower default rates and impairment charge observed across the period. The 'lower for longer' interest rate environment has sustained customer confidence, supporting strong growth in the mortgage portfolio and stable asset quality.

The level of impairment charge on credit exposures has reduced significantly in the period to September 2016 due to the lower levels of specific provision required, reflective of the reduction in the levels of defaulted and impaired lending. Stabilisation of asset values has also supported recoveries and write backs from provisions previously recognised.

The ratio of total provision to customer loans reduced by 14 basis points to 0.79% in the year to 30 September 2016 driven by the reduced levels of specific provision held and continued growth in the portfolio, particularly mortgages which have a lower provisioning requirement.



CREDIT RISK

Maximum exposure to credit risk (audited)

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from the Group’s banking operations.

	2016 £m	2015 £m
Cash and balances with central banks (note 11)	5,955	6,431
Due from related entities (note 12)	-	786
Due from other banks	952	128
Financial assets available for sale (note 13)	1,731	1,462
Other financial assets at fair value (note 14)	750	1,097
Derivative financial assets (note 15)	585	285
Loans and advances to customers (note 16)	29,202	27,482
Due from customers on acceptances	4	4
	39,179	37,675
Contingent liabilities (note 33)	123	109
Other credit commitments (note 33)	7,690	7,801
Maximum credit risk exposure	46,992	45,585

Mitigation

The management and mitigation of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as product, industry or geographic concentrations and delinquency trends.

For customers, there is regular analysis of the borrower’s ability to meet their interest and capital repayment obligations with early support and mitigation steps taken where required. Credit risk mitigation is also supported in part by obtaining collateral, and corporate or personal guarantees where appropriate.

Other mitigating measures are described below:

Specialist expertise

Credit quality is managed and monitored by skilled teams including, where required, specialists who provide dedicated support for customers experiencing financial difficulty.

Credit decisions utilise credit scoring techniques and manual underwriting, as appropriate. These tasks are performed by skilled and competent specialists acting within agreed delegated authority levels set in accordance with their experience and capabilities.

Credit policy and adherence to Policy Standards

Specialist teams oversee credit portfolio performance as well as adherence to credit risk policies and standards. Activities include targeted risk based reviews, providing an assessment of the effectiveness of internal controls and risk management practices. Bespoke assignments are also undertaken in response to emerging risks and regulatory requirements. Independent assurance reviews are also regularly undertaken by Internal Audit.

Portfolio oversight

Portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposures are regularly reviewed. This entails the production and analysis of regular portfolio monitoring reports for review by senior management.

Controls over rating systems

The Group has established an Independent Model Validation Unit that sets common minimum standards. The standards are designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements.

Stress testing

Stress test scenarios are regularly prepared with the outcomes reviewed and relevant actions taken. Outputs will typically include impairment charges, RWA and write-offs. Management will consider how each stress scenario may impact on different components of the credit portfolio. The primary method applied uses migration matrices, modelling the impact of PD rating migrations and changes in portfolio default rates to changes in macroeconomic factors to obtain a stressed position for the credit portfolios. Loss Given Default is stressed based on property price movements.

The Group also utilises other instruments and techniques across its wider balance sheet. These include:

Derivatives

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

Master netting agreements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if any counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis. Derivative financial instrument contracts are typically subject to the International Swaps and Derivatives

Association (ISDA) master netting agreements, as well as Credit Support Annexes (CSA), where relevant, around collateral arrangements attached to those ISDA agreements. Derivative exchange or clearing counterparty agreements exist if contracts are settled via an exchange or clearing house.

Credit Assessment and Mitigation for Retail and SME Customers

The Group uses a variety of lending criteria when assessing applications for retail customers. The approval process uses credit scorecards, as well as manual underwriting, and involves a review of an applicant’s previous credit history using information held by credit reference agencies.

The Group also assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place quantitative thresholds such as maximum limits on the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application.

For residential mortgages, the Group’s policy is to accept only standard applications with a LTV less than 95%. The Group has maximum % LTV limits which depend upon the loan size. Product types such as BTL and residential interest only mortgages are controlled by transactional limits covering both LTV and value.

For SME customers, credit risk is managed in accordance with lending policies, the Group’s risk appetite and the RMF. Lending policies and performance against risk appetite are reviewed regularly. Credit risk is further mitigated by focusing on business sectors where the Group has specific expertise and through limiting exposures on higher value loans and to certain sectors. When making credit decisions for SME customers, the Group will routinely assess the primary source of repayment, most typically the cash generated by the customer through its normal trading cycle. Secondary sources of repayment are also considered and, whilst not the focus of the lending decision, collateral will be taken when available. The Group seeks to obtain security cover, and where appropriate, personal guarantees from borrowers.

## CREDIT RISK

### Lending Balances

Distribution of loans and advances to customers by credit quality (audited)

As at 30 September 2016	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending <sup>(1)</sup> £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	57	388	612	21,485	502	5,665	28,709
Past due but not impaired	6	12	15	285	11	144	473
Impaired	-	-	-	66	2	146	214
	63	400	627	21,836	515	5,955	29,396

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

<sup>(1)</sup> SME lending includes business overdrafts.

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and where there is no objective evidence of impairment.
Past due but not impaired	Loans that are in arrears but have not been individually assessed as impaired.
Impaired	Loans which have been individually assessed for impairment as there is objective evidence of impairment, including changes in customer circumstances.

### Monitoring

Credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group:

- *Credit Risk Committee (CRC)*: The CRC ensures that the Credit RMF and associated policies remain effective. The Committee has oversight of the quality, composition and concentrations of the credit risk portfolio and considers strategies to adjust the portfolio to react to changes in market conditions.
- *RAS Measures*: Measures are monitored monthly and reviewed bi-annually, at a minimum, to ensure that the measures accurately reflect the Group's risk appetite, strategy and concerns relative to the wider macro environment. All measures are subject to extensive engagement with the Executive Leadership Team, the

Board and are subject to endorsement from Executive Governance Committees prior to Board approval. Regulatory engagement is also scheduled as appropriate.

- *Risk Concentration*: Concentration of risk is managed by client / counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to control exposures to a single entity / counterparty. Concentrations are also considered through the RAS process focussing particularly on comparing the portfolio against market benchmarks.
- *Single Large Exposure excesses*: All excesses are reported to the Transactional Credit Committee (TCC) and CCO. Any exposure which continues or is expected to continue beyond 30 days will also be submitted to the TCC with proposals to correct the exposure within an agreed period, not to exceed 12 months.

### Concentrations

Loans and advances to customers (audited)

	2016 £m	2015 £m
Overdrafts	1,536	1,563
Credit cards	400	376
Lease finance	515	426
Mortgages	21,836	20,504
Other term lending – SME	4,393	4,025
Other term lending – retail	690	763
Other lending	26	30
Gross loans and advances to customers	29,396	27,687
Accrued interest receivable	76	75
Unearned income	(26)	(26)
Deferred and unamortised fee income	(29)	(24)
Impairment provisions on credit exposures (note 17)	(215)	(230)
	29,202	27,482

The Group also has a portfolio of fair valued business loans and advances of £750m (2015: £1,097m) (note 14). Combined with the above this is equivalent to total loans and advances of £29,952m (2015: £28,579m).

Retail secured credit by loan size concentration (audited)	2016 £m	%	2015 £m	%
£0 - £100k	4,456	20.4%	4,673	22.8%
£100k - £250k	6,807	31.2%	6,930	33.8%
£250k - £500k	6,153	28.2%	5,257	25.6%
£500k - £1m	3,572	16.3%	2,962	14.5%
£1m - £2.5m	806	3.7%	640	3.1%
> £2.5m	42	0.2%	42	0.2%
Total	21,836	100%	20,504	100%



## CREDIT RISK

### Retail secured credit average LTVs by loan size (unaudited) <sup>(1)</sup>

	2016		
	Residential	BTL	Total
£0 - £100k	46.6%	53.6%	47.8%
£100k - £250k	57.3%	56.2%	56.9%
£250k - £500k	56.3%	56.5%	56.4%
£500k - £1m	54.5%	54.4%	54.5%
£1m - £2.5m	53.1%	46.6%	52.0%
> £2.5m	57.1%	32.1%	55.3%
<b>Total</b>	<b>53.7%</b>	<b>55.5%</b>	<b>54.3%</b>

### Retail secured credit average LTVs by loan size (unaudited) <sup>(1)</sup>

	2015		
	Residential	BTL	Total
£0 - £100k	47.6%	55.0%	48.9%
£100k - £250k	58.0%	58.3%	58.1%
£250k - £500k	57.1%	57.7%	57.3%
£500k - £1m	55.6%	56.0%	55.8%
£1m - £2.5m	54.2%	51.8%	53.8%
> £2.5m	52.3%	36.6%	51.2%
<b>Total</b>	<b>54.5%</b>	<b>57.2%</b>	<b>55.3%</b>

<sup>(1)</sup> LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the Halifax house price index at a given date.

### Industry concentration of assets

The following tables show the levels of industry concentration of credit risk as at 30 September:

Gross loans and advances to customers including loans designated at fair value through profit or loss (audited) <sup>(1)</sup>	2016 £m	2015 £m
Government and public authorities	36	27
Agriculture, forestry, fishing and mining	1,458	1,515
Financial, investment and insurance	698	659
Property – construction	262	260
Manufacturing	577	576
Instalment loans to individuals and other personal lending (including credit cards)	1,344	1,477
Property – mortgage	21,836	20,504
Asset and lease financing	515	426
Other commercial and industrial	3,421	3,340
	<b>30,147</b>	<b>28,784</b>

Contingent liabilities and credit related commitments (audited)	2016 £m	2015 <sup>(2)</sup> £m
Government and public authorities	422	469
Agriculture, forestry, fishing and mining	382	380
Financial, investment and insurance	125	117
Property – construction	156	172
Manufacturing	658	656
Instalment loans to individuals and other personal lending (including credit cards)	1,931	1,955
Property – mortgage	1,780	1,818
Asset and lease financing	98	102
Other commercial and industrial	2,261	2,241
	<b>7,813</b>	<b>7,910</b>

<sup>(1)</sup> Includes balances due from customers on acceptances and excludes accrued interest.

<sup>(2)</sup> The 2015 comparatives have been restated to conform with current year industry categorisation.

## CREDIT RISK

### Mitigation and Management of Credit Risk

#### Credit quality of loans and advances

For SME lending, the Group has an internally developed credit rating system, as defined under the Group's credit risk management policy, that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the PD for each customer and can be broadly mapped to external agencies' rating scales. Impaired assets consist of SME lending and secured retail lending where current circumstances indicate that losses of loan principal and / or interest may be incurred.

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

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

The table below represents the credit quality of SME loans and advances that are neither past due nor impaired (audited):

	2016 £m	2015 £m
Senior investment grade	1,077	1,174
Investment grade	1,557	1,615
Sub-investment grade	3,533	2,906
	6,167	5,695

Credit quality of loans held at fair value through profit and loss that are neither past due nor impaired (audited):

	2016 £m	2015 £m
Senior investment grade	6	47
Investment grade	259	445
Sub-investment grade	466	580
	731	1,072

For retail lending, the Group has developed specific credit rating systems for both origination of new lending and for ongoing customer and account management purposes. These systems assign risk estimates to all retail lending and enable active management of customer exposures and portfolios.

### Collateral

#### Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and

- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties with the proceeds used to reduce or repay the outstanding balance. In general, the Group does not occupy repossessed properties for its own business use.

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

LTV (audited) <sup>(1)</sup>	2016 %	2015 %
Less than 50%	38	34
50% to 75%	48	51
76% to 80%	5	5
81% to 85%	3	4
86% to 90%	2	2
91% to 95%	1	1
96% to 100%	-	-
Greater than 100%	-	-
Unknown	3	3
	100	100

<sup>(1)</sup> LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the Halifax house price index at a given date. Unknown represents loans where data is not currently available due to front book data matching still to be completed and a de minimis amount due to weaknesses in historic data capture processes.

#### Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of the default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to policy rules and confidence levels.

#### Commercial property

Commercial property is the Group's main source of collateral on SME lending and means of mitigating loss in the event of default. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).



## CREDIT RISK

### Non property related collateral

In addition to residential and commercial property based security, the Group also takes other forms of collateral when lending. This can involve obtaining security against the underlying loan through the use of cash collateral and / or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

The following table shows the total non property collateral held by sector at 30 September 2016 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high credit quality) and netting. The exposure amount shown below is the total gross exposure (before any credit risk mitigation and credit conversion factors have been applied where applicable) for arrangements which have some form of associated collateral held against them and is not the total exposure for each asset class, as disclosed elsewhere in this section and in the Strategic Report.

2016 (audited)	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	721	-	-	721	1,027
Corporates	49	40	32	121	135
Financial institutions	504	-	-	504	600
Past due items	-	-	-	-	3
Public sector entities	-	-	-	-	-
Regional Government or local authorities	-	-	94	94	94
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	4	-	35	39	107
Secured by mortgages on residential property	2	-	3	5	12
	1,280	40	164	1,484	1,978

2015 (audited)	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	-	-	-	-	-
Corporates	64	53	57	174	205
Financial institutions	-	-	-	-	-
Past due items	-	-	-	-	4
Public sector entities	-	-	-	-	-
Regional Government or local authorities	-	-	114	114	114
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	4	-	31	35	86
Secured by mortgages on residential property	2	-	7	9	18
	70	53	209	332	427

The increase in cash collateral held and corresponding exposure is due to increased repurchase (repo) transactions outstanding at 30 September 2016, reflected within Central Governments or Central Banks and Financial Institutions. There were no repo transactions outstanding at 30 September 2015.

Corporates is the largest sector utilising other risk mitigation techniques, with all three methods utilised dependent on credit quality. The extent to which these will be used will be dependent on the specific circumstances of the customer.

### Forbearance

Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group. The Group implemented revised forbearance policies and definitions in 2014 in order to align the reporting of forbearance with the guidance established by the European Banking Authority (EBA) for FINREP reporting. Forbearance concessions will include the granting of more favourable terms and conditions than those provided at drawdown of the facility or which would not ordinarily be available to others with a similar risk profile. Forbearance parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions. The Group makes every effort to treat customers fairly and aligns its forbearance practices to that principle.

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

Exposures classified as forborne and performing at the date forbearance measures are granted, continue to be reported as subject to forbearance for a minimum period of two years from that date (the 'probation period'). Exposures classified as forborne and which are non performing when customers were granted forbearance cannot exit non performing status for a minimum of 12 months from the date forbearance was granted, and cannot exit forbearance status for a further two years from the date of returning to performing status (three years in total).

The Group has identified a number of situations that in isolation are not considered to be forbearance:

- Facilities that have been temporarily extended pending review and where no concession has been granted for reasons relating to the actual or apparent financial stress of a customer.
- A reduction in asset quality to a level where actual, or apparent, financial stress is not evident.

- Where changes are made to the terms of a borrower's interest structure or repayment arrangement on a commercial basis.
- Late provision of financial information, in the absence of other indicators of financial difficulty, is not in all cases considered a "non commercial" breach of non-financial covenants.

For both retail and SME, where the Group has made a demand for repayment, the customer's facilities have been withdrawn or where a debt repayment process has been initiated, the exposure is classified as forborne if the debt is subject to any of the mentioned forbearance concessions.

The tables opposite summarise the level of forbearance at 30 September 2016.

### Retail forbearance

The Group utilises various forbearance measures for retail customers, specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action.

### Debt management for Mortgage customers in financial difficulty

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 judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled by various methods. These include the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance including the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

Help is provided through the Financial Care Team where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies when they have multiple credit facilities, including those at other lenders, which require restructuring.

One component of the Group's approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

## CREDIT RISK

As at 30 September 2016 (audited) <sup>(1)</sup>

	Total retail loans and advances subject to forbearance measures			Impairment allowance on retail loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	1,843	169	0.78	5.5	3.27
Temporary arrangements	1,460	160	0.73	2.7	1.68
Interest only conversion	154	22	0.10	0.1	0.26
Term extension	123	11	0.05	0.1	0.61
Other	22	2	0.01	-	0.84
Legal	195	20	0.09	1.1	5.60
	3,797	384	1.76	9.5	2.48

<sup>(1)</sup> All forbearance reporting is at the balance sheet date.

As at 30 September 2015 (audited)

	Total retail loans and advances subject to forbearance measures			Impairment allowance on retail loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	2,115	179	0.87	4.0	2.22
Temporary arrangements	985	99	0.48	1.5	1.57
Interest only conversion	88	12	0.06	-	0.15
Term extension	131	11	0.06	0.1	0.84
Other	11	1	0.01	-	0.39
Legal	216	23	0.11	1.5	6.56
	3,546	325	1.59	7.1	2.19

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to proactively track and facilitate prematurity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2016, the Group had 102 (2015: 116) customers with interest only mortgages not subject to forbearance and which were past six month maturity with a total value of £12m (2015: £12m).

A further forbearance reserve of £4m (2015: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £13.5m (2015: £11.1m) and to increase overall coverage to 3.52% (2015: 3.42%). When all other avenues of resolution including forbearance have been

explored, the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2016 there were 78 repossessions of which 27 were voluntary (2015: 87 including 17 voluntary).

### Retail forbearance – unsecured consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including current accounts, unsecured loans and credit cards. The Group has assessed the total loan balances subject to forbearance on other types of retail to be £14m at 30 September 2016 (2015: £18m), representing 1.33% of the unsecured retail portfolio (2015: 1.62%). Impairment provisions on forbore balances totalled £4.2m at 30 September 2016 (2015: £5.5m), providing overall coverage of 29.02% (2015: 29.90%).

## SME forbearance

Forbearance is considered to exist for SME customers where one or more concessions are granted on a non commercial basis. The Group reports SME forbearance at a customer level and at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Authority to grant forbearance measures for SME customers is held by the Group's Strategic Business Services unit and is exercised, where appropriate, on the basis of detailed consideration of a customer's financial position and prospects.

Where a customer is part of a larger group, forbearance is exercised and reported across the Group at the individual entity level. Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forbore.

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements.

As at 30 September 2016 (audited)

	Total SME loans and advances subject to forbearance measures			Impairment allowance on SME loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	350	320	4.43	25.3	7.90
Deferral of contracted capital repayments	118	143	1.99	18.2	12.69
Reduction in contracted interest rate	7	8	0.12	0.6	7.01
Alternative forms of payment	7	35	0.48	11.2	32.37
Debt forgiveness	8	26	0.36	2.4	9.16
Refinancing	22	51	0.70	4.9	9.76
Covenant breach/reset/waiver	62	208	2.88	8.6	4.12
	574	791	10.96	71.2	8.99

As at 30 September 2015 (audited)

	Total SME loans and advances subject to forbearance measures			Impairment allowance on SME loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	491	429	6.00	42.9	10.02
Deferral of contracted capital repayments	166	152	2.12	18.6	12.23
Reduction in contracted interest rate	17	29	0.40	6.8	23.64
Alternative forms of payment	3	16	0.22	4.5	28.76
Debt forgiveness	24	55	0.78	14.2	25.61
Refinancing	33	61	0.86	4.7	7.56
Covenant breach/reset/waiver	62	166	2.32	6.0	3.64
	796	908	12.70	97.7	10.77

Included in other financial assets at fair value is a portfolio of loans which are included in the above table. The value of fair value loans subject to forbearance at 30 September 2016 is £101m (2015: £162m), representing 1.40% of the total SME portfolio (2015: 2.27%). Impairment allowances on these amounts totalled £11m (2015: £14m), a coverage of 10.82% (2015: 8.68%).



## CREDIT RISK

### Credit Quality of Customer Lending

An assessment of the credit quality of loans and advances to customers is shown below.

#### Distribution of loans and advances to customers by credit quality (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending <sup>(1)</sup> £m	Total £m
<b>As at 30 September 2016 <sup>(2)</sup></b>							
Gross loans and advances:							
Neither past due nor impaired	57	388	612	21,485	502	5,665	<b>28,709</b>
Past due but not impaired	6	12	15	285	11	144	<b>473</b>
Impaired	-	-	-	66	2	146	<b>214</b>
	63	400	627	21,836	515	5,955	<b>29,396</b>

<sup>(1)</sup> SME lending includes business overdrafts.

<sup>(2)</sup> For 30 September 2015 disclosure, please see page 154.

#### Loans and advances which were past due but not impaired

Loans and advances that are past due but not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility.

Unsecured retail lending and credit cards are written off when they reach 180 DPD and are not designated as impaired.

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

<b>2016 (audited)</b>	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending <sup>(1)</sup> £m	Total
1 to 29 DPD	5	6	6	81	11	82	<b>191</b>
30 to 59 DPD	-	2	3	65	-	27	<b>97</b>
60 to 89 DPD	-	1	2	28	-	4	<b>35</b>
Past due 90 days and over	1	3	4	111	-	31	<b>150</b>
	6	12	15	285	11	144	<b>473</b>

<b>2015 (audited)</b>	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending <sup>(1)</sup> £m	Total
1 to 29 DPD	8	6	5	77	6	110	<b>212</b>
30 to 59 DPD	-	2	3	57	-	17	<b>79</b>
60 to 89 DPD	-	2	2	36	-	9	<b>49</b>
Past due 90 days and over	1	3	5	98	-	36	<b>143</b>
	9	13	15	268	6	172	<b>483</b>

<sup>(1)</sup> SME lending includes business overdrafts.

### Movement in impairment provisions throughout the year

<b>2016 (audited)</b>	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending <sup>(1)</sup> £m	Total
Opening balance	5	7	11	39	2	166	<b>230</b>
Charge for the year	(1)	3	5	1	1	30	<b>39</b>
Amounts written off	(4)	(9)	(14)	(2)	-	(39)	<b>(68)</b>
Recoveries of amounts written off in previous years	4	5	7	1	-	1	<b>18</b>
Other <sup>(2)</sup>	(1)	-	1	-	(1)	(3)	<b>(4)</b>
<b>Closing balance</b>	3	6	10	39	2	155	<b>215</b>
Specific	-	-	-	19	1	44	<b>64</b>
Collective	3	6	10	20	1	111	<b>151</b>
	3	6	10	39	2	155	<b>215</b>

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

<sup>(1)</sup> SME lending includes business overdrafts.

<sup>(2)</sup> Other includes the unwind of net present value elements of specific provisions and other minor movements.

## CREDIT RISK

### Movement in gross impaired loan balances throughout the year (unaudited)

	2016 £m	2015 £m
Opening balance	238	319
New	96	87
Write-off	(41)	(70)
Returned to performing	(79)	(98)
<b>Closing balance</b>	<b>214</b>	238

In addition to the gross impaired loans, there were also £19m and £25m impaired fair value loans for September 2016 and September 2015 respectively.

### Other Credit Risks (audited)

The Group is exposed to credit risk on its other banking based activities, which are subject to mitigation and monitoring. No provisions are currently held for these exposures.

The following table shows the maximum exposure to credit risk for the components of the balance sheet excluding loans

and advances to customers and other financial assets at fair value. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

Maximum exposure to credit risk	2016 £m	2015 £m
Cash and balances with central banks (note 11)	5,955	6,431
Due from related entities (note 12)	-	786
Due from other banks	952	128
Financial assets available for sale (note 13)	1,731	1,462
Derivative financial assets (note 15)	585	285
	<b>9,223</b>	9,092
Contingent liabilities (note 33)	123	109
Other credit commitments (note 33)	7,690	7,801
<b>Maximum credit risk exposure</b>	<b>17,036</b>	17,002

### Eurozone risk

The Group has an exposure to the European Investment Bank of £176m at 30 September 2016 (2015: £100m).

### Offsetting of financial assets and liabilities

The Group does not have any financial assets or financial liabilities that are offset with the net amount presented on the balance sheet as IAS 32 'Financial Instruments – Presentation' states that there should be both an enforceable right to set off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions is met by the

Group. The following table illustrates the amounts for financial instruments that are covered by enforceable netting arrangements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. loans and advances).

The net amounts presented in the table are not intended to represent the Group's exposure to credit risk, as the Group will use a wide range of strategies to mitigate credit risk in addition to netting and collateral.



## CREDIT RISK

2016 (audited)

	Gross amounts £m	Gross amounts offset in the balance sheet <sup>(1)</sup> £m	Net amounts presented on balance sheet <sup>(1)</sup> £m	Net amounts not offset in the balance sheet		Net amount £m
				Financial instruments £m	Cash collateral pledged/ received £m	
<b>Assets</b>						
Derivative financial instruments <sup>(2)</sup>	585	-	585	(306)	(55)	224
<b>Liabilities</b>						
Derivative financial instruments <sup>(2)</sup>	598	-	598	(306)	(245)	47
Securities sold under repurchase agreement	1,226	-	1,226	(1,226)	-	-

2015 (audited)

	Gross amounts £m	Gross amounts offset in the balance sheet <sup>(1)</sup> £m	Net amounts presented on balance sheet <sup>(1)</sup> £m	Net amounts not offset in the balance sheet		Net amount £m
				Financial instruments £m	Cash collateral pledged/ received £m	
<b>Assets</b>						
Derivative financial instruments <sup>(2)</sup>	285	-	285	(143)	-	142
<b>Liabilities</b>						
Derivative financial instruments <sup>(2)</sup>	534	-	534	(143)	(246)	145

<sup>(1)</sup> Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation.

<sup>(2)</sup> Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

Derivative financial instrument contracts are typically subject to ISDA master netting agreements, as well as CSAs, where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house. The amounts included in the Financial Instruments column refer to amounts that are

subject to relevant close out netting arrangements under a relevant ISDA agreement.

£5.9bn of cash is held with the BoE. Due from other banks is all with senior investment grade counterparties. Available for sale financial assets and the credit rating of counterparties are discussed in note 13.

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

### STRONG FOUNDATIONS SUPPORTING RESILIENCE AND GROWTH

A robust balance sheet position underpinned by the alignment of Risk Appetite to strategy and a proactive approach to addressing the impact of changing regulatory obligations.

Balance Sheet Risks in the Financial Services Industry are highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. The key risks include Capital, Liquidity and Funding Risks, Market Risk which in the case of the Group is non traded market risk (incorporating Interest Rate and Foreign Exchange Risks), Pension Risk and Non Traded Equity Risk.

#### Capital

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

#### Risk Appetite

The primary objective for the management and oversight of balance sheet risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility. The Group applies a prudent approach to balance sheet risks in order to safeguard the on-going strength and resilience of the balance sheet.

Risk appetite is approved for balance sheet risks by the Group's Board, with authority delegated to ALCO for subsequent implementation and monitoring. The Board has established a range of measures of risk appetite for capital including CET1, leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet and include, amongst others, measures relating to the proportion of Customer Funding, the Group's overall funding profile and an OLAR. The OLAR covers the Board's appetite in relation to regulatory liquidity requirements and also covers the need to maintain a volume of high quality liquid assets that is sufficient to accommodate outflows of funds in a range of stress scenarios over a 3 month period.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities. The Group establishes an appetite for these risks based on an overriding principle that the Group will not engage in proprietary risk taking.

#### Mitigation measures

The Group's Capital Risk Standard provides the framework for the manner in which capital is managed within the Group. The objectives of the Standard are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators' requirements, managing the ratings agencies' assessment of the Group and ensuring that excessive leverage is not taken. A shortfall in capital resources would occur when the Group exceeds its risk appetite and is at risk of not having sufficient capital to support future growth objectives.

#### Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, which implemented CRD IV legislation with effect from 1 January 2014. The Group's approach to Pillar 1 is to use the standardised approaches to calculating RWA. The standardised approaches are inherently conservative and the Group is developing the capability to apply for a waiver to utilise IRB methods for the calculation of credit risk capital.

A rigorous approach is taken to assess risks that are not adequately covered by Pillar 1, including interest rate risk and pension risk. The Group also undertakes a range of stress scenarios in order to test the impact on capital arising from severe yet plausible scenarios. These approaches to capital are thoroughly documented in the Group's ICAAP and this is subject to review, challenge and approval by the Board.

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

12.6%

CET1

112%

LDR

140%

LCR

### Capital Buffers

The regulatory capital buffer framework is intended to ensure firms maintain a sufficient amount of capital above their regulatory minimum in order to withstand periods of stress. The UK is implementing the provisions on capital buffers outlined in the CRD to create combined capital buffers including a: Capital Conservation Buffer (CCB); CCyB; Global Systemically Important Institution Buffer (G-SIIB); and Systemic Risk Buffer (SRB). In the UK, the CCB has been introduced with transitional provisions from 2016 (0.625%) to 2019 (2.5%).

The CCyB has been effective from 1 May 2014 and is dependent upon the BoE view of credit conditions in the economy. In March 2016 the Financial Policy Committee (FPC) raised the rate to 0.5% for UK exposures (with effect from 29 March 2017). As a result of increased concerns around the prospects for the UK economy following the UK's vote to leave the EU, the decision to raise the CCyB to 0.5% has been reversed. The BoE noted that "absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK CCyB rate until at least June 2017" (the FPC reaffirmed the Group's position on 22 September 2016). The BoE commented that this action reinforces their expectation that all elements of the substantial capital and liquidity buffers that have been built up by banks are able to be drawn on, as necessary.

Beyond June 2017, the future path of the CCyB is less certain. It is anticipated that the CCyB will move gradually to 1% in a neutral risk environment. The Group's capital planning considers the impact of all relevant capital buffers.

The PRA's final rules on the approach to identifying other systemically important institutions (O-SII) were published in February 2016. In line with expectations, the Group's principal subsidiary, CB PLC, was not designated an O-SII. Similarly the FPC issued its final framework for setting the SRB in May 2016. This confirmed that banks with total assets of less than £175bn (which includes the Group) will be subject to a 0% SRB.

### Monitoring

The Capital Plan is approved by the Board on an annual basis. The Group's ALCO monitors the capital plan and forecast positions on a monthly basis. This ensures that performance trends are appropriately reviewed and that there is transparency on the impact on capital ratios, risk appetite and the future outlook.

### Capital Restructuring

In February 2016, concurrently with the demerger and IPO of the Group, a capital restructure was completed to simplify the Group's capital base and ensure that the Group is the "single point of entry" for the purposes of Recovery and Resolution planning and MREL requirements. The Group repurchased £450m of existing AT1 and £475m of existing Tier 2 capital, and replaced this with new CRD IV compliant issuance of £450m AT1 (including an equity conversion mechanism) and £475m Tier 2 issued by the Group. The Group simultaneously downstreamed the proceeds in the same form to CB PLC, with the only material difference being the loss absorption mechanism for CB PLC which is a permanent write down of the instrument, not equity conversion. The repurchase took place at market value and this resulted in a net gain of £1m which was realised within the Group.

In September 2016 the capital instruments were remarketed by NAB. At 30 September 2016, NAB is no longer the holder of these instruments.

### Recent Developments

Information on MREL and Banking Reform, ring fencing and resolution all of which may impact the Group's capital and funding structures, are provided in the Emerging Risk section.

### Capital position

The Group's capital position as at 30 September 2016 is summarised below.

#### Regulatory capital (unaudited) <sup>(1)</sup>

	2016 £m	2015 £m
<b>CET1 capital</b>		
Capital instruments	88	223
Share premium account	-	670
Retained earnings and other reserves	2,673	2,097
<b>Regulatory adjustments and deductions</b>		
Prudent valuation adjustment <sup>(2)</sup>	(7)	(5)
Intangible assets <sup>(3)</sup>	(256)	(265)
Deferred tax asset (DTA) relying on future profitability <sup>(4)</sup>	(35)	(273)
Cash flow hedge reserve	(66)	-
Defined benefit pension fund assets (net of deferred tax liabilities) <sup>(5)</sup>	-	(42)
	<b>2,397</b>	2,405
<b>Tier 1 capital</b>		
AT1 capital instruments	450	450
Total Tier 1 capital	<b>2,847</b>	2,855
<b>Tier 2 capital</b>		
Subordinated debt	474	460
Credit risk adjustments	151	138
	<b>625</b>	598
<b>Total capital</b>	<b>3,472</b>	3,453

<sup>(1)</sup> This table shows the capital position on a CRD IV "transitional" basis. As at 30 September 2015 this included grandfathered legacy Tier 2 instruments under the transitional rules implemented by the PRA. These instruments were replaced and are fully compliant with CRD IV at 30 September 2016, accordingly the 30 September 2016 capital also reflects the CRD IV "fully loaded" basis.

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

<sup>(3)</sup> Intangible assets shall be deducted from capital for regulatory purposes.

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

<sup>(5)</sup> Under CRD IV, defined benefit pension fund assets shall be deducted from CET1 capital (net of deferred tax liability).

#### Reconciliation of statutory total equity to regulatory capital (unaudited)

	2016 £m	2015 £m
<b>Statutory total equity</b>	<b>3,211</b>	3,443
Pension regulatory adjustments	-	(42)
Deductions from capital	(263)	(270)
Equity-based compensation reserve	-	(3)
DTA relying on future profitability	(35)	(273)
Cash flow hedge reserve	(66)	-
<b>Regulatory Tier 1 capital</b>	<b>2,847</b>	2,855



## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

Regulatory capital flow of funds (unaudited)	CRD IV 2016 £m	CRD IV 2015 £m
<b>CET1 capital</b>		
CET1 capital at 1 October	2,405	1,747
Share capital: ordinary share new issuance	-	350
Share for share exchange and nominal reduction	(135)	-
Share premium	(670)	670
Retained earnings and other reserves (including structured entities)	576	1,755
Prudent valuation adjustment	(2)	(3)
Intangible assets	9	(52)
DTA relying on future profitability	238	(50)
Defined benefit pension fund assets	42	(3)
Share capital reduction	-	(2,009)
Cash flow hedge reserve	(66)	-
	2,397	2,405
<b>Tier 1 capital</b>		
Tier 1 capital at 1 October	450	300
Capital instruments repurchased: Perpetual Capital Notes	(450)	-
Capital instruments issued: Perpetual Subordinated Contingent Convertible Notes	450	-
Capital instruments issued: AT1 Perpetual Capital Notes	-	150
	450	450
<b>Total Tier 1 capital</b>	2,847	2,855
<b>Tier 2 capital</b>		
Tier 2 capital at 1 October	598	1,260
Credit risk adjustments	13	3
Subordinated debt redemption	-	(665)
Capital instruments repurchased: Subordinated Debt	(475)	-
Capital instruments issued: Subordinated Debt	474	-
Removal of minority interest deduction on Subordinated Debt	15	-
<b>Total Tier 2 capital</b>	625	598
<b>Total capital</b>	3,472	3,453

Minimum Pillar 1 capital requirements (unaudited)	2016 £m	2015 £m
Credit risk	1,352	1,304
Operational risk	130	127
Counterparty risk	17	11
Credit valuation adjustment	23	16
<b>Tier 1 regulatory capital requirements</b>	1,522	1,458

### RWA movements

RWA flow statement (unaudited)	2016 £m	2015 £m
RWA at 1 October	18,227	18,645
Book size growth / (reduction)	619	(103)
Book quality (improvement) / deterioration	183	(180)
Methodology and policy	-	(130)
Other	-	(5)
<b>RWA at 30 September</b>	19,029	18,227

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

### Pillar 1 RWAs and Capital requirements by business line (unaudited)

Capital requirements for calculating RWAs	At 30 September 2016			At 30 September 2015		
	Capital required £m	RWA £m	Exposure £m	Capital required £m	RWA £m	Exposure (restated) £m
Central Governments or Central Banks	-	-	7,002	-	-	6,477
Regional Governments or Local Authorities	2	20	192	2	22	222
Public Sector Entities	-	5	13	-	3	3
Multilateral development banks	-	-	195	-	-	100
Financial Institutions	19	234	1,344	18	222	818
Corporates	283	3,533	3,846	262	3,264	3,621
Retail	72	897	1,196	74	930	1,240
Secured by mortgages on immovable property	897	11,242	26,482	869	10,862	25,241
Exposures in default	33	408	340	34	427	356
Collective investments undertakings	-	3	3	-	3	3
Equity exposures	1	11	9	1	16	10
Items associated with particularly high risk	1	15	10	-	-	-
Covered Bonds	2	19	191	-	-	-
Other items	42	519	1,650	44	545	1,905
<b>Total credit risk</b>	<b>1,352</b>	<b>16,906</b>	<b>42,473</b>	<b>1,304</b>	<b>16,294</b>	<b>39,996</b>
Operational risk	130	1,623		127	1,589	
Counterparty risk	17	214		11	138	
Credit valuation adjustment	23	286		16	206	
	<b>1,522</b>	<b>19,029</b>		<b>1,458</b>	<b>18,227</b>	

The 'Exposure' amounts disclosed above are post credit conversion factors and pre credit mitigation. Comparative disclosures have been restated to conform with the current period's presentation.

### Capital position & CET1 movements (unaudited)

RWA <sup>(1)</sup>	2016 £m	2015 £m
Retail mortgages	7,998	7,526
Business lending	7,087	7,044
Other retail lending	915	951
Other lending	152	113
Other <sup>(2)</sup>	754	660
Credit risk	16,906	16,294
Credit valuation adjustment	286	206
Operational risk	1,623	1,589
Counterparty risk	214	138
<b>Total RWA</b>	<b>19,029</b>	<b>18,227</b>
<b>Capital ratios</b>		
CET1 ratio <sup>(3)</sup>	12.6%	13.2%
Tier 1 ratio	15.0%	15.7%
Total capital ratio	18.2%	18.9%

<sup>(1)</sup> RWA are calculated under the standardised approach.

<sup>(2)</sup> The items included in the "other" exposure class that attract a capital charge include items in the course of collection, cash in hand, fixed assets and deferred tax assets that are not deducted.

<sup>(3)</sup> CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.

Whilst RWAs increased by £802m, driven by growth in mortgages, underlying capital generation of 123bps (before the net impact of AT1 payments, pension movements, and below the line charges such as the Group's proportion of conduct provision charges and exceptional restructuring charges) ensured the CET1 ratio remained robust at 12.6%.



## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

Leverage Ratio (unaudited)	2016 £m	2015 £m
<b>Total Tier 1 capital for the leverage ratio</b>		
Total CET1 capital	<b>2,397</b>	2,405
AT1 capital	<b>450</b>	450
<b>Total Tier 1</b>	<b>2,847</b>	2,855
<b>Exposures for the leverage ratio</b>		
Total assets as per published financial statements	<b>39,929</b>	38,705
Adjustment for off-balance sheet items	<b>1,982</b>	1,998
Adjustment for derivative financial instruments	<b>(399)</b>	19
Adjustment for securities financing transactions (SFTs)	<b>601</b>	-
Other adjustments	<b>(364)</b>	(585)
<b>Leverage ratio exposure</b>	<b>41,749</b>	40,137
<b>Leverage ratio</b>	<b>6.8%</b>	7.1%

The leverage ratio is monitored against a Board set RAS with the responsibility for managing the ratio falling to ALCO, which monitors it on a monthly basis.

The leverage ratio is the ratio of Tier 1 capital to total exposure, defined as:

- capital: Tier 1 capital defined according to CRD IV on an end point basis (assuming the full impact of CRD IV requirements on Tier 1 capital were in force with no transitional provisions).
- exposures: total on and off balance sheet exposures (subject to credit conversion factors) as defined in the Delegated Act amending CRR article 429 (Calculation of the Leverage Ratio), which includes deductions applied to Tier 1 capital.

Other regulatory adjustments consist of adjustments that are required under CRD IV to be deducted from Tier 1 capital. The removal of these from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

The Group's leverage ratio is 6.8% which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018. The Group will continue to monitor closely the leverage ratio against emerging rules and minimum calibration.

### Funding and liquidity risk

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

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

#### Risk Assessment

The framework for the Group's approach to funding risk leads to the development of a Group funding plan that is subject to approval by the Board and is consistent with risk appetite and the Group's strategic objectives. The development of the Group's funding plan is informed by the requirements of the Group's Balance Sheet Risk Policy Standards.

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. Exposures relate to the outflow of funds under a series of stress scenarios less the impact of inflows from assets, liquidation of high quality liquid assets or through other actions instigated by the Group. Liquidity within the Group is managed in accordance with the ILAAP that is approved by the Board. The ILAAP documents the manner in which the Group meets its OLAR which covers all regulatory and internal liquidity requirements. In addition the Group has a liquidity standard which details, amongst other items, the control standards and risk measurement requirements for liquidity and authorities and responsibilities.

Oversight of liquidity risk is undertaken by ALCO. To meet the requirements of regulatory authorities the liquidity of the Group is managed on a daily basis using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are

available to support unforeseen cash outflows. ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances. All balance sheet risks are subject to independent oversight from the second line balance sheet and liquidity risk oversight function.

Stress testing of the Group's liquidity risk is undertaken on a frequent basis and results are provided to ALCO and the Board. The ILAAP is used to establish key risk drivers and assumptions for liquidity risk and these provide the framework for ongoing stress testing. Stress testing considers the impact of severe yet plausible scenarios to consider the potential impact on the Group's funding and liquidity profile. The Group holds a portfolio of high quality assets that act as a buffer against the impact of liquidity risk. Funding plans take a long term view and these consider the impact of prolonged periods of market disruption in order to identify potential vulnerabilities in the profile of the Group's funding.

A Contingency Funding Plan has been established for management of an escalated liquidity requirement if the Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, counterparty, term structure and market.

The Group can source funding through a range of channels including the following:

- Retail, SME and corporate deposits.
- Commercial paper programme.
- Access to money markets through cash deposits and certificates of deposit.
- "Lanark" residential mortgage securitisation programme (owner occupied).
- "Lannraig" BTL mortgage securitisation programme.
- Regulated Covered Bond (RCB) programme.
- Access to the facilities within the BoE Sterling Monetary Framework which include the recently announced Term Funding Scheme.

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage backed debt. These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet.

### Monitoring

The Group's Treasury division is responsible for the development and execution of strategy subject to oversight

from the risk management function. In relation to funding and liquidity risk, the primary management committee is ALCO. ALCO meets monthly and reports to the Executive Risk Committee.

### Key risks

An assessment of a number of key risk drivers for funding and liquidity risks has been completed as part of the ILAAP process and a summary of the most material key risks is shown in the table below.

Risk	Rationale for assessment
Wholesale Funding	While wholesale borrowing is largely medium term and the Group has proven access to term debt markets there is residual refinancing risk around the medium term funding transactions.
Funding Tenors	Funding Tenors are an additional component of wholesale funding risk. The Group must maintain an appropriate mix by tenor in order to manage maturity concentrations.
Retail Funding Risk	While the overall assessment of the retail funding key risk driver is low, the potential impact if this risk were to crystallise is high. This is reflective of the shape of the Group's balance sheet and an appropriate reliance on customer deposits as a retail driven bank. The Group holds a portfolio of high quality liquid assets in order to act as a buffer against the effects of liquidity risk.

At 30 September 2016, the Group continues to have a strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and liquidity risk. Funding is predominantly provided by retail and SME customers and this is supported by medium term secured funding issuance from the Group's Lanark and Lannraig securitisation programmes and its RCB platform. These funding programmes are a source of strength for the Group

and leverage the Group's high quality mortgage book as a source of collateral for secured funding.

The LDR increased from 109% to 112% due to growth in customer lending combined with a managed reduction in short term corporate deposits which provided little liquidity benefit to the Group.

### Sources of funding (audited)

The table below provides an overview of the Group's sources of funding as at 30 September 2016:

	2016 £m	2015 £m
Total Assets	39,929	38,705
Less: Other Liabilities	(3,818)	(3,698)
Funding Requirement	36,111	35,007
<b>Funded by:</b>		
Due to customers	27,090	26,407
Due to Other Banks	1,309	393
Debt Securities in Issue	4,501	3,766
Amounts due to related parties	-	998
Equity	3,211	3,443
Total Funding	36,111	35,007

At 30 September 2016, the Group had a funding requirement of £36,111m (2015: £34,009m). The primary driver of this requirement was loans and advances to customers, which increased by £1,720m, primarily due to strong growth in mortgages. Cash and balances with central banks reduced in 2016 as liquid assets were diversified into other designated Level 1 assets under PRA liquidity guidance, such as debt issued by multilateral development banks and high quality covered bonds, which resulted in financial investments being higher.

### Due to Customers

The majority of the Group's funding requirement was met by Customer Deposits of £27,090m (2015: £26,407m). Customer Deposits are made up of non interest bearing demand deposits, interest bearing demand deposits, term deposits, and certain other wholesale deposits. The increase of £683m in 2016 was predominately due to growth in interest bearing demand deposits and non interest bearing demand deposits.

### Wholesale Funding

Wholesale Funding of £5,810m (2015: £4,159m) was used to meet the Group's remaining funding requirement. This is used to support balance sheet growth, lengthen the tenor and diversify sources of funding. Wholesale funding options utilised by the Group include covered bonds, RMBS, subordinated debt, repo securities, and money market funding. In 2015 NAB provided £998m of funding to the Group, all of which was repaid in 2016 except for the Lannraig securitisation note.

Repo transactions totalling £1.2bn were in place at 30 September 2016, while short term funding of limited liquidity value was managed down throughout the year.

### Equity

Equity of £3,211m (2015: £3,443m) was also used to meet the Group's funding requirement. Equity is made up of ordinary share capital, retained earnings, other equity instruments, as well as a number of other reserves.

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

A number of changes have been made to the Group's equity position during 2016. As a result there were a number of adjustments to retained earnings and reserves. Full details may be seen in notes 31 and 32.

### External credit ratings

The Group (then CYBI) was rated by Standard & Poor's (S&P) and Fitch for the first time in 2015. CB PLC as the main operating entity of the Group has been rated for over ten years. Upon demerger from NAB the ratings for CYBI were withdrawn and new ratings were published for the Group. S&P assigned a long term credit rating of "BBB-" to the Group, two notches below that of CB PLC, reflecting their non-operating holding company methodology. Fitch assigned an issuer default rating of "BBB+", in line with that of CB PLC, again reflecting their holding company methodology. The

lower Fitch ratings in 2016 reflect the absence of any parental support uplift in rating.

The outlook for the Fitch and Moody's ratings is stable, and on 3 October 2016, Fitch affirmed the current ratings of CYBG and CB. On 7 July 2016, as part of an industry wide exercise following the UK's EU referendum, S&P affirmed CYBG's ratings but revised the outlook from Stable to Negative. S&P stated "we could revise down the anchor for UK banks to 'bbb' from 'bbb+' over the next two years if prolonged uncertainty following the referendum weakens the macroeconomic outlook and economic resilience of the UK economy. The negative outlook on CYBG mirrors that of CB".

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

	Outlook as at		
	21 November 2016 <sup>(1)</sup>	30 Sep 2016	30 Sep 2015
<b>CYBG PLC</b>			
Fitch	Stable	BBB+	A <sup>(2)</sup>
Standard & Poor's	Negative	BBB-	BBB <sup>(2)</sup>
<b>Clydesdale Bank PLC</b>			
Fitch	Stable	BBB+	A
Standard & Poor's	Negative	BBB+	BBB+
Moody's <sup>(3)</sup>	Stable	Baa2	Baa1

<sup>(1)</sup> For detailed background on the latest credit opinions, including commentary on the impact of the demerger and IPO, by S&P and Fitch, please refer to the respective rating agency websites.

<sup>(2)</sup> CYBI.

<sup>(3)</sup> Long Term Deposit Rating.

### Additional collateral to be provided in the event of a notch downgrade

The Group monitors the movements in its credit ratings and the related requirement to post collateral for payment systems and clearing houses. These figures are not considered material compared to the volume of unencumbered liquid assets.

### Liquid Asset Reserve

The quantity and quality of the Group's liquid assets are calibrated to the Board's view of liquidity risk appetite and remain at a prudent level above regulatory requirements. The portfolio is managed by diversifying the mix of assets held to reduce basis risk and optimise the yield. Core liquidity is held predominantly in deposits with central banks and UK Government Gilts. The Group was compliant with all internal and regulatory liquidity metrics at 30 September 2016.

Liquid asset reserve (audited)	2016 £m	2015 £m
Cash and balances with central banks	5,955	6,431
Encumbered cash balances	(2,468)	(2,301)
	3,487	4,130
Listed securities	1,695	1,447
Encumbered available for sale securities	(101)	(50)
	1,594	1,397
<b>Total unencumbered liquid assets</b>	<b>5,081</b>	<b>5,527</b>

### Liquidity composition

Liquid assets (audited)	2016 £bn	2015 £bn
UK Government Treasury Bills and Gilts	1,286	1,274
Cash and cash at central bank	3,773	4,398
Note cover <sup>(1)</sup>	2,182	2,033
Other debt securities	409	173
<b>Liquid assets</b>	<b>7,650</b>	<b>7,878</b>

<sup>(1)</sup> Note cover is excluded from PRA regulatory liquidity.



## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

Certain of the Group's assets are encumbered. Examples of reasons for asset encumbrance include, amongst others: supporting the Group's secured funding programmes to provide stable term funding to the Group; use of assets as collateral for payments systems in order to support customer's transactional activity; and providing security for the Group's issuance of Scottish banknotes. The ability to encumber additional assets will also support any future activity through the Bank of England Term Funding Scheme. The Group monitors the level of asset encumbrance to ensure an appropriate balance is maintained.

### Encumbered assets by asset category (audited)

	Assets encumbered with non Central Bank counterparties				Other assets				Total £m	
	Covered Bonds £m	Securiti- sations £m	Other £m	Total £m	Positioned at the Central Bank (including encum- bered) £m	Assets not positioned at the Central Bank				Total £m
						Readily available for encum- brance £m	Other assets capable of being encum- bered £m	Cannot be encum- bered £m		
September 2016										
Cash and balances with central banks	-	-	-	-	2,468	3,487	-	-	5,955	5,955
Due from other banks	156	282	337	775	-	-	177	-	177	952
Investments - available for sale	-	-	-	-	101	1,594	36	-	1,731	1,731
Other financial assets	-	-	-	-	-	-	750	-	750	750
Derivatives	-	-	-	-	-	-	-	585	585	585
Loans and advances to customers	1,149	5,144	-	6,293	2,902	3,946	13,003	3,058	22,909	29,202
Intangible Assets	-	-	-	-	-	-	-	256	256	256
Deferred tax assets	-	-	-	-	-	-	-	183	183	183
Other Assets	-	-	-	-	-	-	122	193	315	315
Total Assets	1,305	5,426	337	7,068	5,471	9,027	14,088	4,275	32,861	39,929

### Assets and liabilities by maturity

The following tables represent a breakdown of the Group's balance sheet, according to the assets and liabilities contractual maturity. Many of the longer term monetary assets are variable rate products, with behavioural maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk. The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
<b>2016 (audited)</b>							
<b>Assets</b>							
Cash and balances with central banks	4,642	-	-	-	-	1,313	5,955
Due from related entities	-	-	-	-	-	-	-
Due from other banks	869	83	-	-	-	-	952
Financial assets available for sale	-	7	20	1,019	649	36	1,731
Other financial assets at fair value	-	34	88	275	353	-	750
Derivative financial instruments	2	46	72	241	224	-	585
Loans and advances to customers	2,021	285	648	4,271	21,577	400	29,202
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	111	36	40	-	-	563	750
<b>Total assets</b>	<b>7,645</b>	<b>495</b>	<b>868</b>	<b>5,806</b>	<b>22,803</b>	<b>2,312</b>	<b>39,929</b>
<b>Liabilities</b>							
Due to other banks	81	417	311	500	-	-	1,309
Other financial liabilities at fair value	-	2	11	35	-	-	48
Derivative financial instruments	2	47	73	123	353	-	598
Due to customers	21,168	1,802	1,933	2,187	-	-	27,090
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	-	-	-	-	-	-	-
Debt securities in issue	-	18	214	3,472	797	-	4,501
All other liabilities	1,960	77	132	-	-	999	3,168
<b>Total liabilities</b>	<b>23,211</b>	<b>2,367</b>	<b>2,674</b>	<b>6,317</b>	<b>1,150</b>	<b>999</b>	<b>36,718</b>
<b>Off balance sheet items</b>							
Contingent liabilities	-	19	44	12	48	-	123
Other credit commitments	7,690	-	-	-	-	-	7,690
<b>Total off balance sheet items</b>	<b>7,690</b>	<b>19</b>	<b>44</b>	<b>12</b>	<b>48</b>	<b>-</b>	<b>7,813</b>

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

2015 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
<b>Assets</b>							
Cash and balances with central banks	4,978	-	-	-	-	1,453	<b>6,431</b>
Due from related entities	772	-	-	-	14	-	<b>786</b>
Due from other banks	36	92	-	-	-	-	<b>128</b>
Financial assets available for sale	-	-	100	782	565	15	<b>1,462</b>
Other financial assets at fair value	1	11	78	731	276	-	<b>1,097</b>
Derivative financial instruments	3	27	48	70	137	-	<b>285</b>
Loans and advances to customers	2,221	203	701	3,844	20,137	376	<b>27,482</b>
Due from customers on acceptances	-	4	-	-	-	-	<b>4</b>
All other assets	86	58	47	-	-	839	<b>1,030</b>
<b>Total assets</b>	<b>8,097</b>	<b>395</b>	<b>974</b>	<b>5,427</b>	<b>21,129</b>	<b>2,683</b>	<b>38,705</b>
<b>Liabilities</b>							
Due to other banks	-	390	3	-	-	-	<b>393</b>
Other financial liabilities at fair value	-	1	1	65	-	-	<b>67</b>
Derivative financial instruments	3	28	41	248	214	-	<b>534</b>
Due to customers	20,370	1,505	2,045	2,487	-	-	<b>26,407</b>
Liabilities on acceptances	-	4	-	-	-	-	<b>4</b>
Due to related entities	135	8	-	380	475	-	<b>998</b>
Debt securities in issue	-	14	852	1,973	927	-	<b>3,766</b>
All other liabilities	1,825	114	114	-	-	1,040	<b>3,093</b>
<b>Total liabilities</b>	<b>22,333</b>	<b>2,064</b>	<b>3,056</b>	<b>5,153</b>	<b>1,616</b>	<b>1,040</b>	<b>35,262</b>
<b>Off balance sheet items</b>							
Contingent liabilities	-	25	13	11	52	8	<b>109</b>
Other credit commitments	7,801	-	-	-	-	-	<b>7,801</b>
<b>Total off balance sheet items</b>	<b>7,801</b>	<b>25</b>	<b>13</b>	<b>11</b>	<b>52</b>	<b>8</b>	<b>7,910</b>

Cash flows payable under financial liabilities by contractual maturity

2016 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	81	420	318	505	-	-	<b>1,324</b>
Other financial liabilities at fair value	-	2	12	40	-	-	<b>54</b>
Trading derivative financial instruments	2	43	43	50	208	-	<b>346</b>
Due to customers	21,169	1,943	1,954	2,217	-	-	<b>27,283</b>
Liabilities on acceptances	-	4	-	-	-	-	<b>4</b>
Debt securities in issue	-	23	285	3,712	991	-	<b>5,011</b>
All other financial liabilities	1,912	-	-	-	-	-	<b>1,912</b>
<i>Hedging derivative liabilities</i>							
Contractual amounts payable	-	8	71	141	100	-	<b>320</b>
Contractual amounts receivable	-	-	-	-	-	-	<b>-</b>
<b>Total liabilities</b>	<b>23,164</b>	<b>2,443</b>	<b>2,683</b>	<b>6,665</b>	<b>1,299</b>	<b>-</b>	<b>36,254</b>

2015 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	390	3	-	-	-	<b>393</b>
Other financial liabilities at fair value	-	2	3	75	-	-	<b>80</b>
Trading derivative financial instruments	3	16	35	52	226	-	<b>332</b>
Due to customers	20,370	1,517	2,074	2,516	-	-	<b>26,477</b>
Liabilities on acceptances	-	4	-	-	-	-	<b>4</b>
Debt securities in issue	-	27	918	2,152	1,123	-	<b>4,220</b>
All other financial liabilities	1,791	-	-	-	-	-	<b>1,791</b>
<i>Hedging derivative liabilities</i>							
Contractual amounts payable	-	49	106	669	41	-	<b>865</b>
Contractual amounts receivable	-	(28)	(50)	(518)	-	-	<b>(596)</b>
<b>Total liabilities</b>	<b>22,161</b>	<b>1,964</b>	<b>3,070</b>	<b>4,929</b>	<b>1,216</b>	<b>226</b>	<b>33,566</b>

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

BALANCE SHEET & PRUDENTIAL  
REGULATION RISKS

Market risk

Market risk is the risk associated with adverse changes in the fair value, or accrual income and expense, of assets and liabilities held by the Group as a result of movements in market factors such as interest rates, foreign exchange rates, volatility and credit spreads. The Group's balance sheet is predominantly UK based and is denominated in GBP therefore foreign exchange risk is not a major part of the Group's risk profile.

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income and economic value to movements in market interest rates. The major contributors to interest rate risk are:

- the investment of non interest bearing deposits and equity into interest bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities;
- Basis risk, for example, the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets or the risk arising from changing relationships between different interest rate yield curves; and
- Customer optionality, e.g. the right to repay borrowing in advance of contract maturity dates.

Exposures

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange products and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. Controls include the hedging of these products as and when they arise.

Measurement

Interest Rate Risk in the Banking Book (IRRBB) is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings based approaches. In accordance with the Group IRRBB standard, risk measurement techniques include: basis point sensitivity, Value at Risk (VaR), Earnings at Risk (EaR), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- the use of basis point sensitivity analysis;
- historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- VaR and EaR are measured on a statistical basis: 99% confidence level with appropriate holding periods depending on varying risk types;
- EaR utilises a 12 month forecast period;
- eight years of business day historical data is used in modelling;
- VaR methodology is based on proportional rather than absolute changes in historical interest rates;
- investment term for capital is modelled with a benchmark term agreed by ALCO;
- investment term for core non interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by ALCO; and
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO.

Foreign exchange risk is assessed based on the absolute exposure in each currency.

Mitigation measures

Market risks are overseen by ALCO with delegation for day to day management given to the Group's Treasury division. The Group's Treasury division use a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange. Basis risk is managed through a combination of wholesale market basis risk management products, pricing strategies and product innovation. As part of an objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income. The use of derivatives gives rise to the need to apportion transactions into hedge relationships.

Fair value hedges

The Group hedges part of its existing interest rate risk, resulting from potential movements in the fair value of fixed rate assets and liabilities, using interest rate swaps. The fair value of these swaps is disclosed in note 15. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate and foreign currency risk. The interest and foreign currency risk arise from variable interest rate assets and liabilities which are hedged using cross currency and interest rate swaps, and material non-GBP denominated transactions which are hedged using FX

forward contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the period as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed in note 15.

Monitoring

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of ALCO. Oversight of market risk is conducted by the Group's Balance Sheet & Liquidity Risk Oversight team that is independent of the Treasury division. The Board and Executive Risk Committee, through ALCO's oversight, monitors risk to ensure it remains within approved policy, limits and Board requirements.

Interest rate risk (audited)

	Value at risk		Earnings at risk	
	2016 £m	2015 £m	2016 £m	2015 £m
As at 30 September	15	27	2	9
Average value during the year	25	25	5	5
Minimum value during the year	13	19	2	2
Maximum value during the year	36	29	11	9



## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

### Principal financial assets and liabilities (audited)

The following table shows the Group's principal financial assets and liabilities and the main non traded market risk types they are exposed to:

	2016 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
<b>Assets</b>					
Cash and balances with central banks	5,955				✓
Financial assets available for sale	1,731	✓	✓		✓
Loans and advances to customers	29,202	✓	✓	✓	✓
Derivative financial instruments	585	✓	✓	✓	✓
Other financial assets at fair value	750	✓	✓		✓
<b>Liabilities</b>					
Due to customers	27,090	✓	✓	✓	
Due to other banks	1,309	✓	✓	✓	
Derivative financial instruments	598	✓	✓	✓	
Other financial liabilities at fair value	48	✓	✓		
Debt securities in issue	4,501	✓	✓	✓	

	2015 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
<b>Assets</b>					
Cash and balances with central banks	6,431				✓
Financial assets available for sale	1,462	✓	✓		✓
Loans and advances to customers	27,482	✓	✓	✓	✓
Derivative financial instruments	285	✓	✓	✓	✓
Other financial assets at fair value	1,097	✓	✓		✓
<b>Liabilities</b>					
Due to customers	26,407	✓	✓	✓	
Due to other banks	393	✓	✓	✓	
Derivative financial instruments	534	✓	✓	✓	
Other financial liabilities at fair value	67	✓	✓		
Debt securities in issue	3,766	✓	✓	✓	

### Foreign currency assets and liabilities split by type

The Group does not incur material foreign currency exposure.

### Repricing periods of assets and liabilities by asset/liability category

The following table shows the repricing periods of the Group's assets and liabilities as assessed by the Group. This repricing takes account of behavioural assumptions where material and the Group's policy to hedge capital over the planning forecast in order to reduce variability in net interest income.

Items are allocated to time buckets in the table below by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

2016 (unaudited)	Overnight £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Non Interest Bearing £m	Total £m
<b>Assets</b>							
Cash and balances with central banks	5,798	8	21	128	-	-	5,955
Due from other banks	949	3	-	-	-	-	952
Financial assets available for sale	252	285	-	665	495	34	1,731
Due from customers	10,122	4,443	4,484	10,958	165	(216)	29,956
Other assets	-	-	-	-	-	1,335	1,335
<b>Total Assets</b>	17,121	4,739	4,505	11,751	660	1,153	39,929
<b>Liabilities</b>							
Due to other banks	67	929	313	-	-	-	1,309
Due to customers	10,738	1,476	3,703	11,213	12	-	27,142
Debt securities in issue	204	3,822	-	475	-	-	4,501
Other liabilities	1,564	38	102	628	-	1,434	3,766
Equity	-	173	460	2,578	-	-	3,211
<b>Total Liabilities and Equity</b>	12,573	6,438	4,578	14,894	12	1,434	39,929
Notional value of derivatives managing interest rate sensitivity	(1,298)	(1,610)	501	2,869	(462)	-	
<b>Total interest rate gap sensitivity</b>	3,250	(3,309)	428	(274)	186	(281)	
<b>Cumulative interest rate gap sensitivity</b>	3,250	(59)	369	95	281	-	

## BALANCE SHEET & PRUDENTIAL REGULATION RISKS

2015 (unaudited)

	Overnight £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Non Interest Bearing £m	Total £m
<b>Assets</b>							
Cash and balances with central banks	5,198	1,078	25	130	-	-	<b>6,431</b>
Due from related entities	786	-	-	-	-	-	<b>786</b>
Due from other banks	36	92	-	-	-	-	<b>128</b>
Financial assets available for sale	251	48	100	600	450	13	<b>1,462</b>
Due from customers	10,092	4,477	3,816	10,112	222	(136)	<b>28,583</b>
Other assets	-	-	-	-	-	1,315	<b>1,315</b>
<b>Total Assets</b>	<b>16,363</b>	<b>5,695</b>	<b>3,941</b>	<b>10,842</b>	<b>672</b>	<b>1,192</b>	<b>38,705</b>
<b>Liabilities</b>							
Due to other banks	289	17	87	-	-	-	<b>393</b>
Due to related entities	523	475	-	-	-	-	<b>998</b>
Due to customers	14,094	910	3,061	8,406	7	-	<b>26,478</b>
Debt securities in issue	(145)	3,911	-	-	-	-	<b>3,766</b>
Other liabilities	402	1,479	137	726	-	883	<b>3,627</b>
Equity	-	377	1,130	1,936	-	-	<b>3,443</b>
<b>Total Liabilities and Equity</b>	<b>15,163</b>	<b>7,169</b>	<b>4,415</b>	<b>11,068</b>	<b>7</b>	<b>883</b>	<b>38,705</b>
Notional value of derivatives managing interest rate sensitivity	(3,554)	4,685	103	(812)	(422)	-	
<b>Total interest rate gap sensitivity</b>	<b>(2,354)</b>	<b>3,211</b>	<b>(371)</b>	<b>(1,038)</b>	<b>243</b>	<b>(309)</b>	
<b>Cumulative interest rate gap sensitivity</b>	<b>(2,354)</b>	<b>857</b>	<b>486</b>	<b>(552)</b>	<b>(309)</b>	<b>-</b>	

### Pension risk

The Group operates a Defined Benefit (DB) pension scheme, the Yorkshire and CB Pension Scheme (the 'Scheme'). CB PLC is the Scheme's principal employer and there are no other participating employers.

DB pension schemes provide a promise to pay members a pre-determined level of income at retirement which is independent of the contributions and investment returns (assets) used to fund these benefit promises (collectively the 'liabilities'). The Scheme provides members with pensions based primarily on years of service and salary. As such, there are significant risks associated with managing a DB scheme, both in terms of benefits already built up and future benefit accrual. These risks will continue until the Scheme is formally wound up, either in the event that all the liabilities are transferred to a third party (for example an insurer) or once all individual member benefits are paid.

The Scheme's assets are held under a separate trust and the Scheme is managed by a corporate Trustee Board independently of the Group, according to the Scheme Trust Deed and Rules. Therefore, the Group's ability to directly manage the Scheme is limited to certain powers within the governing documentation. Aside from the Group's role to sponsor the Scheme to ensure there are sufficient assets to meet benefit payments as they fall due, the Group's main focus is directed on mitigating the impact on capital and earnings through working with the trustee to implement risk reduction initiatives. A number of activities have been implemented since 2003 with the specific aim of reducing risk in the Scheme, including a derisking journey plan and a number of benefit reforms.

The principal cause of risk within the Scheme is the difference between the assets and the liabilities. The assets are exposed to market valuation movements, within and between asset classes, whilst the liabilities are more sensitive to interest rate and inflation rate changes, and changes in other actuarial assumptions which may not be borne out in experience, for example life expectancy.

There are various bases, with differing assumptions, for measuring the Scheme liabilities. Conversely, the Scheme assets are consistently valued at current market values. Therefore, the variation in the net funding position between the bases depends on the liability valuation. The two key bases used to value DB scheme liabilities are IAS 19, a standardised accounting measure which is the basis for income statement, balance sheet and capital reporting, and the Trustee's Technical Provisions basis which determines the cash funding contributions to the Scheme in respect of both future benefit accrual and to repair any deficit agreed as part of a triennial valuation.

The IAS 19 valuation is disclosed in note 29. The rate used to discount the liabilities on the IAS 19 basis is a key driver of volatility and, as prescribed by IAS 19, is based on yields on high quality corporate bonds. As a consequence, the IAS 19 valuation can move adversely as a result of low rates and narrowing credit spreads. Inflation is another key source of volatility. This is because member benefits have an element of index linking and therefore the liabilities increase with rises in long term inflation assumptions, although in practice, over the long term, the relationship between interest and inflation rates tends to be negatively correlated resulting in a degree of risk offset.

The triennial valuation (the 'valuation') uses the trustee's actuarial assumptions and a liability discount rate based on gilt yields. The last formal valuation indicated a deficit of £450m as at 30 September 2013. The Group agreed a deficit repayment schedule with the trustee resulting in payments of £65m and £150m to the Scheme in October 2013 and June 2014 respectively. Further annual payments of £50m are due from 1 October 2017 until October 2022 when a final payment of £55m will be made.

## EFFECTIVELY ADDRESSING LEGACY ISSUES AND BUILDING A PLATFORM FOR GROWTH

Continued focus to address and eliminate legacy conduct issues while seeking to ensure that Regulators' expectations are met and our current and future proposition is compliant and fair to customers.

Regulatory and Compliance risk consists of regulatory strategy and change risk and regulatory relationship risk. Regulatory strategy and change risk is the risk of failing to identify and monitor changes in the regulatory environment and of failing to take opportunities to help shape the development of emerging legislative frameworks and / or to effectively implement the required changes. Regulatory relationship risk is the risk of damaging the Group's relationship with regulators through non compliance with regulatory requirements, not keeping regulators informed of relevant issues impacting (or which may potentially impact) the Group, and not meeting the information requests and review findings of regulators, by providing incorrect or inadequate information, not meeting regulatory deadlines or obstructing the regulator from fulfilling its role.

### Risk appetite

The Group has no appetite for regulatory breaches.

### Mitigation measures

- The Group has a regulatory engagement policy designed to ensure an open and cooperative relationship is maintained with regulators at all times, ensuring that all key interactions with regulators are managed, recorded and escalated as appropriate.
- All employees are required to achieve mandated standards to meet their 'compliance gateway' obligations.
- Material changes to regulatory policies and protocols are approved by either the Executive Leadership Team or the Board.
- The CRO and Risk Leadership Team consider compliance risk topics when setting risk appetite and through ongoing risk assessment, profiling and reporting.

### Monitoring

A risk management oversight and compliance monitoring plan is approved by the Board's Risk Committee on an annual basis which independently assesses the control framework underpinning compliance with laws and regulations.

## Conduct Risk

Conduct Risk is the risk of treating customers unfairly and / or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.

### Risk appetite

The Group has a conservative appetite for conduct risk.

### Exposures

As part of the demerger, NAB and the Group have entered into a Conduct Indemnity Deed where NAB has agreed to provide the Group with an indemnity in respect of certain historic liabilities relating to conduct in the period prior to the demerger date. Details of the Conduct Indemnity Deed are included in note 27 – Provisions.

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 27 reflecting the Group's current position in relation to redress provisions for PPI, IRHPs and other smaller historic conduct matters. The final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

Consideration of customer outcomes is embedded within the Group's operating processes, and metrics are regularly monitored to help ensure outcomes are appropriate.

### Mitigation measures

The Group has a conduct framework which recognises the key conduct risks inherent in the Group's strategy through which it seeks to apply the highest standards in the design and sale of products, and the treatment of its customers. The framework incorporates target outcomes and operating principles to ensure the Group's business model and supporting business practices achieve fair treatment of customers and the avoidance of customer detriment.

Products are subject to a product governance framework methodology and are designed and sold to meet customer needs and expectations with governance processes embedded to ensure those objectives are met.

### Monitoring

This is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly and products are designed and sold to meet their needs, customer expectations are met and complaints are dealt with effectively and fairly. All three lines of defence consider conduct risk as part of their oversight and assurance activities.



OPERATIONAL RISK  
(INCLUDING STRATEGIC, BUSINESS, FINANCIAL  
PERFORMANCE & PEOPLE RISKS)

PROACTIVE OPERATIONAL RISK MANAGEMENT WITH  
ENHANCED RISK FRAMEWORKS

The Group continues to strengthen its controls to manage risk, transferring it via insurance where there is a tangible commercial benefit, and minimising its loss profile, thereby preventing an increased operational risk capital requirement.

Operational risk (including Strategic, Business, Financial Performance and People Risks) is the risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events including, for example, the prospect of a cyber attack. It is a core component of the RMF and is embedded in day to day business activities. Responsibilities are set out in a structured operational risk framework that seeks to identify, assess, mitigate, monitor, and report the operational risks and events that could impact the achievement of business objectives or impact core business processes.

Business Units are responsible for the day to day management of operational risk, with oversight from the risk management function, and independent assurance activities undertaken by Internal Audit.

The requirements of the operational risk management framework are defined in an overarching operational risk policy and related minimum standards, and reflect the Group's operational risk appetite.

Risk Appetite

The Group is prepared to tolerate a level of operational risk exposure within agreed thresholds and limits. Operational risks arise from the day to day business activities, which may result in direct or indirect losses and could adversely impact the Group's financial performance, levels of customer care

and reputation.

Approach to Monitoring and Mitigating Exposures

Losses may result from both internal and external events, and are categorised using risk categories aligned to Basel II. The Basel II categories are used to ensure that the identification, assessment, mitigation, monitoring and reporting of risks and events is applied consistently.

The Group has identified, assessed and is currently monitoring all key operational risks across the above noted categories, including undertaking an assessment of control effectiveness, monitoring trends in key risk indicators and escalating events, in accordance with policy requirements.

Stress testing

The Group undertakes scenario analysis to gain insights into the stresses the business could be subject to in the event of this type of operational risk materialising. The Group maintains a suite of operational risk scenarios covering the Basel II event types relevant to its business. As part of the scenario analysis approach, the suite of operational risk scenarios are reviewed and updated on a regular basis for existing potential impacts and identification of potential new risk events. Management then document a proposed response to identify how the scenarios would be managed and monitored if they occurred.

Risk Category	
Customer, products and sales practices	The risks associated with the fair treatment of customers and the potential customer impact on all the Group's core activities.
Regulatory environment and market practices	The risks associated with ensuring the Group complies with a large volume of laws and regulations, including managing regulatory change.
Payments and process management	The risks associated with the management of large volumes of transactions, including ensuring core processing activities are conducted safely and efficiently.
Workplace practices and environment	The risks associated with failing to provide a safe environment for customers and colleagues, including ensuring there is adequate capacity of resource, with clearly defined objectives and an effective and efficient management structure in place.
Systems and infrastructure	The risks associated with failing to maintain the Group's systems and infrastructure, including as a result of a potential cyber attack.
Third party providers	The risks associated with failing to manage third party providers effectively, which may also impact on the level of service available to customers.
Strategic Execution Risk	The risks associated with failing to manage change effectively, including the ability to define and deliver a plan that enables the Group to meet its strategic objectives.

## A STRENGTHENED AND ROBUST FINANCIAL CRIME FRAMEWORK

The Group continues to invest in its systems and controls to prevent, detect, screen and report financial crime, demonstrating a tangible uplift in effectiveness.

Financial Crime Risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes. It also includes risks associated with external or internal acts intended to defraud, misappropriate, and circumvent policy, funds, information, regulations and property. The Group maintains an overarching financial crime policy and four policy standards aligned to each material financial crime risk. These are:

**Sanctions** – The Group has no appetite for non compliance with the legal and regulatory obligations relative to Sanctions and Embargoes. To reflect the Group's risk appetite and to protect the Group from financial and reputational damage, including regulatory censure, fines and enforcement action, the Sanctions & Embargoes Policy articulates a set of minimum standards and requirements which must be complied with.

**Anti-Money Laundering** – The Group applies a prescribed high risk customer model which sets out the types of customer it has no risk appetite to onboard as well as customers with whom the Group is prohibited from entering into or maintaining a customer relationship. All other customers who are not prescribed shall be subject to controls commensurate with their risk.

**Anti-Bribery and Corruption** – The Group does not tolerate the direct or indirect offer, payment, solicitation or acceptance of bribes in any form. The Group has in place risk assessments, policies and guidelines on interacting with customers, suppliers and agents, including specific policies for gifts and hospitality. Senior managers across the business are required to complete an evaluation of risk areas as part of the risk assessment process.

**Fraud** – The Group accepts that in order to conduct business in a commercially viable manner, it is willing to sustain fraud losses within an agreed set of parameters. The application of fraud risk management considers customer impacts, industry trends and financial impacts of fraud which on occasion provide conflicting priorities. Emerging risks are identified and assessed with action taken to mitigate them. An agreed loss plan is set and performance against this is overseen by the Policy owner and reported through the appropriate Governance Committees. With regard to internal fraud, the Group recognises the risk of internal fraud but has no appetite for it. Consequently there is a control framework in place to mitigate that risk.

### Exposures

There are currently no significant exposures to report. The Group continues to review the external environment for any change in regulatory or legislative direction, taking action as appropriate.

### Mitigation measures

Risk Assessments against the four financial crime policy standards take place on an annual basis. Over and above these assessments, regular oversight of higher risk activities are performed as part of the formal oversight plan and embedded activities take place throughout the year. Key performance metrics relative to the critical financial crime systems (sanctions / politically exposed persons screening for customers and payments, transaction monitoring, account opening performance) are discussed at a regular, formal calibration meeting. Performance of systems is also measured using a third party tool to ensure effectiveness is not being eroded or diminishing. Training completion and compliance is subject to annual oversight.

All standards are reflected in the Group policies and standards and financial crime prevention manual, the content of which is provided by financial crime risk and updated as appropriate.

### Monitoring

The financial crime team is responsible for strategy, governance, standard setting, oversight, training and reporting to the competent authorities and governance committees / Board.

The control framework is owned by financial crime risk but management and execution of customer identity and verification, customer due diligence, enhanced due diligence, identifying high risk customers, including correspondent banking relationships and record keeping is the responsibility of 1st line business units.

Account opening pass rates are oversighted as part of a regular process undertaken by financial crime risk and reported monthly.

Higher risk customers are referred to financial crime risk and senior management within Customer Banking for agreement and sign off that business is within appetite and then continue to be monitored on an ongoing basis.

Screening customers for sanctions / politically exposed persons and transaction monitoring is carried out by financial crime risk. Sanctions screening for payments is carried out by the Payments team in the 1st line. Critical financial crime systems oversight is independently tested by Internal Audit.



# FINANCIAL STATEMENTS



INDEPENDENT AUDITOR’S REPORT  
TO THE MEMBERS OF CYBG PLC

Our opinion on the financial statements

In our opinion:

- the CYBG PLC 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 30 September 2016 and of the Group’s loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements 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.

What we have audited

The CYBG PLC financial statements comprise:

Group	Parent company
Consolidated Income Statement for the year ended 30 September 2016	Company Balance Sheet as at 30 September 2016
Consolidated Statement of Comprehensive Income for the year ended 30 September 2016	Company Statement of Changes in Equity for the year ended 30 September 2016
Consolidated Balance Sheet as at 30 September 2016	Company Statement of Cash Flows for the year ended 30 September 2016
Consolidated Statement of Changes in Equity for the year ended 30 September 2016	Related notes 40 to 46 of the financial statements
Consolidated Statement of Cash Flows for the year ended 30 September 2016	
Related notes 1 to 39 to the financial statements	
Certain required disclosures have been presented elsewhere in the Annual Report and Accounts, rather than in the notes to the financial statements. These have been cross-referenced from the financial statements and are identified as audited.	

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Overview of our audit approach

Risks of material misstatement	<ul style="list-style-type: none"><li>Conduct provision for PPI claims.</li><li>SME lending impairment provisions.</li><li>Recoverability of deferred tax asset.</li><li>Revenue recognition – effective interest method accounting.</li></ul>
Audit scope	We performed an audit of the complete financial information of the Group and Parent. Our Group audit scope included all CYBG PLC subsidiaries.
Materiality	Overall Group materiality was £17m, which represents 0.5% of shareholders’ equity.

Our assessment of the risks of material misstatement

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of the efforts of the audit team. In addressing these risks, we have performed the procedures below which were designed in the context of the financial statements as a whole and, consequently, we do not express an opinion on these individual areas. In addition, we considered the risk of Management override in each of the below risks.

Issue	Our response to the issue	Key observations communicated to the Board’s Audit Committee
<b>Conduct provision for PPI claims</b>  Please refer to pages 90 to 98 (Audit Committee report), pages 256 to 259 (Provisions for liabilities and charges note), pages 269 to 270 (Contingent liabilities and commitments note).  The Group has material provisions relating to its conduct towards its past and present customers relating to PPI sales.  In August 2016, the FCA published a further consultation (CP16/20) on PPI complaint handling, including a proposed public awareness campaign and time-bar on future complaints.  Significant judgements and assumptions are required to be made by the Directors in relation to the timing, volume and quantum of future complaints and subsequent redress payments, and the costs of administering these complaints. The effects of these judgements are material, so this was considered to be a significant audit risk.	 We tested key controls operating within the PPI complaint handling and recording processes which supported PPI complaint data production. We found that we could place reliance on these controls.  We examined the models used by the Directors to determine an updated best estimate of the provision for mis-sold PPI.  We assessed the appropriateness of PPI provision model assumptions, including complaint volumes, payouts per claim, uphold rates and complaint processing costs, which were informed by the Group’s historic experience.  We tested the clerical accuracy of the Directors’ provision calculation and sensitivity analysis.  In evaluating the Directors’ provision assumptions, we examined correspondence during the year between the Group and the FCA, and considered regulatory pronouncements, such as CP16/20. We compared the Directors’ assumptions to our own expectations based on the Group’s historical experience, current trends and our industry knowledge.	 We concluded that the 30 September 2016 Balance Sheet provision represented a suitable best estimate of the amount likely to be required to settle obligations to customers, in line with IAS 37. We considered a range of other potential ultimate cost outcomes by challenging key assumptions made by the Directors.  The provision remains sensitive to variations in key assumptions, such as future complaint volumes and complaint processing costs, where alternative assumptions would result in different ultimate costs to those provided for by the Directors. We concluded that these differences were within a reasonable range of outcomes in the context of the degree of uncertainty as disclosed by the Directors within Notes 3 and 27 to the financial statements.

INDEPENDENT AUDITOR'S REPORT  
TO THE MEMBERS OF CYBG PLC

SME lending impairment provisions

Please refer to pages 90 to 98 (Audit Committee report), and page 247 (Impairment provisions on credit exposures note).

The majority of the Group's non-retail lending portfolio relates to small and medium sized enterprises (SMEs) which can be vulnerable to both domestic and foreign market volatility.

Estimating the Group's collective and specific provisioning is subjective, requires the Directors to exercise significant judgement, and incorporates the use of various assumptions.

Due to the materiality of the provisions and level of judgment involved, this is considered a significant audit risk.

We assessed and tested controls over impairment calculations and the generation of portfolio data for use in these calculations. These controls included those covering the identification and assessment of potentially impaired loans, the transfer of data from source systems to impairment models, and the calculation of specific impairment provisions. We determined that we could rely on these controls for the purposes of our audit.

We performed loan file testing on a sample of non-performing loans to assess whether the specific provisions held by the Group were sufficient and appropriate. Our approach included the use of our own valuation specialists to independently assess key assumptions underpinning a sample of collateral values used in provision calculations.

We evaluated the completeness of SME loans assessed for impairment by the Directors and examined key lending exposures where no impairment provisions were held.

We tested the collective impairment provision model by examining the logic of the model calculations, the accuracy of data inputs, and the appropriateness of key assumptions and loan ratings used within the model.

We challenged identified post model adjustments for completeness and tested material overlays for appropriateness of methodology and accuracy of calculation.

We concluded to the Audit Committee that the impairment models and assumptions employed by the Group were reasonable as at 30 September 2016 and that these resulted in impairment provisions that were appropriately estimated. We also concluded that the disclosures presented were in compliance with IFRS.

We independently determined a range of appropriate outcomes for the level of incurred but not reported losses existing in the Group's loan portfolio. The Directors' post model adjustments resided within our range of acceptable outcomes.

We challenged the judgemental determination and tested the calculation of a sample of specific impairment provisions and concluded that these were derived appropriately.

Recoverability of deferred tax asset

Please refer to pages 90 to 98 (Audit Committee report), and pages 253 to 254 (Deferred tax note).

The Group has recognised deferred tax assets of £156m. The recoverability of the deferred tax asset is substantiated through forecasting future taxable profits against which the deferred tax asset is expected to be recoverable. The uncertainty of recoverability increases as the period of utilisation of deferred tax against future profits lengthens.

Material changes to UK tax legislation were substantively enacted during the year and the changes further restrict the Group's ability to utilise losses carried forward to relieve future taxation.

Due to the materiality of the deferred tax asset and the inherent uncertainty of its recoverability, this is considered a significant audit risk for the year ended 30 September 2016.

We assessed the accuracy of underlying deferred tax computations and recoverability calculations using our specialist tax audit team. We evaluated the accuracy of the Directors' calculations against our knowledge of substantively enacted UK tax legislation.

We challenged the key assumptions underpinning future taxable profit projections used in the Directors' recoverability assessment. We considered the consistency of these forecasts with Board approved financial plans and analysed the Directors' historical budgeting accuracy as an indicator of forecasting reliability.

We compared deferred tax asset recoverability determinations to the Group's previously applied principles, particularly regarding recoverability time horizons.

We agreed with the Directors' decision to record a valuation allowance against the deferred tax asset as at 30 September 2016 such that a deferred tax asset has not been recognised in respect of carried forward losses expected to be recovered beyond the Group's current corporate planning horizon.

We concluded to the Audit Committee that we agreed with the conclusion that suitable future taxable profit forecasts supported the recoverability and therefore recognition of the deferred tax asset recognised in compliance with IFRS by the Group as at 30 September 2016.

Revenue recognition – Effective interest method

For certain product fees, the Group operates a model to recognise fee income (included within interest income) under the effective interest method. The effective interest method spreads the recognition of product fee income over the life of a financial instrument, as these are in substance an integral part of the overall yield.

Effective interest models are sensitive to judgements about the expected lives of the product portfolios to which they relate. Due to the complexity of calculations, the degree of judgement exercised by the Directors in respect of forecast future cash flows, and the different products for which fees are recognised, this is considered a significant audit risk.

We assessed the appropriateness of key assumptions used within the Group's effective interest model, primarily the average loan life assumption, which we assessed against underlying loan data, our knowledge of market conditions and observed practice in the UK mortgage sector.

We performed data integrity testing on the key sources of information feeding the effective interest calculation. This involved sample testing data from business systems to the loan data used in the model and vice-versa.

We examined deferral and amortisation effective interest journals to ensure that the revenue deferred and amortised over the life of the underlying loans was appropriate and aligned with the effective interest model output.

We concluded to the Audit Committee that the effective interest adjustments recognised in interest income were appropriately derived.

We also concluded that the assumptions made by the Directors were reasonable in the context of the Group's lending portfolios and current observable customer behaviours.

Our application of materiality

We apply the concept of materiality in both planning and performing the audit, and in evaluating the effect of identified misstatements on our audit, in the financial statements and on forming our audit opinion.

Audit materiality

We define audit materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements.

Audit materiality provides a basis for determining the nature and extent of our audit procedures. When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole. We determined audit materiality for the Group to be £17m (2015: £15m) which was 0.5% of the total equity attributable to owners of the Parent company ('Group equity'). The reason for selecting this measure as the basis for our audit materiality consideration is that the Group was loss making in recent financial periods. Given the importance of equity to the Group's solvency and regulatory capital resources, we judged equity to be the most relevant basis for setting audit materiality.

This level of audit materiality provided the basis for:

- determining the nature, timing and extent of our risk assessment procedures;
- identifying and assessing the risk of material misstatement; and,
- determining the nature, timing and extent of our audit procedures.

Performance materiality

We define performance materiality as the level of materiality that we use at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds audit materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality should be set at 50% (2015: 75%) of our audit materiality, namely £8.5m (2014: £11.25m). 50% is at the conservative end of the normal range we use which is 50% to 75%. Whilst our previous experience as auditors of the Clydesdale Bank Group has not indicated a high likelihood of material financial statement inaccuracies, we have set performance materiality at this conservative percentage given 2016 is CYBG PLC's first year reporting as a publicly listed company.

INDEPENDENT AUDITOR’S REPORT  
TO THE MEMBERS OF CYBG PLC

Reporting threshold

Our reporting threshold is defined as the amount below which identified misstatements are considered to be clearly trivial. We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.85m (2015: £0.75m), which is set at 5% of our audit materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Respective responsibilities of the Directors and of ourselves as auditor

As explained more fully in the Directors’ Responsibility Statement set out on pages 136 and 137, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

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

What does an audit of financial statements involve?

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group and Parent company’s circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

In addition, we read all of the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

An overview of the scope of the audit

As highlighted, audit materiality for the financial statements as a whole was set at £17m.

All of the Group’s functions and operations were subject to a full scope audit.

Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors’ Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- based on the work undertaken in the course of the audit:
  - the information given in the Strategic Report and the Directors’ Report for the financial year for which the financial statements are prepared is consistent with the financial statements;
  - the Strategic Report and the Directors’ Report have been prepared in accordance with applicable legal requirements

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors’ Report

Matters on which we are required to report by exception

ISAs (UK and Ireland) reporting	We are required to report to you if, in our opinion, financial and non-financial information in the annual report is: <ul style="list-style-type: none"><li>- materially inconsistent with the information in the audited financial statements; or</li><li>- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or</li><li>- otherwise misleading.</li></ul> In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the Directors’ statement that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity’s performance, business model and strategy; and whether the annual report appropriately addresses those matters that we communicated to the audit committee that we consider should have been disclosed.	We have no exceptions to report
Companies Act 2006 reporting	We are required to report to you if, in our opinion: <ul style="list-style-type: none"><li>- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or</li><li>- the Company financial statements and the part of the Directors’ Remuneration Report to be audited are not in agreement with the accounting records and returns; or</li><li>- certain disclosures of Directors’ remuneration specified by law are not made; or</li><li>- we have not received all the information and explanations we require for our audit.</li></ul>	We have no exceptions to report
Listing Rules review requirements	We are required to review: <ul style="list-style-type: none"><li>- the Directors’ statements in relation to going concern, set out on page 136, and longer-term viability, set out on page 38; and</li><li>- the part of the Corporate Governance Statement on page 38 relating to the Company’s compliance with the provisions of the UK Corporate Governance Code specified for our review.</li></ul>	We have no exceptions to report

Statement on the Directors’ Assessment of the principal risks that would threaten the solvency or liquidity of the entity

ISAs (UK and Ireland) reporting	We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to: <ul style="list-style-type: none"><li>- the Directors’ confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;</li><li>- the disclosures in the annual report that describe those risks and explain how they are being managed or mitigated;</li><li>- the Directors’ statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity’s ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and</li><li>- the Directors’ explanation in the annual report as to how they have assessed the prospects of the entity, 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 entity 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.</li></ul>	We have nothing material to add or to draw attention to
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Ernst & Young LLP.

George Reid (Senior Statutory Auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
Edinburgh  
21 November 2016

Notes:  
1. The maintenance and integrity of the CYBG PLC web site is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.  
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



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## CONSOLIDATED INCOME STATEMENT

for the year ended 30 September 2016

	Note	2016 £m	2015 £m
Interest income and similar income		1,101	1,110
Interest expense and similar charges		(295)	(323)
<b>Net interest income</b>	5	<b>806</b>	787
Gains less losses on financial instruments at fair value		9	2
Other operating income		182	238
<b>Non-interest income</b>	6	<b>191</b>	240
<b>Total operating income</b>		<b>997</b>	1,027
Personnel expenses		(280)	(266)
Restructuring expenses		(45)	(17)
Depreciation and amortisation expense		(88)	(83)
Other operating and administrative expenses		(468)	(868)
<b>Total operating and administrative expenses before impairment losses</b>	7	<b>(881)</b>	(1,234)
<b>Operating profit/(loss) before impairment losses</b>		<b>116</b>	(207)
Impairment losses on credit exposures	17	(39)	(78)
<b>Profit/(loss) on ordinary activities before tax</b>		<b>77</b>	(285)
Tax (expense)/credit	8	(241)	56
<b>Loss for the year</b>		<b>(164)</b>	(229)
Loss attributable to ordinary shareholders		(206)	(247)
Profit attributable to other equity holders		42	18
<b>Loss for the year attributable to equity holders</b>		<b>(164)</b>	(229)
Basic loss per share (pence)	10	(22.5)	(28.7)
Diluted loss per share (pence)	10	(22.4)	(28.7)

Comparative disclosures have been amended to conform with the current period's presentation as detailed in note 1.  
All material items dealt with in arriving at the profit/(loss) before tax for the above years relate to continuing activities.  
The notes on pages 212 to 280 form an integral part of these financial statements.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 30 September 2016	Note	2016 £m	2015 £m
Loss for the year		(164)	(229)
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
Gains during the year		105	21
Transfers to the income statement		(1)	(18)
Taxation thereon		(25)	-
		79	3
Change in available for sale reserve			
Gains during the year		29	5
Transfer to the income statement		(8)	-
Taxation thereon		(6)	(1)
		15	4
Total items that may be reclassified to the income statement		94	7
Items that will not be reclassified to the income statement			
Remeasurement of defined benefit pension plans	29	(179)	(36)
Taxation thereon		43	7
Total items that will not be reclassified to the income statement		(136)	(29)
Other comprehensive losses net of tax		(42)	(22)
Total comprehensive losses for the year net of tax		(206)	(251)
Total comprehensive losses attributable to ordinary shareholders		(248)	(269)
Total comprehensive income attributable to other equity holders		42	18
Total comprehensive losses attributable to equity holders		(206)	(251)

Comparative disclosures have been amended to conform with the current period's presentation as detailed in note 1.  
The notes on pages 212 to 280 form an integral part of these financial statements.

## CONSOLIDATED BALANCE SHEET

as at 30 September 2016	Note	2016 £m	2015 £m
<b>Assets</b>			
Cash and balances with central banks	11	5,955	6,431
Due from related entities	12	-	786
Due from other banks		952	128
Financial assets available for sale	13	1,731	1,462
Other financial assets at fair value	14	750	1,097
Derivative financial instruments	15	585	285
Loans and advances to customers	16	29,202	27,482
Due from customers on acceptances		4	4
Current tax assets		2	4
Property, plant and equipment	19	99	109
Investment properties	20	22	32
Investments in controlled entities and associates	21	-	2
Intangible assets	22	256	265
Deferred tax assets	23	183	389
Defined benefit pension assets	29	-	52
Other assets	24	188	177
<b>Total assets</b>		<b>39,929</b>	<b>38,705</b>
<b>Liabilities</b>			
Due to other banks	25	1,309	393
Other financial liabilities at fair value	14	48	67
Derivative financial instruments	15	598	534
Due to customers	26	27,090	26,407
Liabilities on acceptances		4	4
Provisions for liabilities and charges	27	852	1,006
Due to related entities	12	-	998
Debt securities in issue	28	4,501	3,766
Retirement benefit obligations	29	79	4
Deferred tax liabilities	23	27	10
Other liabilities	30	2,210	2,073
<b>Total liabilities</b>		<b>36,718</b>	<b>35,262</b>
<b>Equity</b>			
Share capital	31.32	88	223
Other equity instruments	32	450	450
Share premium	32	-	670
Capital reorganisation reserve	32	(839)	-
Merger reserve	32	633	-
Other reserves	32	100	4
Retained earnings	32	2,779	2,096
<b>Total equity</b>		<b>3,211</b>	<b>3,443</b>
<b>Total liabilities and equity</b>		<b>39,929</b>	<b>38,705</b>

The notes on pages 212 to 280 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 21 November 2016 and were signed on its behalf by



David Duffy, Chief Executive Officer



Ian Smith, Chief Financial Officer

CYBG PLC. Registered number: 09595911

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for the year ended  
30 September 2016CONSOLIDATED STATEMENT OF  
CHANGES IN EQUITY

Note	Share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reorganisation reserve £m	Merger reserve £m	Other equity instruments £m	Equity based compensation reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
<b>As at 1 October 2014</b>	1,882	-	100	-	-	-	2	2	8	(16)	260	2,538
Loss for the year	-	-	-	-	-	-	-	-	-	-	(229)	(229)
Other comprehensive income/(losses), net of tax	-	-	-	-	-	-	-	-	4	3	(29)	(22)
Total comprehensive income/(losses) for the year	-	-	-	-	-	-	-	-	4	3	(258)	(251)
AT1 distribution paid (net of tax)	-	-	-	-	-	-	-	-	-	-	(14)	(14)
Share capital reduction	(2,009)	-	-	-	-	-	-	-	-	-	2,009	-
Capital note issued	-	-	-	-	-	150	-	-	-	-	-	150
Shares issued	350	670	-	-	-	-	-	-	-	-	-	1,020
Transfer from capital redemption reserve	-	-	(100)	-	-	-	-	-	-	-	100	-
Transfer to equity based compensation reserve	-	-	-	-	-	-	1	-	-	-	(1)	-
Equity based compensation expensed	-	-	-	-	-	-	7	-	-	-	-	7
Equity based compensation settled	-	-	-	-	-	-	(7)	-	-	-	-	(7)
<b>As at 30 September 2015</b>	31.32 223	670	-	-	-	450	3	2	12	(13)	2,096	3,443
Loss for the year	-	-	-	-	-	-	-	-	-	-	(164)	(164)
Other comprehensive income/(losses), net of tax	-	-	-	-	-	-	-	-	15	79	(136)	(42)
Total comprehensive income/(losses) for the year	-	-	-	-	-	-	-	-	15	79	(300)	(206)
AT1 distribution paid (net of tax)	9 -	-	-	-	-	-	-	-	-	-	(28)	(28)
Insertion of new parent company	(223)	(670)	-	893	-	-	-	-	-	-	-	-
Share for share exchange	1,099	-	-	(1,732)	633	-	-	-	-	-	-	-
Share capital reduction	(1,011)	-	-	-	-	(450)	-	-	-	-	1,011	-
Capital note repurchase (net of tax)	-	-	-	-	-	-	-	-	-	-	(5)	(455)
Capital note issued	-	-	-	-	-	450	-	-	-	-	-	450
Transfer from equity based compensation reserve	-	-	-	-	-	-	(4)	-	-	-	4	-
Transfer from asset revaluation reserve	-	-	-	-	-	-	-	(1)	-	-	1	-
Equity based compensation expensed	-	-	-	-	-	-	5	-	-	-	-	5
Equity based compensation settled	-	-	-	-	-	-	2	-	-	-	-	2
<b>As at 30 September 2016</b>	31.32 88	-	-	(839)	633	450	6	1	27	66	2,779	3,211

Comparative disclosures have been amended to conform with the current period's presentation as detailed in note 1. The notes on pages 212 to 280 form an integral part of these financial statements.

CONSOLIDATED STATEMENT  
OF CASH FLOWS

for the year ended 30 September 2016

	Note	2016 £m	2015 £m
<b>Operating activities</b>			
Profit/(loss) on ordinary activities before tax		77	(285)
Adjustments for:			
Non-cash or non-operating items included in profit/(loss) before tax	34	(643)	(679)
Changes in operating assets	34	(2,285)	(1,494)
Changes in operating liabilities	34	1,587	1,983
Interest received		1,101	1,257
Interest paid		(200)	(418)
Tax repayment received		-	5
Tax received/(paid) - group relief		4	(20)
<b>Net cash (used in)/provided by operating activities</b>		<b>(359)</b>	349
<b>Cash flows used in investing activities</b>			
Interest received		11	8
Proceeds from sale or maturity of investments		101	-
Proceeds from sale of tangible fixed assets <sup>(1)</sup>		17	17
Purchase of tangible fixed assets <sup>(1)</sup>		(22)	(19)
Purchases of investments		(357)	(269)
Proceeds from sale of available for sale investments		56	-
Purchase and development of intangible assets		(99)	(119)
<b>Net cash used in investing activities</b>		<b>(293)</b>	(382)
<b>Cash flows from financing activities</b>			
Interest received		1	3
Interest paid		(98)	(122)
Proceeds from ordinary shares issued	31	-	1,020
Proceeds from other equity instruments issued		450	150
Repurchase of other equity instruments		(457)	-
Redemption of medium term notes	12	-	(427)
Repurchase of subordinated debt	12	(474)	(591)
Redemption, principal repayment on residential mortgage backed securities and covered bonds	18	(1,029)	(921)
Issuance of residential mortgage backed securities and covered bonds	18	750	1,207
Issuance of subordinated debt	28	475	-
Net decrease in amounts due from related entities		786	686
Net decrease in amounts due to related entities		(106)	(512)
AT1 distributions	9	(35)	(18)
Equity based compensation		2	-
<b>Net cash provided by financing activities</b>		<b>265</b>	475
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(387)</b>	442
Cash and cash equivalents at the beginning of the year		6,337	5,895
<b>Cash and cash equivalents at the end of the year<sup>(2)</sup></b>	34	<b>5,950</b>	<b>6,337</b>

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

<sup>(2)</sup> Cash and cash equivalents is cash and balances with central banks less mandatory deposits plus cash equivalents within other assets, less due to other banks, due to related entities and other liabilities.

The notes on pages 212 to 280 form an integral part of these financial statements.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1. Basis of preparation

### Reporting entity

The Company is incorporated in the UK and registered in England and Wales. On 8 February 2016, the Company became the new holding company for the CYBI Group by way of a share for share exchange and was unconditionally listed on the London Stock Exchange. On the basis that the transaction was effected by creating a new parent that is itself not a business, the transaction is considered to be outside the scope of IFRS 3 Business Combinations. It has therefore been accounted for using the pooling of interest method as a continuation of the existing group. The consolidated financial statements for the year ended 30 September 2016 comprise the Company and its controlled entities (together the "Group"). The Group's controlled entities are listed in note 42. The comparative figures provided are those of the CYBI Group.

### Statement of compliance

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

The consolidated financial statements of the Group for the year ended 30 September 2016 were authorised for issue by the Board of Directors on 21 November 2016.

### Basis of measurement

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

### Presentation of risk offsetting and maturity disclosures

Certain disclosures required under IFRS 7 'Financial instruments: disclosures' and IAS 1 'Presentation of financial statements' have been included within the audited sections of the Risk Report. Where information is marked as audited, it is incorporated into these financial statements by this cross reference and it is covered by the Independent Auditor's report.

### Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. In addition, the Risk Report

includes the Group's risk management objectives and the Group's objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2016, the Directors have considered a number of factors, including the current balance sheet position, the principal and emerging risks which could impact the performance of the Group and the Group's strategic and financial plan which includes future projections of profitability, capital adequacy, liquidity and funding. The assessment concluded that, for the foreseeable future, the Group has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that performance will continue to improve as the Group's strategy is executed.

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

### Restatement of comparative amounts - Presentation of tax on AT1 distributions

In comparative periods, the tax deduction associated with AT1 distributions was recognised in the income statement rather than directly in equity. Whilst this approach is permitted under IFRS, it is not aligned with other UK banks. Accordingly, the accounting policy has been revised to require recognition of the AT1 distributions directly in equity, net of any tax relief. This has resulted in a restatement of comparative amounts as described below.

The impact on the Group's result for the year ended 30 September 2015 was a decrease in the tax credit by £4m from £60m to £56m, increasing the loss for the year from £225m to £229m. There was a corresponding decrease in the amounts taken to Retained earnings in relation to AT1 distributions by £4m from £18m to £14m. In addition, note 8 'Taxation' has been impacted by the restatement. There has been no impact on the Group's total assets, net assets or closing reserves as a result of the change.

The tax credit associated with AT1 distributions is now recognised directly in equity rather than in the income

statement. The profit after tax attributable to other equity holders of £42m (2015: £18m) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £7m on AT1 dividends (2015: £4m) and a £1m tax credit attributable to ordinary shareholders on the refinancing of the AT1 debt (2015: £Nil).

## 2. Accounting policies

The accounting policies adopted in the preparation of these consolidated financial statements are consistent with, and are a continuation of, those policies followed in the preparation of the CYBI annual report and consolidated financial statements for the year ended 30 September 2015. Newly applicable accounting policies in relation to earnings per share and updates to the Group's policies on equity based payments, the equity based compensation reserve and the presentation of tax on AT1 distributions are detailed in the relevant sections within this note and note 1.

### Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. An assessment of control is performed on an ongoing basis. For details of controlled structured entities refer to note 21. For details of investments in subsidiaries and associates refer to note 42.

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

### New accounting standards and interpretations adopted during the year

The Group has not adopted any new or amended accounting standard or interpretation in the current year.

### New accounting standards and interpretations not yet adopted

The following standards and amendments are relevant to the Group and were available for adoption in the European Union (EU), but are not mandatory and have not been

applied by the Group in preparing these financial statements. The Group is currently assessing the impact of IFRS 15: 'Revenue from Contracts with Customers'; with this exception, none of the amendments listed are expected to have a significant impact for the Group:

- IFRS 15 'Revenue from Contracts with Customers', issued May 2014 and effective for financial years beginning on or after 1 January 2018. This standard establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard provides a single, principles based five step model to be applied to all contracts with customers. In April 2016, the International Accounting Standards Board (IASB) issued Clarifications to IFRS 15 to address certain implementation issues identified and provide additional transitional relief options.
- Amendments to IAS 16 and IAS 38: 'Clarification of Acceptable Methods of Depreciation and Amortisation', issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation are not appropriate.
- 'Annual Improvements to IFRS 2012-2014 Cycle', issued September 2014 and effective for financial years beginning on or after 1 January 2016. The IASB have made amendments to the following standards that are relevant to the Group and Company: IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'.
- Amendments to IAS 1: 'Disclosure Initiative', issued December 2014 and effective for financial years beginning on or after 1 January 2016. This includes narrow scope amendments providing clarification to existing IAS 1 'Presentation of Financial Statements' requirements.

There are a number of other standards and amendments relevant to the Group that are not available for adoption in the EU, nor effective at 30 September 2016 and have not been applied by the Group in preparing these financial statements. The most significant of these pronouncements is IFRS 9 'Financial Instruments' issued July 2014 and effective for financial years beginning on or after 1 January 2018. An update on the Group's implementation of IFRS 9 is provided overleaf.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Update on the implementation of IFRS 9

#### CYBG implementation strategy and approach

The Group continues to work on its implementation strategy for IFRS 9, which is expected to receive EU endorsement by the end of the 2016 calendar year, and has mobilised an IFRS 9 project team to ensure implementation in line with the standard and other evolving regulatory guidance and industry practice. The project has representation from both the Finance and Risk functions, with a Steering Committee and formal Project Control Board in place to provide the necessary oversight. As noted in the Corporate Governance Report the Board has also established a sub committee to oversee the implementation of IFRS 9 and the application of IRB to regulatory capital.

The primary objectives of the project include: defining accounting policies and approaches; co-ordinating with the Group's IRB Programme to ensure risk models meet the required specifications; delivery of data and system changes; and updating the credit provisioning operating model and overall governance framework. Key decisions on the impairment requirements of IFRS 9 involve appropriate internal stakeholder consultation; rigorous internal review performed by senior representation from both Finance and Risk Management; external review and challenge exercises; and presentation of the adopted impairment accounting policy decisions to the project oversight committees.

The Group's intention is to perform an end-to-end parallel run during the year commencing 1 October 2017, capturing the IFRS 9 requirements for classification, measurement and impairment. The most significant of these will be the impairment requirements of the standard, which will be closely monitored during the parallel run phase, to compare the results with expectations and to ensure that the Group's initial proposed staging criteria produces an impairment allowance which accurately reflects the credit risk provision in those financial assets that will be subject to a lifetime expected loss calculation.

The Group's current view on the three phases of IFRS 9 (classification and measurement, impairment and hedging) is as follows:

### Classification and measurement

An initial assessment of the classification and measurement requirements of IFRS 9 has been undertaken with the main issue arising being the classification of financial assets in the IAS 39 category of available for sale (AFS) that does not exist under IFRS 9.

IFRS 9 simplifies the classification of financial assets by reducing the number of categories to just three (amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL)). The final classification is based on a combination of the Group's business model and the contractual cash flow characteristics of the instruments. The option to designate a financial asset at FVTPL in IAS 39 is largely retained in IFRS 9, with IFRS 9 also affording a further option to designate certain equity instruments at FVOCI instead of accounting for these as FVTPL.

The majority of the Group's financial assets under IAS 39 relate to loans and advances to customers and are currently classified under loans and receivables and held at amortised cost; the Group expects these will remain in the amortised cost category on implementation of IFRS 9.

The Group is still considering the classification options that are available for other financial assets including Treasury assets and other debt instruments currently held as AFS.

### Impairment (including modelling development)

The impairment of financial assets under IFRS 9 is based on an expected credit loss (ECL) model which replaces the current incurred loss methodology under IAS 39 and is the area where IFRS 9 will have the most significant impact.

IFRS 9 requires a 12 month (Stage 1) ECL calculation where financial assets have not experienced a significant increase in credit risk since origination; and a lifetime ECL calculation where it has been demonstrated that there has been a significant increase in credit risk (Stage 2 and 3). The lifetime ECL calculation is further refined into separate stages depending on whether the financial asset is credit impaired or not. When a financial asset is credit impaired (Stage 3), the resultant methodology to calculate the loss allowance under IFRS 9 uses the same criteria as the Group's IAS 39 methodology for specific provisions, however, it is anticipated that not all financial assets which are classified as Stage 3 will already have been subject to a specific provision under IAS 39.

The area of IFRS 9's impairment criteria where the greatest judgement is required relates to when financial assets display a significant deterioration in credit quality since initial recognition and subsequently move from a 12 month ECL calculation (Stage 1) to a non-credit impaired lifetime ECL calculation (Stage 2).

The Group has reflected on what a significant increase in credit risk since initial recognition means in terms of both retail and SME portfolios and determined that there is no single factor that influences this decision; rather, a combination of different criteria require to be assessed before concluding that a significant increase in credit risk since initial recognition has taken place. For example, in SME portfolios, a combination of the Group's internal rating system and other qualitative factors such as 'watch' status and 'approaching financial difficulty' status could be used in making this determination. For retail portfolios, the proposed approach will move accounts to a lifetime ECL when the residual lifetime PD has deteriorated since origination by a pre-determined threshold, supplemented with other credit quality indicators. The 30 DPD presumption for a significant increase in credit risk since origination that exists within IFRS 9 will not be rebutted, and will form part of the overall assessment. The Group will not take advantage of the low credit risk exemption offered in IFRS 9. The low credit risk exemption allows entities not to assess whether there has been a significant increase in credit risk in a financial asset since initial recognition where the financial asset is deemed as being of low credit risk at the reporting date. The Group will assess all financial assets under the same criteria. For both retail and SME portfolios, the Group's forbearance programmes will also play a part in determining a significant increase in credit risk since initial recognition.

The Group will look to align the accounting and regulatory definition of default for IFRS 9 in both retail and SME portfolios. As part of this alignment, a review of the Group's forbearance strategies will be necessary and where a total or partial change outside the normal terms and conditions of a contract is identified, this may come under the Group's revised definition of default. Other forbearance measures undertaken by the Group that do not fall under the definition of default would form part of the assessment of a significant increase in credit risk since origination and attract a lifetime ECL calculation under Stage 2.

The Group will look to leverage off the model development work that is necessary under the IRB Programme as far as practically possible for IFRS 9 purposes with new retail models

and the transformation and alignment of existing SME models developed for all products and portfolios. The model development programme for IFRS 9 will run concurrently with the IRB Programme. The Group will look to apply appropriate and proportional segmentation to the modelling approach for the retail portfolio of mortgages, personal loans, credit cards and current accounts. For the SME portfolio, the segmentation that exists within the Group's internal rating system already meets the requirements of IFRS 9.

The Group's loan commitments and financial guarantee contracts will be assessed under IFRS 9's impairment criteria as part of the overall retail and non-retail impairment methodologies. In addition, the Group will also apply the single impairment principles introduced by IFRS 9 to all other financial assets identified by the Group under the amortised cost and FVOCI classification categories.

The Group will continue to refine the ECL approach under IFRS 9 and provide an update on the progress made at each reporting period until implementation. This is in line with the approach recommended by the Enhanced Disclosure Task Force in their ECL report in November 2015.

### Hedging

Until the guidance on hedging accounting is finalised by the IASB, the Group will look to exercise the accounting policy choice afforded by IFRS 9 and continue to apply the hedge accounting requirements of IAS 39. The Group is assessing the revised hedge accounting disclosures required by the amendment to IFRS 7 'Financial Instruments: Disclosures' and will look to implement these where appropriate.

### Other standards and amendments

Listed below are the other standards and amendments relevant to the Group that are not available for adoption in the EU, nor effective at 30 September 2016 and that have not therefore been applied by the Group in preparing these financial statements. The Group is currently assessing the impact of these standards and amendments.

- IFRS 16 'Leases' issued on 13 January 2016 and effective for financial years beginning on or after 1 January 2019. This standard replaces IAS 17: Leases and will result in most leases being brought onto a lessee's balance sheet under a single lease model, removing the distinction between finance and operating leases. The standard requires lessees to recognise a right of use, asset and a liability for future payments arising from a lease contract. Lessor accounting requirements remain aligned to the current approach under IAS 17.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

- Amendments to IAS 12: 'Recognition of Deferred Tax Assets for Unrealised Losses' issued on 19 January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments clarify the requirements on the recognition of deferred tax assets for unrealised losses.
- Amendments to IAS 7: 'Disclosure initiative' issued on 29 January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments to IAS 7: Statement of Cash Flows require disclosures that enable users of the financial statements to evaluate changes in liabilities arising from an entity's financing activities.
- Amendments to IFRS 2: 'Classification and Measurement of Share-based Payment Transactions' issued on 20 June 2016 and effective for financial years beginning on or after 1 January 2017. The amendments provide guidance on the effects of vesting and non-vesting conditions on the measurement of cash-settled equity based payments; classification of equity based payments with a net settlement feature for withholding tax obligations; and accounting for modifications to a equity based payment that change the classification from cash-settled to equity-settled.

### Foreign currency

#### *Functional and presentation currency*

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

#### *Transactions and balances*

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

Subsequently, at each reporting date, the Group translates foreign currency monetary items at the closing spot rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the year in which the gains or losses arise.

Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction. Foreign currency non-monetary items measured at fair value will be translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby the associated gains or losses are recognised in the income statement, are also recognised in the income statement.

### Revenue recognition

#### *Net interest income*

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

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

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

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

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

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

#### *Fees and commissions*

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

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

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

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

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

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

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

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

#### *Dividend income*

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

### Taxation

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

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

#### *Current tax*

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

#### *Deferred tax*

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

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise against which those temporary differences and losses may be utilised.

### Dividends on ordinary shares

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

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

### Earnings per share

Basic earnings per share is calculated by taking the profit attributable to ordinary shareholders of the parent company and dividing this by the weighted-average number of ordinary



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shares outstanding during the period. Any own shares held in employee benefit trusts are excluded from this calculation.

Diluted earnings per share requires that the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. These arise from awards made under share-based incentive schemes. Share awards with performance conditions attaching to them are not considered to be dilutive unless these conditions have been met at the reporting date.

**Cash and cash equivalents**

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

**Repurchase and reverse repurchase agreements**

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

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

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

**Financial instruments**

*Recognition and derecognition of financial instruments*

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

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

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

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

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

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

*Offsetting financial instruments*

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

*Financial instruments designated at fair value through profit or loss*

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

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

- if a host contract contains one or more embedded derivatives, the Group may designate the entire contract as being held at fair value;

- designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (i.e. eliminate an accounting mismatch) that would otherwise arise from measuring related assets or liabilities on a different basis; or
- assets and liabilities are both managed and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

*Financial assets held for trading*

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

*Financial assets available for sale*

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

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

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise.

*Financial liabilities*

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

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

*Fair value measurement*

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

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument.

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

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

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

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

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held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Derivative financial instruments and hedge accounting

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

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

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

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in the fair value of the hedged item attributable to the hedged risk is

made as an adjustment to the carrying value of the hedged asset or liability. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

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

Cash flow hedge

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

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

Derivatives that do not qualify for hedge accounting

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

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

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

Loans and advances

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

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

Impairment of financial assets other than fair value loans

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

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

For loans and advances, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

The amount of the loss is recognised using an allowance account and is included in the income statement.

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

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

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

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

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

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

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previously written off reduce the amount of the expense in the income statement.

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

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

### *Equity and debt instruments – classed as available for sale*

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

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

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

### **Leases**

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

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

### *As lessee*

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

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

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

### *As lessor*

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

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

### **Property, plant and equipment**

All freehold and long term leasehold land and buildings are revalued annually on an open market basis by the Directors to reflect current market values, based on advice received from independent valuers. In addition, full independent valuations are carried out on a three year cycle on an open market basis, including directly attributable acquisition costs but without deducting expected selling costs. For properties that are vacant, valuations are carried out on an open market basis. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged

to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

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

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

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

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

- buildings – 2%;
- leasehold improvements – the lower of the expected lease term and the asset's useful life; and
- fixtures and equipment – 10% to 33.33%.

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

### **Investment properties**

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

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

Investment property assets are carried at fair value, with fair value movements taken to the income statement in the year in which they arise. Investment property assets are revalued annually by the Directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis being the amounts for which the assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction at the valuation date. Newly acquired investment property assets are held at cost (equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding 12 months.

### **Investments in controlled entities and associates**

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

### **Intangible assets**

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

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



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Impairment of non-financial assets

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

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

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

Provisions for liabilities and charges

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

Conduct Indemnity

As part of the demerger, NAB and the Company have entered into a Conduct Indemnity Deed. The accounting for this matter is discussed in note 27.

Pension and post retirement costs

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

Defined contribution pension scheme

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

Defined benefit pension scheme

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

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

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

Subordinated debt and related entity balances

Subordinated debt and related entity balances, other than derivatives, are recorded at amortised cost. Prior to the demerger, the subordinated debt was included within amounts due to related entities on the balance sheet. Subordinated debt outstanding at 30 September 2016 is included in debt securities in issue.

Debt issues

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

Securitisation

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

Financial guarantees

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

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

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

Contingent liabilities

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

Equity based compensation

The Group engages in equity based compensation transactions in respect of services received from certain of its employees and to provide long term incentives. The fair value of the services received is recognised as an expense. The total amount to be expensed is measured by reference to the fair value of the Company's shares, performance options or performance rights granted, including, where relevant, any market performance conditions and any non-vesting conditions.

The impacts of any service and non-market performance vesting conditions are not included in the fair value and instead are included in estimating the number of awards or options that are expected to vest.

The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. A corresponding credit is recognised in the equity based compensation reserve. In some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between the start of the service period and grant date.

At the end of each reporting period, the Group revises its estimates of the number of shares, performance options and performance rights that are expected to vest based on the non-market and service vesting conditions. The impact of the revision to original estimates, if any, is recognised in the income statement, with a corresponding adjustment to the equity based compensation reserve.

Equity

Equity based compensation reserve

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

In comparative periods the equity based compensation reserve represented the outstanding fair value amount in respect of share based payment expense recharged by the Group's former ultimate parent, NAB, which had been charged through the income statement and adjusted for deferred tax.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At the date of the demerger, current and former employees of the Group held awards granted in previous periods for which vesting is subject to continuing employment, and in some instances specified performance criteria being met. Following the demerger, existing unvested awards remain in place. NAB will settle the awards granted to Group employees in previous periods in accordance with the original terms of the grant. The Group will compensate NAB for the cost of the awards provided to the Group's employees. Subsequent to the demerger, the amounts payable to NAB in respect of such awards no longer meet the definition of equity based payments under IFRS 2: Share based payment. Consequently, amounts within the equity based compensation reserve relating to outstanding NAB awards were reclassified to due to other banks in the consolidated balance sheet immediately following the demerger.

### *Cash flow hedge reserve*

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

### **Other equity instruments**

Other equity instruments represent AT1 notes. These are perpetual capital notes with no fixed maturity or redemption date and are classified as equity instruments. Distributions on the AT1 notes are deducted from equity on the payment date net of any tax relief. 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.

### **Combination of businesses under common control**

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

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

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

### **3. Critical accounting estimates and judgements**

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

#### **Fair value of financial instruments**

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. Sensitivity analysis indicating the impact of reasonably possible changes in this input on the fair value is included within note 37.

The valuation of these financial instruments is described in more detail in note 14.

#### **Impairment losses on loans and advances**

The Group reviews its individually significant loans and advances at each balance sheet date to assess whether an impairment loss should be recorded in the income statement.

In particular, management judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Group makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, and real estate price indices). If the PDs were to improve from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £5m. Alternatively, if PDs deteriorate by 5%, the impairment provision on loans and advances would increase by £5m. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £12m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £22m. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The impairment loss on loans and advances is disclosed in more detail in note 17 and in the Risk Report.

#### **PPI redress provision and other conduct related matters**

Disclosures in relation to the Group's PPI redress provision can be found in note 27 with the Group holding a provision of £725m at 30 September 2016 (2015: £774m). Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes (both historic and estimated future complaint volumes), uphold rates (how many claims are, or may be, upheld in the customer's favour) and

redress costs (the average payment made to customers). Also factored into the estimate is the effect of the past business review and the judgements required around customer mailing response rates. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2016. Consequently, the provision calculated may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. Sensitivity analysis indicating the impact of reasonably possible changes in key assumptions on the PPI provision is included within note 27.

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

#### **Retirement benefit obligations**

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

#### **Carrying value of investments**

In accordance with the requirements of IAS 36, an impairment test was performed on the carrying value of the Company's investment in Clydesdale Bank PLC at the Group's standard annual impairment test date in September 2016. The results of this test did not indicate any impairment in the carrying value of Clydesdale Bank PLC.

The key assumptions and sensitivities involved in these calculations are discussed further in note 42 of the Company financial statements.

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Deferred tax assets

Disclosures in relation to the Group's deferred tax assets of £183m (2015: £389m) can be found in note 23. The reduction of £206m principally reflects the impact of changes in legislation restricting the use of certain historic losses to 25% of future profits and the change in future tax rates, coupled with management's decision to reduce its horizon for recognition of losses reflecting the uncertainty inherent in the taxation of banks. The Group has assessed the recoverability of these deferred tax assets at 30 September 2016 and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The Group has made this assessment with reference to the latest available profit forecasts. The tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses; the Group expects the assets remaining on its balance sheet to be recovered over a horizon consistent with the Group's current corporate planning period which is deemed to be the reasonably foreseeable future in light of the uncertainty surrounding the taxation of banking groups.

4. Segment information

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

The Group's business is organised into two principal operating segments: SME Banking and Retail Banking. The Central Functions of the Group consist of: Finance, Risk Management, Chief Operating Office, Corporate Development and Stakeholder Engagement, CEO Office Support, Products, Propositions & Marketing, Internal Audit and Human Resources.

Other reflects elements of income and expenditure that are not recharged to the Group's two principal operating segments such as conduct related provisions, impairment of intangibles and restructuring costs.

SME Banking

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

The Group's SME franchise is comprised of small businesses (which the Group defines as businesses with lending of up to £0.5m but less than £2.0m in turnover) and commercial businesses (which the Group defines as businesses with lending of more than £0.5m and greater than £2.0m in turnover). Across all business segments, the Group provides working capital solutions through asset finance, invoice finance, international trade, merchant acquiring and treasury services.

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

- Term lending: the Group offers a wide variety of term loans, both secured and unsecured, and offers customers a range of repayment and interest rate options. The majority of the Group's business term lending is LIBOR based.
- Overdrafts: business overdrafts are the primary type of revolving variable rate credit facility offered by the Group to business customers.
- Invoice finance: the Group advances funds against the customer's trade receivables.
- Asset finance: these products provide a method of financing capital equipment purchases.
- International trade services: these products facilitate transactions between a buyer and seller located in different countries. The Group offers import loans, export loans, documentary collections and currency guarantees, together with letters of credit for securing trade.
- BCAs: the Group provides business customers' day to day banking, current account facilities (including debit cards, cheque books, regular statements, direct debits and standing orders), online banking and overdraft facilities.

Retail Banking

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

- PCA: a stable source of funding with a large number of PCA customers having a tenure with the Group of more than ten years.
- Savings accounts: the Group offers a variety of savings accounts that pay a variable rate of interest. It also offers cash ISAs that offer depositors tax free returns.
- Term deposits (sometimes referred to as fixed rate savings accounts or time deposits): offer a fixed interest rate for a fixed term.
- Mortgages: the Group provides mortgage loans on a capital repayment basis, where the loan is required to be repaid during its life, and on an interest-only basis, where the customer pays interest during the term of the mortgage loan with the principal balance required to be repaid in full at maturity. The Group offers both owner-occupied mortgage loans (pursuant to which the borrower is the owner and occupier of the mortgaged property) and BTL loans (pursuant to which the borrower intends to let the mortgaged property).

- Personal loans: the Group provides unsecured personal loans through its branch network and through its digital and telephone distribution channels.
- Credit cards: the Group currently offers three credit card products, Private MasterCard, Business MasterCard and Gold MasterCard.
- Overdrafts: the Group provides overdraft lending across a variety of PCA products, subject to the account holder's status.

Major customers

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

Geographical areas

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 4. Segment information (continued)

2016	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Operating segments					
Net interest income	285	472	49	-	806
Non-interest income	77	77	29	8	191
Operating income	362	549	78	8	997
Operating and administrative expenses	(70)	(119)	(540)	(152)	(881)
Impairment losses on credit exposures <sup>(1)</sup>	(30)	(9)	-	-	(39)
Segment operating profit/(loss) before tax	262	421	(462)	(144)	77
Average interest-earning assets	10,406 <sup>(2)</sup>	19,049	6,802	-	36,257

<sup>(1)</sup> The impairment losses on credit exposures figure of £9m (2015: £33m) for Retail Banking includes losses on certain retail products attributable to SME (private banking) customers.

<sup>(2)</sup> Average interest earning assets for SME Banking include £3.3bn (2015: £3.3bn) of mortgages originated by private banking.

2015	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Operating segments					
Net interest income	274	461	52	-	787
Non-interest income	77	94	6	63	240
Operating income	351	555	58	63	1,027
Operating and administrative expenses	(82)	(116)	(529)	(507)	(1,234)
Impairment losses on credit exposures <sup>(1)</sup>	(45)	(33)	-	-	(78)
Segment operating profit/(loss) before tax	224	406	(471)	(444)	(285)
Average interest-earning assets	10,908 <sup>(2)</sup>	17,400	7,472	-	35,780

The components of the 'Other' segment are £1m for gains on capital and debt restructure (2015: £63m), £7m gain on available for sale asset disposal (2015: £Nil) through non-interest income. Operating and administrative expenses include £44m for PPI redress expense (2015: £390m), £Nil for PPI handling fine (2015: £21m), £Nil for IRHP redress expense (2015: £75m), other conduct expenses £7m (2015: £Nil), £45m for restructuring expenses (2015: £17m), £11m for separation costs (2015: £10m), £Nil for pension increase exchange result (2015: £18m), £45m of impairment of intangible assets (2015: £10m), £Nil for loss on capital restructure (2015: £2m).

### 5. Net interest income

	2016 £m	2015 £m
Interest income and similar income		
Loans and advances to other banks	22	28
Financial assets available for sale	11	8
Loans and advances to customers	1,037	1,033
Financial assets at fair value through profit or loss	27	37
Due from related entities (note 12)	1	3
Other interest income	3	1
Total interest income and similar income	1,101	1,110
Less: Interest expense and similar charges		
Due to other banks	8	5
Financial liabilities at fair value through profit or loss	1	1
Due to customers	188	195
Debt securities in issue	87	82
Due to related entities (note 12)	11	40
Total interest expense and similar charges	295	323
Net interest income	806	787

### 6. Non-interest income

	2016 £m	2015 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	3	29
Other assets and liabilities at fair value	7	(29)
Ineffectiveness arising from fair value hedges (note 15)	-	1
Ineffectiveness arising from cash flow hedges (note 15)	(1)	1
Other operating income	9	2
Fees and commission	151	144
Margin on foreign exchange derivative brokerage	19	19
Gains on disposal of available for sale financial assets	8	-
Net fair value movement on investment properties	(1)	(1)
Other income	5	76
	182	238
Total non-interest income	191	240

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 6. Non-interest income (continued)

Gains less losses on financial instruments at fair value incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans and movements in fair value are recognised in the income statement as part of non-interest income. The fair value of these loans is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. In general, as interest rates fall, the fair value of the loan portfolio increases. Conversely, as interest rates rise, the fair value of the loan portfolio decreases. Similarly, if credit spreads widen, the fair value of these loans will decrease, and vice versa. A credit risk gain on fair value loans and associated liabilities of £11m, offset by a fair value loss of £4m, has been recognised in the current period (2015: £18m and £47m, respectively). The valuation technique used is reflective of current market practice.

In the year ended 30 September 2016 fees and commission income includes an additional £13m of income as a result of the acquisition of CYB Intermediaries Limited on 30 September 2015.

On 2 November 2015 Visa Inc. announced the proposed acquisition of Visa Europe Limited ('Visa Europe') which was completed on 21 June 2016. The Group was a principal member and shareholder of Visa Europe and in exchange for its share received a combination of cash and preferred stock. Following the acquisition announcement, the fair value of the

Group's share in Visa Europe was increased by £7m, with a corresponding increase in the Group's available for sale reserve. The fair value gain recognised within the available for sale reserve was recycled to the income statement on completion of the sale and is included within 'Gains on disposal of available for sale financial assets' above.

In the year ended 30 September 2016 other income includes a gain of £1m (2015: £2m) on early repurchase of medium term subordinated debt (note 28 and 12) and a gain of £Nil (2015: £61m) arising on capital restructures. A loss of £Nil arising on a capital restructure is included in related entity charges (notes 7 and 12) (2015: £2m).

In December 2014, £650m of Tier 2 subordinated debt issued was redeemed. These instruments would have become progressively ineligible for Tier 2 treatment under CRD IV's transitional rules from 1 January 2015 as well as being impacted by the introduction of a 25% capital limit under Pillar 2A. These instruments were replaced by an issue of £350m of ordinary shares and an issue of AT1 capital instruments of £150m. As a result of the redemptions, the prior year results include gains of £61m in other income arising on capital restructures and a further gain of £2m on early redemption of medium term funding on 30 September 2015, resulting in total gains in the year to 30 September 2015 of £63m.

### 7. Operating and administrative expenses

	2016 £m	2015 £m
<b>Personnel expenses</b>		
Salaries, wages and non-cash benefits	184	175
Related personnel expenses	27	22
Defined contribution pension expense	20	16
Defined benefit pension expense	28	11
Equity based compensation	5	7
Other personnel expenses	16	35
	280	266
<b>Restructuring</b>		
Restructuring expense	45	17
<b>Depreciation and amortisation expense</b>		
Depreciation of property, plant and equipment (note 19)	25	26
Amortisation of intangible assets (note 22)	63	57
	88	83
<b>Other operating and administrative expenses</b>		
Operating lease rental	30	32
Other occupancy charges	39	38
Related entity charges (note 12)	5	20
Impairment losses on software (note 22)	45	10
PPI redress expense (note 27)	44	390
Other conduct expenses (note 27)	7	75
Other operating and administrative expenses	298	303
	468	868
<b>Total operating and administrative expenses</b>	<b>881</b>	<b>1,234</b>

Related entity charges includes a loss on capital restructuring of £Nil (2015: £2m) (note 12).

During the year ended 30 September 2015, the Group's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After taking independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right

to future inflation based increases. Accounting for this change resulted in a credit to the income statement of £18m in 2015, resulting in a reduction in the defined benefit pension expense for that year.

Separation costs of £11m and £Nil (2015: £8m and £2m) are included within other operating and administrative expenses and personnel expenses respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 7. Operating and administrative expenses (continued)

	2016 £'000	2015 £'000
<b>Auditor's remuneration</b>		
Included within other operating and administrative expenses:		
Fees payable to the Company's auditor for the audit of the Company's financial statements	20	242
Fees payable to the Company's auditor for the audit of the Company's subsidiaries	1,387	858
Total audit fees	1,407	1,100
Audit related assurance services	180	337
Other assurance services	35	1,926
Total non-audit fees	215	2,263
Fees payable to the Company's auditor in respect of associated pension schemes	75	75
Total fees payable to the Company's auditor	1,697	3,438

Included within other assurance is £Nil in respect of assurance work related to the demerger and IPO (2015: £1,926k) which was paid by NAB.

The movement in audit fees from 2015 to 2016 primarily relates to the demerger and changes in the Group structure.

### 8. Taxation

	2016 £m	2015 £m
<b>Current tax</b>		
<b>UK corporation tax</b>		
Current year	12	2
Adjustment in respect of prior years	(3)	(21)
	9	(19)
<b>Deferred tax (note 23)</b>		
Current year	236	(43)
Adjustment in respect of prior years	(4)	6
	232	(37)
<b>Tax expense/(credit) for the year</b>	<b>241</b>	<b>(56)</b>

The tax assessed for the year differs from that arising from applying the standard rate of corporation tax in the UK. A reconciliation from the expense/(credit) implied by the standard rate to the actual tax expense/(credit) is as follows:

	2016 £m	2015 £m
Profit/(loss) on ordinary activities before tax	77	(285)
Tax expense/(credit) based on the standard rate of Corporation Tax in the UK of 20% (2015: 20.5%)	15	(58)
<b>Effects of:</b>		
Disallowable expenses	8	8
Conduct indemnity adjustment	(1)	-
Non-deductible FCA fine	-	4
Regulatory capital and debt restructure	-	(12)
Deferred tax assets derecognised (note 23)	237	16
Impact of rate changes	(11)	1
Adjustments in respect of prior years	(7)	(15)
<b>Tax expense/(credit) for the year</b>	<b>241</b>	<b>(56)</b>

Comparative disclosures have been amended to conform with the current period's presentation as detailed in note 1.

Finance Act (No2) 2015 introduced the Bank Surcharge for the banking entity within the Group from 1 January 2016, being an 8% charge on taxable profits above £25m before the offset of brought forward losses or group relief. There are no such taxable profits in the underlying banking entity and accordingly no surcharge liability arises.

The 'Conduct indemnity adjustment' represents the receipt from the Group's former parent less refunds attributable in accordance with the indemnity agreement (note 27).

The impact of the corporation tax rate change, restriction on loss utilisation, and the impact of management's concurrent reassessment of the recoverability of deferred tax assets, is discussed in note 23 Deferred tax.

### 9. Distributions paid

	2016 £m	2015 £m
AT1 distribution paid	35	18



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 10. Earnings per share

The Group presents basic and diluted loss per share data in relation to the ordinary shares of CYBG PLC.

	2016 £m	2015 £m
Loss attributable to ordinary shareholders	(206)	(247)
Tax relief on AT1 distribution attributable to ordinary equity holders (note 1)	7	4
Tax relief on loss on repurchase of CYBI AT1 issued to NAB	1	-
Loss attributable to ordinary equity holders for the purposes of basic and diluted EPS	(198)	(243)

The numbers of shares used for calculating the earnings per share are those of CYBG PLC. The number of CYBI shares in the comparative periods have been converted into the equivalent number of CYBG PLC shares to reflect the corporate reorganisation on 8 February 2016 (note 1).

	2016 Number of shares (million)	2015 Number of shares (million)
Weighted-average number of ordinary shares in issue		
- Basic	880	846
- Diluted	881	846
Basic loss per share (pence)	(22.5)	(28.7)
Diluted loss per share (pence)	(22.4)	(28.7)

### 11. Cash and balances with central banks

	2016 £m	2015 £m
Cash assets	1,313	1,452
Balances with central banks (including EU payment systems)	4,642	4,979
	5,955	6,431
Less mandatory deposits with central banks <sup>(1)</sup>	(43)	(44)
Included in cash and cash equivalents (note 34)	5,912	6,387

<sup>(1)</sup> Mandatory deposits are not available for use in the Group's day to day business and are non-interest bearing.

### 12. Related party transactions

As explained in note 1, on 8 February 2016, CYBG PLC became the new holding company for the CYBI Group by way of a share for share exchange and was listed on the London Stock Exchange. Following the demerger and completion of the IPO, NAB no longer controls, jointly controls or has significant influence over the Company or its subsidiaries. Consequently, there is no related party relationship between NAB and the Company or its subsidiaries following the demerger date. As a result, amounts due to and due from NAB and its controlled entities have been reclassified from 8 February 2016, as explained below.

As the related party relationship ceased between the Group and NAB at the date of the demerger, only those transactions with NAB taking place up to the demerger date are reportable as related party transactions. The comparative financial information has not been restated.

During the period there have been transactions between the Group, NAB, controlled entities of NAB, controlled entities of the Group, and other related parties. Any transactions with NAB subsequent to the demerger are not included in the disclosures below.

The Group provides a range of services to NAB and controlled entities of NAB, including the provision of banking facilities, granting loans and accepting deposits.

The Group receives a range of services from NAB and its related parties, including loans and deposits, foreign exchange and various technical and administrative services.

Subsequent to the date of the demerger, these are governed by TSAs and Reverse TSAs.

	2016 £m	2015 £m
Amounts due from NAB Group		
Loans	-	673
Other receivables	-	113
	-	786

The interest income on the amounts due from NAB was £1m to 8 February 2016 (2015: £3m) (note 5).

	2016 £m	2015 £m
Amounts due to NAB Group		
Deposits	-	125
RMBS	-	382
Subordinated debt	-	478
Other payables	-	13
	-	998

The interest expense on the amounts due to NAB was £11m to 8 February 2016 (2015: £40m) (note 5).

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

On 8 February 2016, amounts due from NAB were reclassified as amounts due from other banks. Deposits and other payables previously classified within amounts due to NAB were reclassified as amounts due to other banks. The comparative financial information has not been restated.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 12. Related party transactions (continued)

#### Derivatives

The following derivative positions were held with NAB:

	2016 £m	2015 £m
<b>Derivative financial assets</b>		
Designated as hedging instruments	-	86
Designated as held for trading	-	60
	-	146
<b>Derivative financial liabilities</b>		
Designated as hedging instruments	-	173
Designated as held for trading	-	263
	-	436

On 8 February 2016 derivative positions with NAB were reclassified as positions with third parties.

#### Subordinated debt

Subordinated debt comprises loan capital. Prior to the demerger, the subordinated debt was included within amounts due to related entities on the balance sheet. Subordinated debt outstanding at 30 September 2016 is included in debt securities in issue (note 28). The comparative financial information has not been restated.

Interest on the debt is payable at fixed rates, is subordinated to the claims of other creditors and is unsecured. The debt is employed in the general business of the Group.

On 8 February 2016, the Group repurchased £475m of subordinated debt from NAB at a market value of £474m, resulting in a gain on debt restructure of £1m included within other income (note 6). The replacement notes issued on 8 February 2016 are disclosed in note 28.

The rates of interest stated below applied to the notes prior to their repayment on 8 February 2016:	2016 £m	2015 £m
10-year, non-call with a final maturity of 20 December 2023 - LIBOR + 3.41%	-	300
10-year, non-call with a final maturity of 25 January 2021 - LIBOR + 4.42%	-	175
	-	475
Accrued interest payable	-	3
<b>Total subordinated debt</b>	-	478

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

#### Securitisation

The Group has securitised part of its residential mortgage portfolio and the cash raised from the issue of RMBS through structured entities forms part of the Group's medium term funding. A portfolio of BTL mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £352m (2015: £382m) of the securities issued are held by NAB, which is no longer a related entity. Following the demerger, these notes are included within debt securities in issue (note 28). The comparative financial information has not been restated.

#### Other transactions with NAB Group

	2016 £m	2015 £m
Gain on repurchase of subordinated debt	1	63
Non-interest income received	-	10
Other operating and administrative expenses (note 7)	5	20

#### Compensation of key management personnel (KMP)

During the year, the Group has reviewed and updated its definition of key management personnel ('KMP') for the purposes of IAS 24 (Related Party Disclosures). KMP comprises Directors of the Bank and members of the Executive Leadership Team. The 2015 comparative figure has been amended to conform with this revised definition.

	2016 £m	2015 £m
Salaries and short term benefits <sup>(1)</sup>	8	6
Other long term employee benefits <sup>(1)</sup>	1	-
Post-employment benefits <sup>(1)</sup>	-	-
Termination benefits <sup>(1)</sup>	2	2
Equity based compensation <sup>(2)</sup>	4	2
	15	10

<sup>(1)</sup> Directors' emoluments are analysed in the Directors' Remuneration Report.

<sup>(2)</sup> Basis of the expense recognised in the period in accordance with IFRS2: equity based compensations, including associated employers NIC.

The following information regarding Directors' remuneration is presented in accordance with the Companies Act 2006. Directors' remuneration figures for 2015 have been included for comparative purposes. These reflect the remuneration received by the Directors, as Directors of CYBI and CB PLC during 2015.

	2016 £m	2015 £m
Aggregate remuneration <sup>(1)</sup>	6	3
Long term incentive plans	-	-
	6	3

<sup>(1)</sup> Aggregate remuneration and benefits are set out on a different basis to the Directors' Remuneration Report, in line with statutory requirements.

None of the Directors were members of the Group's defined contribution pension scheme during 2016 (2015: Nil). One of the Directors was a member of the Group's defined benefit pension scheme during 2016 (2015: one). None of the Directors hold share options and none were exercised during the year (2015: Nil).

#### Transactions with KMP

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

	2016 £m	2015 £m
Loans and advances	8	11
Deposits	3	1

No provisions have been recognised in respect of loans provided to KMPs (2015: £Nil). There were no debts written off or forgiven during the year to 30 September 2016 (2015: £Nil). Included in the above are six (2015: ten) loans totalling £74m (2015: £9.5m) made to Directors. In addition to the above, there are guarantees of £0.4m (2015: £0.4m) made to Directors and their related parties.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 12. Related party transactions (continued)

#### Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.5m in the year ended 30 September 2016 (2015: £0.6m), were charged to the Group sponsored Scheme. The Group has deposits of £31.7m (2015: £2.1m) at the year end placed by the Scheme at market rates.

Pension contributions of £84m (2015: £51m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (note 29).

The Group also has a £Nil (2015: £3m) term deposit balance due to the Group's associated entity (note 21) on normal commercial terms. The balance is disclosed within due to customers (note 26).

### 13. Financial assets available for sale

	2016 £m	2015 £m
Listed securities	1,695	1,447
Unlisted securities	29	8
Other financial assets	7	7
	1,731	1,462

#### Listed securities

Included in the available for sale (AFS) listed securities are £1,286m (2015: £1,274m) in UK Government Gilts.

increased by £20m to £25m at 30 September 2016 (2015: £5m), with the corresponding gain recognised in the available for sale reserve within equity.

#### Unlisted securities

These consist of unquoted equity and debt instruments, primarily:

##### *VocaLink Holdings Limited (VocaLink)*

On 21 July 2016, MasterCard announced that it has entered into a definitive agreement to acquire 92.4% of VocaLink for consideration of £700m with an additional earn out of £169m based on attainment of certain performance targets. The allocation of earn out between equity holders varies depending on the exit option chosen. The transaction is subject to regulatory approvals and the completion date is uncertain. VocaLink is an unquoted company which operates the BACS and direct debit schemes in the UK as well as connecting ATMs using the LINK network. The Group currently owns a 3.24% shareholding in VocaLink. Following the announcement of the sale, the fair value of the Group's investment in VocaLink was

##### *Visa Inc.*

Included within financial assets available for sale – unlisted securities at 30 September 2016 is £2m (2015: £Nil) representing the fair value of Visa Inc. preferred stock received as partial consideration for the sale of the Group's share in Visa Europe (note 6). The preferred stock is convertible into Visa Inc. common stock or its equivalent at a future date, subject to potential reduction for certain litigation losses that may be incurred by Visa Europe.

#### Other financial assets

The other AFS financial asset of £7m represents deferred consideration receivable and consists of the rights to future commission.

For further information on valuation methodology for available for sale assets and their classification within the fair value hierarchy, refer to note 37.

Credit quality of investments	2016 £m	2015 £m
Available for sale		
Senior investment grade	1,695	1,447
Other	36	15
	1,731	1,462

### 14. Other financial assets and liabilities at fair value

	2016 £m	2015 £m
Other financial assets at fair value through profit or loss		
Loans and advances	750	1,097
Other financial liabilities at fair value through profit or loss		
Due to customers – term deposits	48	67

Derivatives which do not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 15).

#### Loans and advances

Included in other financial assets at fair value is a historical portfolio of loans (sales ceased in 2012). Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £750m (2015: £1,097m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £24m (2015: £38m) and the change for the current year is a decrease of £14m (2015: decrease of £36m).

The loans are classified as Level 3 in the fair value hierarchy (note 37).

#### Due to customers – term deposits

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

The change in fair value attributable to changes in the Group credit risk is £Nil (2015: £Nil). The Group is contractually obligated to pay £3m (2015: £4m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as Level 3 in the fair value hierarchy (note 37).



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 15. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, derivatives that do not meet the hedging criteria within IAS 39, or those for which hedge accounting is not desirable, are accounted for as

held for trading (although they are used for risk mitigation). The tables below analyse derivatives between those designated as hedging instruments and those classified as held for trading.

	2016 £m	2015 £m
<b>Fair value of derivative financial assets</b>		
Designated as hedging instruments	351	103
Designated as held for trading	234	182
	<b>585</b>	285
<b>Fair value of derivative financial liabilities</b>		
Designated as hedging instruments	257	244
Designated as held for trading	341	290
	<b>598</b>	534

Cash collateral on derivatives placed with banks totalled £337m as at 30 September 2016 (2015: £246m). Cash collateral received on derivatives totalled £57m as at 30 September 2016 (2015: £Nil). These amounts are included within due from other banks and due to other banks respectively.

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

Total derivative contracts as at 30 September 2016	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
<b>Derivatives designated as hedging instruments</b>			
<i>Cash flow hedges</i>			
Interest rate swaps	15,526	154	79
Cross currency swaps	760	88	-
Forward contracts	5	-	-
	16,291	242	79
<i>Fair value hedges</i>			
Interest rate swaps	1,452	109	178
<b>Derivatives designated as held for trading</b>			
<i>Foreign exchange rate related contracts</i>			
Spot and forward contracts	2,202	84	78
Cross currency swaps	150	11	11
Options	216	5	5
	2,568	100	94
<i>Interest rate related contracts</i>			
Swaps	1,512	123	233
Swaptions	47	-	1
Options	569	2	4
	2,128	125	238
Commodity related contracts	127	9	9
<b>Total derivative contracts</b>	<b>22,566</b>	<b>585</b>	<b>598</b>

### Total derivative contracts as at 30 September 2015

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

Derivatives traded to manage the Group's interest rate exposure on a net portfolio basis are accounted for as cash flow hedges. Derivatives traded to manage interest rate risk on certain fixed rate assets, such as UK Government Gilts, are accounted for as fair value hedges. In addition, the Group cash flow hedges its foreign currency exposure on material, highly probable non-GBP denominated transactions.

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

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 15. Derivative financial instruments (continued)

Nominal values per time period	2016 £m	2015 £m
Within 0 to 3 months	1,452	4,230
Between 3 and 12 months	6,710	2,028
1 to 5 years	8,063	11,148
Greater than 5 years	66	92
	16,291	17,498

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

	Forecast receivable cash flows 2016 £m	Forecast payable cash flows 2016 £m	Forecast receivable cash flows 2015 £m	Forecast payable cash flows 2015 £m
Within 1 year	29	261	47	112
Between 1 and 2 years	16	368	38	235
Between 2 and 3 years	15	59	26	319
Between 3 and 4 years	14	77	21	57
Between 4 and 5 years	8	112	9	68
Greater than 5 years	-	6	-	96
	82	883	141	887

	2016 £m	2015 £m
Gain/(loss) arising from fair value hedges (note 6)		
Hedging instrument	15	109
Hedged item attributable to the hedged risk	(15)	(108)
	-	1

	2016 £m	2015 £m
(Loss)/gain from cash flow hedges due to hedge ineffectiveness (note 6)	(1)	1

### 16. Loans and advances to customers

	2016 £m	2015 £m
Overdrafts	1,536	1,563
Credit cards	400	376
Lease finance	515	426
Mortgages	21,836	20,504
Other term lending – SME	4,393	4,025
Other term lending – retail	690	763
Other lending	26	30
Gross loans and advances to customers	29,396	27,687
Accrued interest receivable	76	75
Unearned income	(26)	(26)
Deferred and unamortised fee income	(29)	(24)
Impairment provisions on credit exposures (note 17)	(215)	(230)
	29,202	27,482

The Group has transferred £5,435m (2015: £5,923m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 18). The mortgages do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements, the Group continues to be exposed primarily to the credit, liquidity and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities is £3,208m (2015: £3,413m) (note 18).

Included within Group loans and advances to customers are £1,149m (2015: £1,475m) of mortgages assigned to a bankruptcy remote structured entity, Clydesdale Covered Bonds No. 2 LLP (note 18). These loans provide security for covered bond issuances made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2016 there were £797m (2015: £721m) of covered bonds in issue under the covered bond programme (note 18).

The Group also has a portfolio of fair valued business loans and advances of £750m (2015: £1,097m) (note 14). Combined with the above this is equivalent to total loans and advances of £29,952m (2015: £28,579m).

Further information on the Group's loans and advances to customers and impairment provisions on credit exposures is included within the Risk Report.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 16. Loans and advances to customers (continued)

#### Lease finance

The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The cost of assets acquired by the Group during the year for the purpose of letting under finance leases

and hire purchase contracts amounted to £5m (2015: £2m) and £381m (2015: £297m) respectively. The total receivables from finance leases and hire purchase contracts were £8m (2015: £6m) and £482m (2015: £395m) respectively.

Finance lease and hire purchase receivables	2016 £m	2015 £m
Gross investment in finance lease and hire purchase receivables		
Due within 1 year	224	183
Due within 1 to 5 years	288	241
Due after more than 5 years	3	2
	515	426
Unearned income	(25)	(25)
Net investment in finance lease and hire purchase receivables	490	401

### 17. Impairment provisions on credit exposures

	2016 £m	2015 £m
Opening balance	230	245
Charge for the year	39	78
Amounts written off	(68)	(100)
Recoveries of amounts written off in previous years	18	12
Other <sup>(1)</sup>	(4)	(5)
Closing balance	215	230
Specific	64	92
Collective	151	138
	215	230

<sup>(1)</sup> Other includes the unwind of net present value elements of specific provisions and other minor movements.

	2016 £m	2015 £m
Amounts included in		
Loans and advances to customers (note 16)	215	230
Non-accrual loans		
Loans and advances to customers	214	238
Specific provisions	(64)	(92)
	150	146

Further information on impairment provisions on credit exposures and related credit information is set out within the Risk Report.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 18. Securitisations and covered bonds

#### Securitisations

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

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

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

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

The assets and liabilities in relation to securitisation and covered bonds in issue at 30 September 2016 within the consolidated balance sheet are as follows:

#### Covered bonds

2016	Securitisation £m	Covered bonds £m	Total £m
At 1 October 2015	3,031	721	3,752
Issuance of debt	750	-	750
Reclassification of notes previously held internally	380	-	380
Repayments	(1,029)	-	(1,029)
Other movements	76	76	152
<b>At 30 September 2016</b>	<b>3,208</b>	<b>797</b>	<b>4,005</b>
<b>Securitisised assets</b>	<b>5,435</b>	<b>1,149</b>	<b>6,584</b>

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

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

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

Included within the securitisation notes disclosed above are £352m (initial transfer value of £380m less repayments during the year of £28m) of Lannraig debt securities (including accrued interest) which are held by NAB and were

previously disclosed within amounts due to related entities (note 12). Following the demerger, these notes are included within debt securities in issue (note 28).

The following table sets out the net position of the fair value of financial assets where the counterparty to the associated liabilities has recourse only to the financial assets:

	2016		2015	
	Securitisation £m	Covered Bonds £m	Securitisation £m	Covered Bonds £m
Fair value of transferred assets	5,417	-	5,870	-
Fair value of associated liabilities	3,233	-	3,048	-
	<b>2,184</b>	<b>-</b>	<b>2,822</b>	<b>-</b>

There were no events in the year that caused any Group transferred financial assets to be derecognised.

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

#### Securitisation vehicles

The Group provides credit support to the structured entities via reserve funds through subordinated debt arrangements and by holding junior notes. The carrying value of exposures totalled £20m in subordinated debt (2015: £Nil) and £610m in junior notes held (2015: £593m) at the reporting date. The Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities as at the reporting date of £977m (2015: £1,308m). Furthermore, the Group has an obligation to repurchase mortgage exposures if certain representations and warranties are breached.

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

#### Covered bonds

At the reporting date the nominal level of over-collateralisation was £599m (2015: £855m) of the outstanding covered bonds. From time to time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme. Furthermore, the Group has an obligation to repurchase mortgage exposures if certain representations and warranties are breached.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 19. Property, plant and equipment

	Freehold land and buildings £m	Long term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
<b>Cost or valuation</b>					
At 1 October 2014	11	3	161	114	289
Additions	-	-	10	9	19
Disposals	(1)	-	(7)	(11)	(19)
Transfers	-	-	7	(7)	-
<b>At 30 September 2015</b>	<b>10</b>	<b>3</b>	<b>171</b>	<b>105</b>	<b>289</b>
Additions	-	-	15	7	22
Disposals	(4)	-	(32)	(12)	(48)
<b>At 30 September 2016</b>	<b>6</b>	<b>3</b>	<b>154</b>	<b>100</b>	<b>263</b>
<b>Accumulated depreciation</b>					
At 1 October 2014	1	-	92	75	168
Charge for the year	-	-	14	12	26
Disposals	-	-	(4)	(10)	(14)
Transfers	-	-	3	(3)	-
<b>At 30 September 2015</b>	<b>1</b>	<b>-</b>	<b>105</b>	<b>74</b>	<b>180</b>
Charge for the year (note 7)	-	-	15	10	25
Disposals	-	-	(30)	(11)	(41)
<b>At 30 September 2016</b>	<b>1</b>	<b>-</b>	<b>90</b>	<b>73</b>	<b>164</b>
<b>Net book value</b>					
<b>At 30 September 2016</b>	<b>5</b>	<b>3</b>	<b>64</b>	<b>27</b>	<b>99</b>
<b>At 30 September 2015</b>	<b>9</b>	<b>3</b>	<b>66</b>	<b>31</b>	<b>109</b>

#### Valuations

The Group's freehold and long term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Group's own Directors' valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors, including adjustments to observable market inputs reflecting any specific characteristics of the land and buildings

(Level 3 of the fair value hierarchy as defined in note 37). Valuations are performed annually in July.

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

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

	2016 £m	2015 £m
Carrying value as included on the revaluation basis	8	12
Carrying value if the historical cost basis had been used	7	10

### 20. Investment properties

	2016 £m	2015 £m
At 1 October	32	44
Disposals	(10)	(11)
Revaluation	-	(1)
<b>At 30 September</b>	<b>22</b>	<b>32</b>

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

Investment property is compared to property for which there is observable market data about its realisable value on disposal. Adjustments to this observable data are applied for specific characteristics of the property such as the nature, location or condition of the specific asset. Investment properties are classified in Level 3 of the fair value hierarchy

as defined in note 37. There has been no change to the valuation technique during the year. There were no transfers between levels of the fair value hierarchy during the year.

During the year, 97% (2015: 99%) of the investment properties generated total rental income of £1m (2015: £2m) and incurred operating and administrative expenses of £1m (2015: £1m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2015: £Nil).

### 21. Investments in controlled entities and associates

	2016 £m	2015 £m
<b>At 30 September</b>	<b>-</b>	<b>2</b>

#### Associates

Associates are undertakings over which the Group exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2016. The Group has an interest in The Scottish Agricultural Securities Corporation PLC which is registered and operates in Scotland. This investment is accounted for as an associate undertaking on the basis that the Group has significant

influence but not control. The associated undertaking's principal activity was the provision of finance and the Group's interest of 33.33% in the issued equity capital of £Nil is held by Clydesdale Bank PLC. The associated undertaking has a 31 March year end. As at 30 September 2016, The Scottish Agricultural Securities Corporation PLC was in the process of being liquidated.

The controlled entities of the Group and Company are provided in note 42.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 21. Investments in controlled entities and associates (continued)

#### Structured entities

The Group sponsors the formation of structured entities, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well-defined objectives. Although the Group has no shareholding in these entities, where it is exposed, or has rights, to variable returns from its involvement with the entities and it has the ability to affect those returns through

its power over the entity, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's financial statements.

Details of the Group's interests in consolidated structured entities are set out in note 18.

The following companies are consolidated structured entities:

#### Other controlled entities as at 30 September 2016

	Nature of business	Country of incorporation
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England
Lanark Holdings Limited	Holding company	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Trustees Limited	Mortgages trustee	England
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Holdings Limited	Holding company	England
Lannraig Trustees Limited	Mortgage trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

On 15 July 2016 the business activities of Lanark Trustees Limited (Jersey) transferred to Lanark Trustees Limited (England). All of the above controlled entities have financial year end of 30 September.

#### Common control business combinations

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

#### Significant restrictions

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

#### Contractual requirements - asset encumbrance

The Group uses its financial assets to raise finance in the form of securitisations and through the sale of securities subject to repurchase agreements leading to the assets becoming encumbered. Once encumbered, the assets are not available for transfer around the Group. The encumbered assets are disclosed in the Risk Report, and in relation to securitisation, are disclosed in note 18.

### 22. Intangible assets

Capitalised software costs	2016 £m	2015 £m
<b>Cost</b>		
At 1 October	427	354
Additions	99	119
Disposals	-	(41)
Write-off	(63)	(5)
<b>At 30 September</b>	<b>463</b>	427
<b>Accumulated amortisation</b>		
At 1 October	162	141
Disposals	-	(41)
Charge for the year (note 7)	63	57
Write-off	(63)	(5)
Impairment (note 7)	45	10
<b>At 30 September</b>	<b>207</b>	162
<b>Net book value at 30 September</b>	<b>256</b>	265

Impairment testing of capitalised software assets is performed in accordance with IAS 36. The impairment charge follows a detailed review of the recoverable amount of the various assets. Where the benefits associated with the software were substantially reduced from what had originally been anticipated, or the asset has been superseded by a subsequent investment, the software has been written down to its recoverable

amount. An impairment charge of £45m has been recognised in the year to 30 September 2016 (2015: £10m).

Intangible assets are reviewed annually to consider whether these assets are currently in use. Fully amortised intangible assets of £63m (2015: £5m) that were no longer in use were written off during the year.

### 23. Deferred tax

Movement in net deferred tax asset	2016 £m	2015 £m
At 1 October	379	339
Recognised in the income statement (note 8)	(232)	37
Recognised directly in equity	9	3
<b>At 30 September</b>	<b>156</b>	379



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 23. Deferred tax (continued)

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

	2016 £m	2015 £m
<b>Deferred tax assets</b>		
Tax losses carried forward	35	273
Capital allowances	127	108
Cash flow hedge reserve	1	4
Impairment provision on credit exposures	-	3
Employee equity based compensation	2	1
Defined benefit pension scheme deficit	18	-
	<b>183</b>	389
<b>Deferred tax liabilities</b>		
Defined benefit pension scheme surplus	-	(10)
Cash flow hedge reserve	(21)	-
Gains less losses on financial instruments at fair value	(6)	-
	<b>(27)</b>	(10)
<b>Net deferred tax asset</b>	<b>156</b>	379

At 30 September 2016, the Group had an unrecognised deferred tax asset of £202m (2015: £16m) representing trading losses with a gross value of £1,186m (2015: £80m). A deferred tax asset has not been recognised in respect of these losses as the Directors have insufficient certainty over their recoverability in the foreseeable future. Under current UK tax legislation there is no prescribed time period for loss utilisation, however, as outlined in "Emerging/Principal risk and uncertainties", the UK tax environment for banks in particular is unsettled and has been subject to repeated change and increased restrictions, principally on the use of historic losses as discussed below. As a result the period over which brought forward losses will be used to offset taxable profits in the future has lengthened considerably.

The statutory rate of UK corporation tax is 20% from 1 April 2015. A series of reductions in that rate have been enacted by subsequent legislation, in particular to 19% from 1 April 2017 and to 17% from 1 April 2020. In accordance with IAS 12, these rates are taken into account in assessing the value

at which assets are expected to be realised and liabilities settled. In addition, from 1 April 2016, only 25% of a bank's profits can be relieved by brought forward losses, significantly extending the timeframe taken to realise value for existing tax losses and capital allowances. This is a further significant restriction on top of the 50% limit imposed at 1 April 2015.

In accordance with IAS 12, the Directors have re-assessed the recoverability of the deferred tax assets, and have chosen to derecognise deferred tax assets relating to those losses that the Group does not expect to be able to utilise within the Group's current corporate planning horizon. The combined impact of the legislative changes outlined above, and the Directors' reassessment of the recoverable horizon, is £226m, within a total deferred tax charge (note 8) of £232m.

The deferred tax asset of £0.6m and liability of £21.3m in respect of cash flow hedge reserves (2015: £4.0m asset) relate to different entities within the Group.

### 24. Other assets

	2016 £m	2015 £m
Prepayments and accrued income	29	35
Other (including items in the course of collection)	159	142
	<b>188</b>	177

### 25. Due to other banks

	2016 £m	2015 £m
Transaction balances with other banks	23	-
Securities sold under agreements to repurchase *	1,226	-
Deposits from other banks	60	393
	<b>1,309</b>	393

\* The underlying securities sold under agreements to repurchase have a carrying value of £1.657m (2015: £Nil).

### 26. Due to customers

	2016 £m	2015 £m
Non-interest bearing demand deposits	2,160	1,986
Interest bearing demand deposits	19,328	18,786
Term deposits	5,454	5,416
Other wholesale deposits	12	94
	<b>26,954</b>	26,282
Accrued interest payable	136	125
	<b>27,090</b>	26,407

Included within term deposits is £Nil (2015: £3m) relating to the Group's associated entity (notes 12 and 21).

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27. Provisions for liabilities and charges

	2016 £m	2015 £m
<b>PPI redress provision</b>		
Opening balance	774	515
Charge to the income statement (note 7)	44	390
Charge reimbursed under Conduct Indemnity	406	-
Utilised	(499)	(131)
Closing balance	725	774
<b>Customer redress and other provisions</b>		
Opening balance	214	413
Charge to the income statement (note 7)	8	76
Charge reimbursed under Conduct Indemnity	27	-
Utilised	(148)	(275)
Closing balance	101	214
<b>Restructuring provision <sup>(1)</sup></b>		
Opening balance	18	24
Charge to the income statement	39	17
Utilised	(31)	(23)
Closing balance	26	18
<b>Total provisions for liabilities and charges</b>	<b>852</b>	<b>1,006</b>

<sup>(1)</sup> Restructuring provision includes surplus lease space provision.

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated. The most significant of the provisions held at 30 September 2016 are in relation to conduct risk related liabilities. The Group's economic exposure to the impact of historic conduct related liabilities is mitigated by the Capped Indemnity from NAB (see below).

The Group has provided its best estimate of conduct risk related liabilities at 30 September 2016 which have arisen as a result of its historical products and past sales practices.

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

**PPI redress**

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. In the first half of the year the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £450m was required incorporating the Group's estimate of the impact of CP 15/39 and a proposed time bar for complaints in summer 2018. It also incorporated a reassessment of the costs of processing cases and the impact of experience adjustments. Only 9.7% of the charge impacts the Group's income statement (£44m) as a result of the Capped Indemnity. Following the FCA's updated proposal in respect of the time bar and Plevin in CP 16/20 issued on 26 July 2016, the provision was reassessed in the light of these proposals and recent experience. No further change was made. The total provision raised to date in respect of PPI is £1,646m (2015: £1,196m), with £725m of this remaining (2015: £774m) comprising £299m for customer initiated complaints and proactive customer contact (2015: £301m); £257m for the

remediation of complaints closed prior to August 2014 (2015: £270m); and £169m for costs of administering the redress programme (2015: £203m).

To 30 September 2016, the Group has received 282,000 complaints and has allowed for 59,000 further walk in complaints.

The Group implemented a comprehensive new PPI complaint handling process from August 2014 which involved making a number of significant changes to the PPI operations, which resulted in an increase in operational and administrative costs, in addition to committing to undertake a full review of PPI complaints that were closed prior to August 2014 (approximately 180,000). The Group has begun to reopen these complaints and review the original decisions reached in light of the new PPI complaint handling processes. The provision at 30 September 2016 includes a redress provision of £257m for this review.

In addition to the remediation activity described above, the Group is undertaking a past business review (PBR) of certain PPI sales to determine if there was actual or potential customer detriment in the sales process leading to a risk of mis-sale and the potential for proactive redress. The provision increase booked in March 2016 incorporated a revised estimate of the cost of contacting and redressing, where appropriate, customers who have faced actual detriment or may have experienced potential detriment but who have not actually raised a claim. Proactive customer mailings commenced in March 2016 and will be complete by the end of the calendar year. Key inputs to the calculation of the costs estimate, such as the level of customer response to mailings, are not currently known but have been based on relevant

historical experience and related industry data. Actual experience to date has been below the assumptions used but further customer responses will be received.

The increase in provision, recorded at 31 March 2016, took into account all of the above factors as well as a revision in the Group's expectation of new customer initiated complaints in light of current experience with the overall provision based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including: (i) the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies, the proposed but delayed application of a time bar, Plevin, and FCA advertising); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; (iv) any additional amounts that may need to be paid in respect of previously handled claims; (v) the response rates to the proactive customer contact; and (vi) the costs of administering the remediation programme.

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

The table below sets out the key assumptions and the effect on the provision at 30 September 2016 of future, potential, changes in key assumptions:

Assumptions	Change in assumption	Sensitivity <sup>(1)</sup>
Number of expected future customer initiated complaints	+/-10%	£16m
<b>Uphold rates:</b>		
Future complaints	+/-1%	£3m
Pre August 2014 complaints review	+/-1%	£6m
<b>Customer contact response rate</b>		
PBR customer contact response rate <sup>(2)</sup>	+/-1%	£4m
Average redress costs <sup>(3)</sup>	+/-1%	£5m

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

<sup>(2)</sup> The Group's current estimate includes an expected customer response rate of 40%. Approximately 85,000 proactive customer mailings will be sent.

<sup>(3)</sup> Sensitivity to a change in average redress across customer initiated complaints, pre August 2014 complaints review and PBR customer populations.

27. Provisions for liabilities and charges (continued)

The number of complaints received is monitored against past experience and future expectations and the Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop.

Customer redress and other provisions

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

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

The Group also undertook a secondary review of all past fixed rate tailored business loans (FRTBL) complaints not in the scope of the formal review. Where the secondary complaint assessment identified a different outcome, the customer has been contacted and, if appropriate, redress offered. The Group is also dealing with a number of new complaints from customers in relation to FRTBLs.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for all of these matters and concluded that no changes to the level of provision held are required, reflecting the continued wind down of the formal programmes, which are expected to have completed within the next six months, and the current level of complaints received.

Other provisions also include amounts in respect of a number of individually less significant conduct related matters, legal proceedings, and claims arising in the ordinary course of the Group's business. Over the course of the year the Group has

raised further provisions of £35m for these matters, the majority of which were offset by the Conduct Indemnity. The ultimate cost to the Group of other customer redress matters is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. The matters are at varying stages of their lifecycle and in certain circumstances, usually early in the life of a potential issue, elements of the potential exposure are contingent (note 33). These factors could result in the total cost of review and redress varying materially from the Group's current estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required. During the year £1m was recognised for provisions not related to customer redress/conduct risk.

Conduct Indemnity Deed

The Company and NAB have entered into an agreement under which NAB has provided the Company with a Capped Indemnity to meet the costs of dealing with conduct matters related to products sold in the period prior to the demerger date (the "Conduct Indemnity Deed"). The legacy conduct matters covered by the Capped Indemnity are referred to as "Relevant Conduct Matters". The Capped Indemnity provides the Group with economic protection against certain costs and liabilities (including financial penalties imposed by a regulator) resulting from conduct issues relating to:

- a) PPI, standalone interest rate hedging products, voluntary scope tailored business loans and fixed rate tailored business loans; and
- b) Other conduct matters, subject to certain limitations and minimum financial thresholds.

Amounts payable under the Capped Indemnity include, subject to certain limitations, payments to customers to satisfy, settle or discharge a Relevant Conduct Matter and the direct costs and expenses of satisfying, settling, discharging or administering such Relevant Conduct Matter.

It has been agreed that NAB will meet 90.3% of Qualifying Conduct Costs claimed by the Company, up to the amount of the Capped Indemnity.

Claims under the Capped Indemnity are recognised in the consolidated income statement simultaneously with the charge for Relevant Conduct Matters. The conduct expense

and associated reimbursement income are presented net within Other operating and administrative expenses. A reimbursement receivable is recognised on the consolidated balance sheet within Due from Other Banks; this receivable is periodically settled by NAB. The reimbursement receivable is not offset against the provision amount on the Group's consolidated balance sheet. The provision expense and reimbursement income are disclosed above.

No reimbursement income or receivable is recognised on the consolidated balance sheet in relation to contingent liabilities for Relevant Conduct Matters. Any possible future reimbursement income linked to contingent liabilities in respect of Relevant Conduct Matters is not disclosed as a contingent asset as the amounts cannot be reliably estimated and are not virtually certain to be received.

To the extent that it is no longer probable that provisions for a Relevant Conduct Matter previously raised will be required to settle conduct obligations and a provision for a Relevant Conduct Matter is released as unutilised, the related Capped Indemnity amounts received will become repayable to NAB.

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

The utilisation and undrawn balance of the Capped Indemnity is set out below:

	Conduct protection £m
Conduct protection provided by NAB	1,700
Capital injected into CYBI prior to demerger <sup>(1)</sup>	(120)
Drawn in period to 30 September 2015 <sup>(2)</sup>	(465)
Undrawn Conduct Indemnity as at 30 September 2015	1,115
Drawn in the period to 30 September 2016	(433)
Undrawn balance as at 30 September 2016	682

<sup>(1)</sup> £120m of the £670m of capital injected in CYBI on 24 September 2015 was related to the Conduct Indemnity Deed.  
<sup>(2)</sup> £465m represents the Pre-Covered provision amount.

Restructuring provision

Restructuring of the business is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. In the year £45m (2015: £17m) was charged to the income statement of which £6m (2105: £Nil) was charged directly to the income statement and £39m (2015: £17m) was provided for in accordance with the requirements of IAS 37, with £31m (2015: £23m) of the total provision being utilised in the period.

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 28. Debt securities in issue

	Subordinated debt £m	Securitisation £m	Covered bonds £m	2016 Total £m	2015 Total £m
Carrying value	477	3,208	698	4,383	3,714 <sup>(1)</sup>
Fair value hedge adjustments	-	-	99	99	38
Total debt securities	477	3,208	797	4,482	3,752
Accrued interest payable	3	6	10	19	14
	480	3,214	807	4,501	3,766

<sup>(1)</sup> £3,017m related to securitisation and £697m related to covered bonds.

There were no new issuances of covered bonds during the year. The following new issuance of securitised debt occurred:

- 4 August 2016 – GBP 750m Lanark 2016-1 1A.

The following redemptions occurred during the year in line with the scheduled programme terms:

- 22 February 2016 – USD 800m Lanark 2012-2 1A note;
- 22 August 2016 – USD 300m Lanark 2013-1 1A1 note; and
- 22 August 2016 – GBP 350m Lanark 2013-1 1A2 note.

On 8 February 2016, the Group repurchased £475m of subordinated debt from NAB at a market value of £474m,

resulting in a gain on debt restructure of £1m included within other income (note 6). On the same day the Group issued £475m of 10 year, non-call five years, fixed 5% subordinated debt with a final maturity date of 9 February 2026 to NAB.

Following the demerger from NAB on 8 February 2016, subordinated debt and securitised debt issued to NAB, previously included within amounts due to related entities (note 12), were included within debt securities in issue. Comparative financial information has not been restated. In September 2016 the subordinated debt was remarketed and sold by NAB. Accordingly at 30 September 2016 the debt was no longer held by NAB.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC as at 30 September 2016 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Call date
<b>Class A RMBS</b>				
27 July 2012	GBP	440	3M GBP LIBOR + 1.63%	22 November 2017
19 March 2014	EUR	214	3M EURIBOR + 0.40%	22 August 2017
19 March 2014	GBP	311	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	EUR	389	3M EURIBOR + 0.40%	22 August 2018
11 December 2014	GBP	274	3M GBP LIBOR + 0.60%	22 February 2020
6 August 2015	GBP	239	3M GBP LIBOR + 0.50%	22 August 2018
6 August 2015	EUR	241	3M EURIBOR + 0.45%	22 May 2021
4 August 2016	GBP	748	3M LIBOR +1.00%	22 February 2019
<b>Class A BTL RMBS</b>				
30 September 2011	GBP	352	3M GBP LIBOR + 2.20%	19 November 2017
		3,208		
<b>Covered bonds</b>				
31 May 2012	GBP	797	4.63%	8 June 2026
		4,005		

### 29. Retirement benefit obligations

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

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

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members.

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

	2016 £m	2015 £m
Active members' defined benefit obligation	(1,264)	(891)
Deferred members' defined benefit obligation	(1,776)	(1,299)
Pensioner and dependent members' defined benefit obligation	(1,497)	(1,323)
Total defined benefit obligation	(4,537)	(3,513)
Fair value of scheme assets	4,462	3,565
<b>Net defined benefit pension (liability)/asset</b>	<b>(75)</b>	52
<b>Post-retirement medical benefits obligations</b>	<b>(4)</b>	(4)

IAS 19 allows the recognition of an asset, which reflects the Group's ability to recover a surplus either through reduced contributions in the future or through refunds from the Scheme following the settlement of plan assets once all members have left the Scheme.

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

The last scheme funding valuation was at 30 September 2013 with a calculated deficit of £450m. In the recovery plan dated 7 May 2014 the Group agreed to make the following contributions to eliminate the deficit: £65m on 1 October 2013; £150m by 30 June 2014; £50m on 1 October 2017; thereafter £50m annually until 1 October 2021; and £55m on 1 October 2022. Work in relation to the 30 September 2016 scheme funding valuation is presently under way.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 29. Retirement benefit obligations (continued)

Reconciliation of the net defined benefit pension asset/(liability)	2016 £m	2015 £m
Opening net defined benefit pension scheme asset	52	49
Service cost	(31)	(11)
Interest on net defined benefit (liability)/asset	3	3
Remeasurement effects recognised in SOCI	(179)	(36)
Employer contributions	84	51
Administrative expenses	(4)	(4)
<b>Closing fair value of net defined benefit pension scheme (liability)/asset</b>	<b>(75)</b>	52

Reconciliation of the defined benefit pension scheme assets	2016 £m	2015 £m
Opening fair value of defined benefit pension scheme assets	3,565	3,269
Interest income on scheme assets at discount rate	135	133
Return on scheme assets greater than discount rate	791	206
Employer contributions (note 12)	84	51
Benefits paid	(90)	(84)
Transfer payments	(19)	(6)
Administrative costs paid	(4)	(4)
<b>Closing fair value of defined benefit pension scheme assets</b>	<b>4,462</b>	3,565

Reconciliation of the defined benefit pension scheme obligations	2016 £m	2015 £m
Opening defined benefit pension scheme obligations	(3,513)	(3,220)
Current service cost	(27)	(27)
Past service (cost)/credit	(4)	16
Interest expense on the defined benefit obligation	(132)	(130)
Actuarial gain - experience adjustments	51	40
Actuarial loss - financial assumptions	(1,021)	(282)
Benefits paid from scheme assets	90	84
Transfer payments	19	6
<b>Closing defined benefit pension scheme obligations</b>	<b>(4,537)</b>	(3,513)

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

	2016 £m	2015 £m
<i>Quoted</i>		
Equities	784	645
Government bonds	1,640	1,382
Global sovereign bonds	38	49
Corporate bonds	968	767
Infrastructure	254	217
Secure income alternatives	124	67
Derivatives <sup>(1)</sup>	440	229
Other	6	45
Cash	93	32
<i>Unquoted</i>		
Property	115	132
<b>Fair value of defined benefit pension scheme assets</b>	<b>4,462</b>	3,565

<sup>(1)</sup> Derivative financial instruments are used to modify the profile of the assets of the Scheme to better match the Scheme's liabilities. Derivative holdings may lead to increased or decreased exposures to the physical asset categories disclosed above.

The Scheme is not invested in any of the Group's own financial instruments.

other risks typical of the assets held, in particular credit risk on bonds and exposure to the property market.

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

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

Amounts recognised in the income statement	2016 £m	2015 £m
Current service cost	27	27
Past service cost/(credit)	4	(16)
Net interest on net defined benefit (liability)/asset	(3)	(3)
<b>Defined benefit expense for the year</b>	<b>28</b>	8
Administration costs incurred	4	4
<b>Cost recognised in the income statement (note 7)</b>	<b>32</b>	12

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 29. Retirement benefit obligations (continued)

During the year ended 30 September 2015 the Group's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After the taking of independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change resulted in a one-off credit to the income

statement of £18m in the prior year (shown within past service costs).

In the current and prior year, past service cost of £4m (2015: £2m) relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements, and in both years these were fully offset in the income statement by a corresponding release from the restructure provision.

Amounts recognised in the statement of comprehensive income	2016 £m	2015 £m
Opening cumulative actuarial losses	(670)	(634)
Actuarial gain due to liability experience adjustments	51	40
Actuarial loss due to liability assumption changes	(1,021)	(282)
Return on scheme assets greater than discount rate	791	206
<b>Cumulative actuarial losses recognised in the statement of comprehensive income</b>	<b>(849)</b>	<b>(670)</b>

Actuarial assumptions	2016 % p.a.	2015 % p.a.
<b>Financial assumptions</b>		
Discount rate	2.38	3.80
Inflation (RPI)	3.02	3.25
Inflation (CPI)	2.02	2.25
Career average revalued earnings (CARE) revaluations:		
Pre 31 March 2012 benefits (RPI)	3.02	3.25
Post 31 March 2012 benefits (CPI capped at 5% per annum)	2.02	2.25
Pension increases (capped at 2.5% per annum)	2.05	2.10
Pension increases (capped at 5% per annum)	2.94	3.15
Rate of increase for pensions in deferment	2.02	2.25

Demographic assumptions	2016 years	2015 years
<b>Post retirement mortality:</b>		
Current pensioners at 60 – male	27.7	27.6
Current pensioners at 60 – female	29.6	29.5
Future pensioners at 60 – male	29.2	29.1
Future pensioners at 60 – female	31.1	31.0

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

Assumption change	Impact on defined benefit obligation £m	Impact on pension cost £m
<b>Discount rate</b>		
+0.25%	(234)	(8)
-0.25%	253	7
<b>Inflation</b>		
+0.25%	170	5
-0.25%	(167)	(5)
<b>Life expectancy</b>		
+1 year	159	5
-1 year	(152)	(4)

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

The discounted mean term of the defined benefit obligation at 30 September 2016 is 22 years. The expected contributions for the year ending 30 September 2017 are £Nil and expected benefit payments for the year ending 30 September 2017 are £85m.

### 30. Other liabilities

	2016 £m	2015 £m
Notes in circulation	1,912	1,791
Accruals and deferred income	152	136
Other	146	146
	<b>2,210</b>	<b>2,073</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 31. Called up share capital

As a consequence of the insertion of the new holding company, share capital in the current period reflects CYBG PLC. The comparative reflects CYBI.

Allotted, called up and fully paid	2016 Number of shares	2015 Number of shares	2016 £m	2015 £m
<b>Ordinary shares</b>				
Opening ordinary share capital	2,232,012,512	1,882,012,500	223	1,882
Issued during the year	-	350,000,012	-	350
Share for share exchange	(1,352,697,256)	-	876	-
Share capital reduction	-	-	(1,011)	(2,009)
Issued under employee share schemes	2,216,596	-	-	-
<b>Closing ordinary share capital</b>	<b>881,531,852</b>	<b>2,232,012,512</b>	<b>88</b>	<b>223</b>

On 18 May 2015, the Company was incorporated as a public limited company with one ordinary £1 share. On 11 September 2015, 49,999 ordinary shares of £1 were issued.

On 20 November 2015, the 50,000 ordinary shares were consolidated into one ordinary share of £50,000 and then immediately divided into ordinary shares with a nominal value of £1.25 each in the capital of the Company on the basis of 40,000 divided ordinary shares for every one consolidated ordinary share.

#### Listing on the LSE and ASX

On 3 February 2016 CYBG PLC obtained a Premium listing on the LSE and listed on the ASX with effect from 4 February 2016.

On 8 February 2016, CYBG PLC became the new holding company for the CYBI Group by way of a share for share exchange with its then sole shareholder, NAB, and became unconditionally listed on the London Stock Exchange. As a consequence of the insertion of the new holding company, share capital, share premium and the capital reorganisation reserve in the current period reflect the capital structure of CYBG PLC whilst the comparative reflects that of CYBI. During the period 2,216,596 ordinary shares were issued under employee share schemes with a nominal value of £0.2m.

#### Share for share exchange

On 8 February 2016, CYBG PLC issued 879,275,256 £1.25 ordinary shares in exchange for the acquisition of the entire share capital of CYBI which comprised 2,232,012,512 £0.10 ordinary shares. The consideration for the issuance of CYBG PLC shares was determined by applying the 5-day volume weighted average price (VWAP) of CYBG shares and CYBG Chess Depositary Instruments (CDIs) over the first 5 trading days from 3 February 2016, giving a value of £1,732m. The nominal value of the shares issued was £1,099m and the balance of £633m was transferred to a merger reserve in accordance with Section 612 of the Companies Act.

#### Share capital reduction

Following court approval, on 10 February 2016, the nominal share capital of the Company was reduced to £0.10 per share by the cancellation of £1.15 from the nominal value of each ordinary share; as a result, £1,011m was transferred to retained earnings.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Company. All shares in issue at 30 September 2016 rank equally with regard to the Company's residual assets.

### 32. Total equity

As a consequence of the insertion of the new holding company, share capital, share premium and the capital reorganisation reserve in the current period reflect CYBG PLC. The comparative reflects CYBI.

	2016 £m	2015 £m
Share capital (note 31)	88	223
Share premium account	-	670
<b>Total share capital and share premium</b>	<b>88</b>	<b>893</b>
Other equity instruments	450	450
Capital reorganisation reserve	(839)	-
Merger reserve	633	-
Equity based compensation reserve	6	3
Asset revaluation reserve	1	2
Available for sale reserve	27	12
Cash flow hedge reserve	66	(13)
<b>Total other reserves</b>	<b>100</b>	<b>4</b>
Retained earnings	2,779	2,096
<b>Total equity</b>	<b>3,211</b>	<b>3,443</b>

#### Share premium account

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

There is no share premium held within CYBG PLC.

#### Other equity instruments

Other equity instruments represent AT1 notes. On 20 December 2013, Perpetual Capital Notes (6m LIBOR + 763bps) were issued with a principal amount of £300m to NAB. These were perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV. A further £150m Perpetual Capital Notes (6m LIBOR + 690bps) were issued to NAB on 29 December 2014. These AT1 notes were repurchased by CYBI on 8 February 2016 for £457m. The

resulting loss of £7m (£5m net of tax) was recognised directly within retained earnings.

AT1 distributions of £35m were paid in the current period (being £28m net of tax) (2015: £18m paid, £14m net of tax).

In addition, on 8 February 2016, the Company issued Perpetual Contingent Convertible Notes (fixed 8%) with a principal amount of £450m to NAB with an optional redemption on 8 December 2022. In September 2016 these notes were remarketed by NAB, accordingly at 30 September 2016 they are held by third party investors other than NAB.

#### Capital reorganisation reserve

The capital reorganisation reserve was recognised on the issuance of CYBG PLC ordinary shares in exchange for the acquisition of the entire share capital of CYBI. The reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and CYBI's share capital and share premium.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 32. Total equity (continued)

#### Merger reserve

As described in note 31, a merger reserve was recognised on the issuance of CYBG PLC ordinary shares in exchange for the acquisition of the entire share capital of CYBI. The merger reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and the nominal value of the shares issued.

#### Equity-based compensation reserve

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

In comparative periods the equity based compensation reserve represents the outstanding fair value amount in respect of share based payment expense recharged by the Group's former ultimate parent, NAB, which has been charged through the income statement and adjusted for deferred tax.

#### Asset revaluation reserve

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

#### Available for sale reserve

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

#### Cash flow hedge reserve

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

As at 30 September 2016, the cash flow hedge reserve comprised crystallised fair value losses arising from de-designated and matured cash flow hedges of £7.1m (2015: £2.2m loss) offset by deferred gains on derivatives in ongoing cash flow hedges of £94.2m (2015: £15.2m loss). The balance on the cash flow hedge reserve within the consolidated statement of changes in equity is net of tax.

A £2m gain (2015: £17m gain) was recycled into the income statement in relation to de-designated and matured hedges in the period. A £1m loss (2015: £1m gain) was transferred to the income statement due to ineffectiveness arising from cash flow hedges.

### 33. Contingent liabilities and commitments

The table below sets out the contractual amounts of contingent liabilities and commitments which are not recorded on the balance sheet. Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments

to extend credit. The contractual amounts do not represent the amounts at risk at the balance sheet date but the amounts that would be at risk should the contracts be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

Contingent liabilities	2016 £m	2015 £m
Guarantees and assets pledged as collateral security:		
Due in less than 3 months	19	25
Due between 3 months and 1 year	44	13
Due between 1 year and 3 years	9	9
Due between 3 years and 5 years	3	2
Due after 5 years	48	52
No specified maturity	-	8
	123	109
<b>Other credit commitments</b>		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	7,690	7,801

#### Capital commitments

The Group had future capital expenditure which had been contracted for but not provided for in the financial statements at 30 September 2016 of £2m (2015: £2m).

Operating lease commitments	2016 £m	2015 £m
<b>Leases as lessor</b>		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	2	2
Between 1 year and 5 years	4	6
Over 5 years	1	2
	7	10
<b>Leases as lessee</b>		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	29	31
Between 1 year and 5 years	94	95
Over 5 years	117	122
	240	248

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 33. Contingent liabilities and commitments (continued)

#### Other contingent liabilities

##### Financial Services Compensation Scheme (FSCS)

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

The FSCS has estimated levies due to 31 March 2017 and an accrual of £8m (2015: £9m) is held for the Group's calculated liability to that date. The ultimate FSCS levy as a result of the failures is uncertain.

#### Conduct risk related matters

There continues to be significant uncertainty and thus judgement required in determining the quantum of conduct risk related liabilities with note 27 reflecting the Group's current position in relation to redress provisions including those for PPI and IRHPs. The final amount required to settle the Group's potential liabilities for these, and other conduct related matters, is materially uncertain. Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated. The financial exposure to the Group related to legacy conduct risks is mitigated by the Capped Indemnity provided by its former parent (note 27). The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

#### Legal claims

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

### 34. Notes to the statements of cash flows

	2016 £m	2015 £m
<b>Adjustments included in the loss before tax</b>		
Interest receivable	(1,101)	(1,110)
Interest payable	295	323
Depreciation and amortisation (note 7)	88	83
Net gain on capital and debt restructure (note 6)	(1)	(61)
Loss on sale of tangible fixed assets <sup>(1)</sup>	-	1
Transfer from cash flow hedge reserve	1	(1)
Derivative financial instruments fair value movements	(10)	(2)
Impairment losses on credit exposures (note 17)	39	78
Impairment losses on software (note 7)	45	10
Fair value movement on investment properties	1	-
	(643)	(679)
<b>Changes in operating assets</b>		
Net (increase)/decrease in:		
Balances with supervisory central banks	1	(2)
Due from other banks	(826)	(113)
Derivative financial instruments	(63)	1
Financial assets at fair value through profit or loss	346	478
Loans and advances to customers	(1,758)	(1,663)
Due from customers on acceptances	-	1
Defined benefit pension assets	-	(39)
Other assets	15	(157)
	(2,285)	(1,494)
<b>Changes in operating liabilities</b>		
Net increase/(decrease) in:		
Due to other banks	960	(567)
Derivative financial instruments	60	(39)
Financial liabilities at fair value through profit or loss	(19)	(23)
Due to customers	672	2,380
Liabilities on acceptances	-	(1)
Provisions for liabilities and charges	(154)	54
Defined benefit pension obligations	(52)	-
Other liabilities	120	179
	1,587	1,983

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 34. Notes to the statements of cash flows (continued)

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

	2016 £m	2015 £m
Cash and balances with central banks (note 11)	5,912	6,387
Other assets	111	86
Due to other banks	(25)	(72)
Due to related entities	-	(33)
Other liabilities	(48)	(31)
	5,950	6,337

### 35. Employees

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

	2016 Number	2015 Number
Managers	2,460	2,449
Clerical staff	4,258	4,367
	6,718	6,816

The average monthly number of employees was 7,567 (2015: 7,694).

All staff are contracted employees of the Group and its subsidiary undertakings. The average figures above do not include contractors.

### 36. Equity based compensation

Equity based compensation charges comprise:

	2016 £m	2015 £m
Equity settled share based payments	5	7

The 2015 and 2016 figures include awards under the Group's and NAB share plans. The charges under the NAB share plans were classified as equity settled share based payments up to the demerger date, and are included in the total above.

Following the demerger these plans no longer meet the definition of share based payments under IFRS 2: Share based payment accordingly, the total above excludes NAB share plan costs after 8 February 2016.

### CYBG awards

The Group implemented a number of share plans with the following awards made during the year:

Plan	Nature	Awards made during in 2016	Award date
Deferred Equity Plan (DEP)	Conditional rights to shares	2015 demerger LTIP award	11 Feb 2016
			31 May 2016
		2015 Deferred bonus awards	11 Feb 2016
		2015 Upfront retained bonus awards	11 Feb 2016
		Commencement awards	4 March 2016
Long Term Incentive Plan (LTIP)	Conditional rights to shares	No awards made	n/a
Share Incentive Plan (SIP)	Non-conditional share award	Demerger Freeshare award	4 March 2016
Save As You Earn Plan (SAYE)	Options to purchase shares at the end of the saving period	No awards made	n/a

Further detail on each award is provided below:

#### Deferred Equity Plan (DEP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards include:

- The upfront and deferred elements of bonus awards where required to comply with the PRA Remuneration Code or the Bank's deferral policy.
- Buyout of equity from previous employment for senior new hires.
- Demerger awards which are also subject to the achievement of performance conditions over a three year period. Details of the performance conditions are set out in the Directors' Remuneration Report.

#### Share Incentive Plan (SIP)

Eligible employees, with shares at the date of the award, were awarded Group shares, which are held in the Share Incentive Plan Trust (SIP Trust). Awards are not subject to performance conditions and participants are the beneficial owners of the shares granted to them, but not the registered owners. Voting rights over the shares are normally exercised by the registered owner at the direction of the participants. For the demerger award made in March 2016, leavers (with the exception of gross misconduct) retain their awards but they must withdraw their shares from the SIP Trust.

Awards /rights made during the year	Number outstanding on incorporation	Number awarded	Number forfeited	Number released	Number outstanding at 30 September 2016	Average fair value of awards at grant
<b>Deferred Equity Plan</b>						
2015 Demerger	-	2,235,204	-	-	2,235,204	196.96
2015 Bonus	-	1,749,431	(10,037)	(250,004)	1,489,390	195.17
2015 Commencement	-	111,127	-	-	111,127	194.67
<b>Share Incentive Plan</b>						
2016 Demerger award	-	1,966,592	(2,304) <sup>(1)</sup>	(141,312) <sup>(2)</sup>	1,822,976	194.67

<sup>(1)</sup> Forfeited shares remain in the SIP Trust

<sup>(2)</sup> Shares withdrawn from SIP Trust on leaving the Group.

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36. Equity based compensation (continued)

Determination of grant date fair values

Participants of the DEP and LTIP plans are not entitled to dividends until the awards vest, but the number of shares which vest may be increased to reflect the value of dividends that would have been paid up to the end of the holding period for the awards. Accordingly, the grant date fair value of the awards with only service conditions and/or non-market performance conditions has been taken as the market value of the Company's ordinary shares at the grant date. Where

awards are subject to non-market performance conditions, an estimate is made of the number of awards expected to vest in order to determine the overall share-based payment charge to be recognised over the vesting period.

The Group has not issued awards under any CYBG plan with market performance conditions.

Legacy NAB awards

Prior to the demerger, employees of the Group received awards under the following NAB share plans as described below. No deferred bonus, LTIP or freeshare awards were made under NAB plans in December 2015 due to the planned demerger.

Plan	Nature	Awards
National Australia Bank Staff Share Ownership Plan	Conditional NAB shares which are held in trust	1. Commencement awards 2. Deferred bonus awards (excluding Executive Leadership Team) 3. Upfront bonus awards
National Australia Bank Performance Rights Plan	Conditional NAB Performance rights	4. Deferred bonus awards to the Executive Leadership Team 5. Long Term Incentive awards
NAB Share Incentive Plan	Non-conditional NAB shares through SIP Trust	6. Freeshare awards

National Australia Bank Staff Share Ownership Plan

The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards included:

- The upfront and deferred elements of bonus awards where required to comply with the PRA Remuneration Code or the Bank's deferral policy.
- Buyout of evidenced equity from previous employment for senior new hires.

National Australia Bank Performance Rights Plan

Legacy NAB awards made as performance rights over NAB shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards included:

- Deferred elements of bonus awards for members of the Executive Leadership Team, where required to comply with the PRA Remuneration Code or the Bank's deferral policy.
- LTIP awards were also subject to performance hurdles (both internal and external) are measured at the end of a four to five year restriction period. During the restriction period an executive's performance rights will lapse if performance hurdles are not met. A variety of performance measures are used for different grants of long term incentives including Total Shareholder Return (TSR) compared against peer companies, and regional or NAB Group ROE and cash earnings. The measures used depend on the level and impact of the participant's role, the business or region in which they work and the relevant programme. Further details on the measures are included in the Directors' Remuneration Report.

Each performance right is exchanged for one fully paid ordinary share in NAB Limited upon exercise, subject to standard adjustments for capital actions. No exercise price is payable by the holder on exercise of performance rights.

NAB Freeshare awards

Eligible employees in December 2014 were awarded NAB shares, held in the NAB SIP Trust. With the exception of gross misconduct, awards were not subject to service or performance conditions and vested on the date of award. As a result of the demerger, all participants were treated as good leavers from the SIP and their NAB shares were withdrawn from the SIP Trust.

NAB Performance rights related to CYBG Group employees	2016 number	2015 number
Outstanding at 1 October	281,066	259,093
Granted during the year	-	136,812
Forfeited and lapsed during the year	(21,995)	(103,965)
Exercised during the year	(19,471)	(10,874)
Outstanding at 8 February	239,600	n/a
Exercisable at 8 February	-	n/a
Outstanding at 30 September		281,066
Exercisable at 30 September		18,480

No performance rights lapsed in the period to 8 February 2016 (2015: Nil).

Of the performance rights exercised in the period to 8 February 2016, 4,233 related to long term incentive awards (2015: Nil).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 37. Fair value of financial instruments

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

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

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

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

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

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

	30 September 2016					30 September 2015				
	Fair value measurement using:					Fair value measurement using:				
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
<b>Financial assets</b>										
Loans and advances to customers	29,202	29,298	-	1,076	28,222	27,482	27,537	-	1,111	26,426
<b>Financial liabilities</b>										
Due to customers	27,090	27,114	-	27,114	-	26,407	26,423	-	26,423	-
Due to related entities	-	-	-	-	-	998	1,017	-	1,017	-
Debt securities in issue	4,501	4,592	459	4,133	-	3,766	3,869	-	3,869	-

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

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

- (c) Amounts due to related entities – the fair value of subordinated debt and notes issued to related entities was determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity. The comparable instruments are presented within 'Debt securities in issue' in the current year. All other amounts due to related entities were repayable under varying maturities but were materially repriced every 3-6 months relative to market rates.
- (d) Debt Securities in issue – the fair value is taken directly from quoted market prices where available or determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

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

The following tables provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, using the fair value hierarchy described in note 37(a) above.

	Fair value measurement as at 30 September 2016				Fair value measurement as at 30 September 2015			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Financial assets</b>								
Derivative financial assets	-	585	-	585	-	285	-	285
AFS investments – listed	1,695	-	-	1,695	1,447	-	-	1,447
AFS investments – unlisted	-	-	29	29	-	-	8	8
AFS – other	-	-	7	7	-	-	7	7
Other financial assets at fair value	-	-	750	750	-	-	1,097	1,097
Total financial assets at fair value	1,695	585	786	3,066	1,447	285	1,112	2,844
<b>Financial liabilities</b>								
Derivative financial liabilities	-	598	-	598	-	534	-	534
Other financial liabilities at fair value	-	-	48	48	-	-	67	67
Total financial liabilities at fair value	-	598	48	646	-	534	67	601

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

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

- (b) *Available for sale investments*
  - *Listed* (level 1) – the fair values of listed investments are based on quoted closing market prices.
  - *Unlisted* (level 3) – includes the unlisted equity investment in VocaLink of £25m (2015: £5m) (see note 13). The valuation of these shares is based on offers received for the Group's shareholding as the best indicator of the fair value of these shares at the reporting date. Unlisted (level 3) also includes £2m for the Group's US Dollar denominated convertible



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

preference shares in Visa Inc. (see note 13). The fair value of the preference shares has been calculated by taking the period end NYSE share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity and debt investments, the Group's share of the net asset value or the transaction price respectively are considered the best representation of the exit price and are the Group's best estimates of fair value.

- *Available for sale – other* (level 3) – the other available for sale financial asset represents deferred consideration receivable and consists of the rights to future commissions. The valuation is determined from a

discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

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

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

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

### Level 3 movements analysis:

	2016		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	15	1,097	(67)
Fair value gains/(losses) recognised <sup>(1)</sup>			
In profit or loss (unrealised)	-	10	2
In profit or loss (realised)	8	-	-
In available for sale reserve	21	-	-
Purchases	2	-	-
Sales	(8)	-	-
Settlements <sup>(2)</sup>	(2)	(357)	17
<b>Balance at the end of the year</b>	<b>36</b>	<b>750</b>	<b>(48)</b>

### 37. Fair value of financial instruments (continued)

#### Level 3 movements analysis:

	2015		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	1,583	(91)
Unrealised gains <sup>(1)</sup>			
In profit or loss	-	2	2
Purchases	8	-	-
Settlements <sup>(2)</sup>	-	(488)	22
<b>Balance at the end of the year</b>	<b>15</b>	<b>1,097</b>	<b>(67)</b>

<sup>(1)</sup> Net gains or losses were recorded in non-interest income, interest income or expense and impairment losses or within the Available for Sale Reserve as appropriate.

<sup>(2)</sup> Settlements for the year ended 30 September 2016 include a realised loss of £5m (2015: loss of £33m) relating to financial assets that are measured at fair value at the end of each reporting period. Such fair value gains or losses are included in non-interest income (note 6)

There were no transfers into or out of Level 3 in the year ended 30 September 2016 (2015: £Nil).

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

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

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2016.

	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
<b>Financial assets</b>					
Available for sale – investments – unlisted	27	Recent market value	Offers received	n/a	n/a
Available for sale – investments – unlisted	2	Discounted cash flow	Contingent litigation risk	0%	100%
Available for sale – other	7	Discounted cash flow	Customer attrition rate	10%	30%
Other financial assets at fair value	750	Discounted cash flow	Portfolio lifetime PD	3.3%	11.4%

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The Group has £48m (2015: £67m) of financial liabilities at fair value classed as Level 3 which represent a portfolio of term deposits that are directly linked to the customer loans, which are also held at fair value and classed as Level 3. Their relationship to the fair value assets is such that should the liability be settled, the amount payable would be net of the fair value asset.

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

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

The most significant exposure to Level 3 fair value measurements is in respect of the Group's fair value loan portfolio and the most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £5m and vice versa.

As disclosed above, the fair value of the Group's investment in VocaLink is based on the offer set out in the definitive agreement to acquire 92.4% of VocaLink Holdings Limited announced by MasterCard on 21 July 2016. Whilst this transaction is subject to regulatory approval and other customary closing conditions, the Group expects that the sale will be completed under these terms. The sensitivity of fair value to possible changes in the cash offer or the associated future earn-out entitlements (which have a limited range of potential variation) has not therefore been modelled.

The most significant input impacting the carrying value of the available for sale - other asset is the Funds Under Management Attrition rate. If this rate was 30% the carrying value would reduce by £3m; if it was 10% the carrying value would increase by £2m. The Group currently assumes a 15% attrition rate.

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

### 38. Pillar 3 disclosures

#### Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation (CRR). The consolidated disclosures of the Group, for the 2016 financial year, can be found at [www.cybg.com/investor-centre/financial-results/](http://www.cybg.com/investor-centre/financial-results/)

### 39. Events after the balance sheet date

On 25 October 2016, the Group announced that it has engaged in discussions with The Royal Bank of Scotland Group plc (RBS) and has made a preliminary non-binding proposal to RBS in relation to its Williams and Glyn operations. This engagement is ongoing and there can be no certainty that any transaction will occur, nor as to the terms on which any transaction might be concluded.

## COMPANY BALANCE SHEET

as at 30 September 2016

	Note	2016 £m	2015 £m
<b>Assets</b>			
Due from related entities	41	498	-
Due from other banks		7	-
Current tax assets		3	-
Investments in controlled entities and associates	42	2,193	-
Deferred tax asset		1	-
<b>Total assets</b>		<b>2,702</b>	-
<b>Liabilities</b>			
Due to other banks		36	-
Due to related entities	41	7	-
Debt securities in issue	43	480	-
Other liabilities		2	-
<b>Total liabilities</b>		<b>525</b>	-
<b>Equity</b>			
Share capital	44	88	-
Other equity instruments	45	450	-
Merger reserve	45	633	-
Other reserves	45	3	-
Retained earnings	45	1,003	-
<b>Total equity</b>		<b>2,177</b>	-
<b>Total liabilities and equity</b>		<b>2,702</b>	-

The notes on pages 284 to 290 form an integral part of these financial statements.

## COMPANY STATEMENT OF CHANGES IN EQUITY

for the year ended 30 September 2016	Note	Share capital £m	Share premium account £m	Capital reorganisation reserve £m	Merger reserve £m	Other equity instruments £m	Equity based compensation reserve £m	Cashflow hedge reserve £m	Retained earnings £m	Total Equity £m
On incorporation		-	-	-	-	-	-	-	-	-
Shares issued - ordinary		-	-	-	-	-	-	-	-	-
<b>As at 30 September 2015</b>	44.45	-	-	-	-	-	-	-	-	-
Loss for the year		-	-	-	-	-	-	-	(3)	(3)
Other comprehensive losses, net of tax		-	-	-	-	-	-	(3)	-	(3)
Total comprehensive losses for the year		-	-	-	-	-	-	(3)	(3)	(6)
AT1 distributions paid (net of tax)		-	-	-	-	-	-	-	(9)	(9)
Share for share exchange		1,099	-	-	633	-	-	-	-	1,732
Share capital reduction		(1,011)	-	-	-	-	-	-	1,011	-
Capital note issued		-	-	-	-	450	-	-	-	450
Transfer from equity based compensation reserve		-	-	-	-	-	(4)	-	4	-
Equity based compensation		-	-	-	-	-	10	-	-	10
<b>As at 30 September 2016</b>	44.45	88	-	-	633	450	6	(3)	1,003	2,177

The notes on pages 284 to 290 form an integral part of these financial statements.

## COMPANY STATEMENT OF CASH FLOWS

for the year ended 30 September 2016

	2016 £m	2015 £m
<b>Operating activities</b>		
(Loss)/profit on ordinary activities before tax	(3)	-
Adjustments for:		
Changes in operating assets		
Due from other banks	(7)	-
Changes in operating liabilities		
Due to other banks	36	-
Other liabilities	2	-
Interest receivable	(15)	-
Interest payable	16	-
Due to related entities	7	-
<b>Net cash (used in)/provided by operating activities</b>	<b>36</b>	<b>-</b>
<b>Cash flows from investing activities</b>		
Investment in controlled entities	(2,184)	-
<b>Net cash provided by investing activities</b>	<b>(2,184)</b>	<b>-</b>
<b>Cash flows (used in)/from financing activities</b>		
Interest received	11	-
Interest paid	(12)	-
Insertion of a new parent company	1,732	-
Issuance of subordinated debt	474	-
Proceeds for issue of other equity instruments	450	-
Net decrease in amounts due from related entities	(480)	-
AT1 distributions	(12)	-
<b>Net cash (used in)/provided by financing activities</b>	<b>2,163</b>	<b>-</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>15</b>	<b>-</b>
Cash and cash equivalents at the beginning of the year	-	-
<b>Cash and cash equivalents at the end of the year</b>	<b>15</b>	<b>-</b>

Cash and cash equivalents comprise the following balances with less than three months' maturity from the date of acquisition.

	2016 £m	2015 £m
Due from related parties (note 41)	15	-

The notes on pages 284 to 290 form an integral part of these financial statements.



40. Company basis of preparation

The Company is incorporated in the UK and registered in England and Wales.

The Company financial statements of CYBG 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 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.

Basis of measurement

The financial information has been prepared under the historical cost convention.

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates

and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The accounting policies of the Company are the same as those of the Group which are set out in note 2 of the consolidated financial statements except that the Company has no policy in respect of consolidation. These accounting policies have been applied consistently to all periods presented in these financial statements.

The financial information for the comparative period is shown as £Nil throughout as the Company only had £50,000 of share capital funded by a bank deposit as at 30 September 2015.

41. Company related party transactions

During the year there have been transactions between the Company, controlled entities of the Company, and other related parties. All companies listed in note 42 are related parties to the Company.

The Company receives and provides a range of services with its principal subsidiary undertaking, including loans and deposits.

Amounts due from controlled entities of the Company	2016 £m	2015 £m
Loans	15	-
Subordinated debt	483	-
Total amounts due from related entities	498	-

Included within the amounts due from related entities is £15m (2015: £Nil) of cash and cash equivalents.

On 8 February 2016, the Company purchased £475m of 10 year, callable, fixed 5% subordinated debt with a final maturity date of 9 February 2026 from CB PLC.

Amounts due to controlled entities of the Company	2016 £m	2015 £m
Other payables	7	-
Total amounts due to related entities	7	-

As discussed in note 36 to the consolidated financial statements, the Group provides share based compensation to employees through a number of schemes, all in relation to shares in the Company. The cost of providing these benefits is recharged to the employing company, CB PLC. Recharges are calculated based on the fair value of awards expensed in the period in accordance with IFRS 2: Share Based Payments.

The key management personnel of the Company are the key management personnel of the Group, with relevant disclosures given in note 12 to the consolidated financial statements. The Company has no employees (2015: Nil).

42. Company investments in controlled entities and associates

	2016 £m
At 30 September	2,193

The acquisition of CYBI is explained within the 'share for share exchange' section of note 31 of the Group's consolidated financial statements.

On 30 September 2016 the Company acquired the issued share capital of Clydesdale Bank PLC (the 'Bank'), from its subsidiary CYBI for consideration of £1. The purpose of the transaction was to eliminate the requirement to retain CYBI as an intermediate holding company, with a view to ultimately liquidating the company and simplifying the Group's structure.

Immediately prior to the transfer, the Company held the investment in CYBI at cost of £1,764m. The value of the investment in CYBI is primarily supported by the net assets and future cash flows of the Bank, the main trading subsidiary of the Group. It is the Company's policy in this situation to transfer the proportion of the carrying value of the investment in CYBI relating to its investment in the Bank, to the cost of the newly recognised direct investment in the Bank. This method recognises that part of the cost to the Company of this transaction is a reduction in the value of its investment in CYBI. Applying this approach, the Company's cost of the investment in the Bank (excluding the pre-existing investment in the Bank's AT1 instruments) is recorded at £1,762m, calculated as the consideration paid, plus a £1,762m transfer from the carrying value of the investment in CYBI. There are no gains or losses recognised in the Bank's income statement as a consequence of the transfer.

On 8 February 2016, the Company acquired Perpetual Subordinated Permanent Write Down Notes (fixed 8%) with a principal amount of £450m from the Bank. These are carried at cost in accordance with IAS 27. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV.

As disclosed in note 27 to the consolidated financial statements, the Company and NAB have entered into the Conduct Indemnity Deed. Claims under the Conduct Indemnity Deed are made by the Company, whilst the provisions in respect of the qualifying conduct costs are raised and incurred by the Bank. As a consequence, the recognition and measurement basis of the Capped Indemnity in the Company differs from that

of the Group. For the Company, the substance of the indemnity agreement is that of variable consideration in relation to the purchase of CYBI.

When a claim is raised under the Capped Indemnity, the Company recognises a receivable from NAB presented within amounts due from other banks with a corresponding decrease in the cost of the Company's investments in controlled entities and associates. The Company does not recognise any income or expense in relation to claims under the Capped Indemnity. It is intended that upon collection of the claim proceeds from NAB the capital impact of providing for Relevant Conduct Matters in the Bank is mitigated by the Company using the proceeds to subscribe for share capital. During the year ended 30 September 2016 a £426m reduction to the investment in CYBI was recognised in relation to Conduct Indemnity adjustments and the Company subscribed for £426m of additional share capital in CYBI.

Where provisions for Relevant Conduct Matters are increased in respect of a reporting period, but proceeds from that claim are not received from NAB prior to the reporting date, CYBG has put in place an agreement with the Bank in order to mitigate the effect of capital losses at the end of the reporting period. Upon raising a provision for a Relevant Conduct Matter, The Company indemnifies the Bank for the Qualifying Conduct Costs (excluding the Group's loss share) until it subscribes for an equivalent amount of capital in the Bank. The Company recognises a capital contribution within investments in controlled entities and associates and a liability in amounts due to other entities in respect of these amounts. This totalled £7m at 30 September 2016 (2015: Nil).

Impairment review for subsidiary undertakings

As highlighted in note 3 to the consolidated financial statements, an impairment test on the carrying value of the Company's investment in Clydesdale Bank PLC has been undertaken during the year. This testing did not result in any impairment. For the purposes of the impairment test, Clydesdale Bank PLC is regarded as the cash generating unit with the value in use calculation compared to the current carrying value of the investment in Clydesdale Bank PLC in the Company balance sheet.

42. Company investments in controlled entities and associates (continued)

The key assumptions involved in these calculations are set out below.

Key assumptions used in impairment testing

The recoverable amount of the cash generating unit has been derived from a value in use calculation using discounted cash flow techniques and a forecasted performance approved by the Board. Cash flows beyond the forecasted period have been extrapolated using similar forecasted assumptions as in the forecast period. The following rates are used by the Company:

	2016 %
Post tax discount rate	10.0
Projected terminal growth rate	2.5

The calculation of the value in use is based on a Board approved five year forecast projection and is then extrapolated forward with a terminal growth rate applied. The five year forecast projections encompass a range of economic indications such as GDP growth, unemployment statistics as well as a range of other business assumptions specific to the Bank such as asset volumes, product volumes and margins which are commercially sensitive. The Board is satisfied that the assumptions used both within and beyond the forecasted period are appropriate and reasonable at the balance sheet date.

Discount rate

The discount rate applied reflects the current market assessment of the risk specific to the Bank. The discount rate was calculated by reference to a series of internal indicators combined with certain identifiable and available sector specific information. The impairment model used is based on post-tax cash flows and utilises a post-tax discount rate.

Projected terminal growth rate

The projected terminal growth rate is based on management's expectation of the long term average growth prospects for UK GDP after taking into account the broader historic UK economic outlook and trends.

Sensitivity to changes in assumptions

Changes in the post-tax discount rate or projected terminal growth rate will impact the Company's assessment of the value in use of Clydesdale Bank PLC. If adjusted independently of all other variables, a 10 basis point increase in the post-tax discount rate would not result in an impairment charge and a 10 basis point decrease in the projected terminal growth rate would also not result in an impairment charge.

## COMPANY NOTES TO THE ACCOUNTS

The table below represents the wholly owned subsidiary undertakings of the Group and Company as at 30 September 2016:

Wholly owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation
<b>Direct holdings</b>				
Clydesdale Bank PLC	Banking	Ordinary	100%	Scotland
CYB Investments Limited	Holding company	Ordinary	100%	England
<b>Indirect holdings</b>				
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland
Clydesdale Bank (Head Office) Nominees Limited	In liquidation	Limited by guarantee	100%	Scotland
Craig Yr Haul Management Company Limited	Property management	Ordinary	100%	England
CYB Intermediaries Holdings Limited*	Holding company	Ordinary	100%	England
CYB Intermediaries Limited	Insurance intermediary	Ordinary	100%	England
CYB Services Limited*	IT and Group services	Ordinary	100%	Scotland
Shadwell Holdings (UK) Limited	In liquidation	Ordinary	100%	England
St Vincent (Equities) Limited	Investment company	Ordinary	100%	England
Plaza Ventures Limited	In liquidation	Ordinary	100%	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England
11 Tudor Hill Residential Management Company Limited	Dormant	Ordinary	100%	England
CB Nominees Limited	Dormant	Limited by guarantee	100%	Scotland
CYB SSP Trustee Limited	Dormant	Ordinary	100%	England
Linton Springs Residential Management Company Limited	Dormant	Ordinary	100%	England
St Johns Place Residential Management Company Limited	Dormant	Ordinary	100%	England
YCB DC Trustee Limited	Dormant	Ordinary	100%	Scotland
YCBPS Property Nominee Company Limited	Dormant	Ordinary	100%	England
Yorkshire and Clydesdale Bank Pension Trustee Limited	Dormant	Ordinary	100%	Scotland
Yorkshire Bank PLC	Dormant	Ordinary	100%	England

\*Approved to enter members voluntary liquidation on 4 October 2016

The Company also has an interest in the Yorkshire and Clydesdale Bank Foundation, a charitable foundation registered in Scotland as a company limited by guarantee. Clydesdale Bank PLC acts as a guarantor for £10 and is the main donor.

In addition to the above, the Company also has an interest in a number of securitisation vehicles. Full details of these can be found in note 21 to the consolidated financial statements.

All subsidiaries have a 30 September year end with the exception of the following entities:

Wholly owned subsidiary undertakings	Accounting reference date
Craig Yr Haul Management Company Limited	31 January
11 Tudor Hill Residential Management Company Limited	31 December
Linton Springs Residential Management Company Limited	31 December
St Johns Place Residential Management Company Limited	31 December

## COMPANY NOTES TO THE ACCOUNTS

### 43. Debt securities in issue

	2016 £m	2015 £m
Subordinated debt	480	-

Information on subordinated debt in issue is provided in note 28 to the Group's consolidated financial statements.

### 44. Company called up share capital

Information on share capital is provided in note 32 to the Group's consolidated financial statements.

### 45. Company total equity

	2016 £m	2015 £m
Share capital (note 44)	88	-
Other equity instruments	450	-
Merger reserve	633	-
Equity based compensation reserve	6	-
Cash flow hedge reserve	(3)	-
Total other reserves	3	-
Retained earnings	1,003	-
<b>Total equity</b>	<b>2,177</b>	<b>-</b>

#### Cash flow hedge reserve

As at 30 September 2016, the cash flow hedge reserve comprised crystallised fair value losses arising from a matured cash flow hedge of £3m (2015: £Nil). This hedge relationship was entered to mitigate the interest rate risk exposure prior to the issuance of the subordinated debt. The hedge matured at the date of issue. The balance on the cash flow hedge reserve within the statement of changes in equity is net of tax.

The crystallised fair value losses will be amortised from the cash flow hedge reserve to the income statement over the life of the subordinated debt. In respect of this, a £1m loss (2015: £Nil) was recycled into the income statement during the year.

#### Other equity instruments and reserves

Information on other equity instruments and other reserves is provided in note 32 to the Group's consolidated financial statements. Included within Retained earnings above is the loss for the year ended 30 September 2016 of £3m (2015: £Nil).



46. Company fair value of financial instruments

Fair value of financial instruments carried at amortised cost

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

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

- Level 1 fair value measurements – quoted prices (unadjusted) in active markets for identical financial assets or liabilities.
- Level 2 fair value measurements – inputs other than quoted prices within Level 1 that are observable for the

financial asset or liability, either directly (as prices) or indirectly (derived from prices).

- Level 3 fair value measurements – inputs for the financial asset or liability that are not based on observable market data (unobservable inputs).

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

There are various limitations inherent in this fair value disclosure particularly where prices may not represent the underlying value due to dislocation in the market. Not all of the Company's financial instruments can be exchanged in an active trading market.

Company	30 September 2016					30 September 2015				
	Fair value measurement using:					Fair value measurement using:				
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets										
Due from related entities	498	480	-	480	-	-	-	-	-	-
Financial liabilities										
Debt securities in issue	480	459	459	-	-	-	-	-	-	-

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

Amounts due from related entities – the fair value of subordinated debt due from related entities is derived from quoted market prices of the debt security in issue after accounting for differences in credit spread. All other amounts due from related entities are redeemable at call and therefore carrying value approximates fair value.

Debt securities in issue – the fair value of subordinated debt is taken directly from quoted market prices.

Term	Definition
90+ DPD to customer loans *	Customer loans where the repayment is more than 90 days overdue as a percentage of total customer loans at a given date.
Additional Tier 1 securities (AT1)	Securities that are considered additional tier 1 capital in the context of CRD IV.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bad and doubtful debt charge to average customer loans *	Impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances).
Bank	Clydesdale Bank PLC.
Bank Levy	Applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision (BCBS) in June 2006 defining how firms should calculate their regulatory capital requirements.
Basel III	Reforms issued by the BCBS in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In Europe the new requirements were implemented by "CRD IV", on a phased basis from 1 January 2014 with full implementation by 1 January 2019.
Board	Refers to the CYBG PLC Board or the CB PLC Board as appropriate.
Capped Indemnity	The indemnity from NAB in favour of CYBG PLC in respect of certain qualifying conduct costs incurred by CYBG Group, which is capped at the "Capped Indemnity Amount", subject to the "Loss Sharing Arrangement", under the terms of the "Conduct Indemnity Deed".
Capped Indemnity Amount	An amount equal to £1.58bn less any "Pre Covered provision amount".
Carrying value (also referred to as carrying amount)	The value of an asset or a liability in the balance sheet based on either amortised cost or fair value principles.
Collateral	The assets of a borrower that are used as security against a loan facility.
Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Commercial paper	An unsecured promissory note issued to finance short term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.
Company	CYBG PLC.
Conduct Indemnity Deed	The deed between NAB and CYBG PLC setting out the terms of: <ul style="list-style-type: none"><li>• The "Capped Indemnity"; and</li><li>• Certain arrangements for the treatment and management of certain "Conduct Matters".</li></ul>
Conduct Matters	In the context of the "Conduct Indemnity Deed", conduct issues relating to PPI, standalone "IRHP", voluntary scope TBL and FRTBL and other conduct matters in the period prior to the demerger date whether or not known at the "demerger date".
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
Common Equity Tier 1 capital (CET1)	The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Common Equity Tier 1 ratio *	CET1 capital divided by RWAs at a given date.
Counterparty	The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete.
Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.

GLOSSARY

CRD IV	European legislation to implement Basel III. It replaces earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. CRD IV raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also “Basel III”.
Credit risk adjustment / credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
Customer deposits	Money deposited by individuals and corporate entities that are not credit institutions, and can be either interest bearing, non-interest bearing or term deposits.
Default	A customer is in default when either they have breached a pre-set arrears threshold or are considered unlikely to pay their credit obligations in full without the Group taking actions to secure repayment.
Delinquency	See “Arrears”.
Demerger	The demerger of CYBG Group from NAB pursuant to which all of the issued share capital of CYBI Limited was transferred to CYBG PLC by NAB in consideration for the issue and transfer of CYBG shares to NAB in part for the benefit of NAB (which NAB subsequently sold pursuant to the IPO) and in part for the benefit of NAB shareholders under a scheme of arrangement.
Demerger date	8 February 2016
Derivative	A financial instrument that is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
Earnings at risk (EaR)	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Effective interest method	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Encumbered assets	Assets that have been pledged as security, collateral or legally “ringfenced” in some other way which prevents those assets being transferred, pledged, sold or otherwise disposed of.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (Level 2 and Level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
FINREP	A standardised Financial Reporting framework mandated by the EBA. Its aim is to establish a single rule book to ensure a robust and uniform regulatory framework.
Forbearance	The term generally applied to the facilities provided or changes to facilities provided to assist borrowers, both retail and SME, who are experiencing, or are about to experience, a period of financial stress.
Forborne performing loans	Loans to which forbearance measures have been granted and which are less than or up to 90 DPD and do not otherwise meet the criteria of forborne non-performing loans.
Forborne non-performing loans	Loans to which forbearance measures have been granted and which are more than 90 DPD, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of DPD.
Financial Services Compensation Scheme (FSCS)	The UK’s compensation fund of last resort for customers of authorised financial services firms and is funded by the financial services industry. The FSCS may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Gross impaired assets to customer loans *	Gross impaired assets as a percentage of total customer loans at a given date.
Group	CYBG and its controlled entities.
Hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value or cash flows of hedging instruments not being fully offset by changes in fair value or cash flows of hedged items.
Housing lending	Mortgages secured by residential properties as collateral.
Impaired loans	Loans in arrears with insufficient security to cover principal and arrears of interest revenue or where there is sufficient doubt about the ultimate collectibility of principal and interest.

Impairment losses	Where an asset’s recoverable amount is less than its carrying value and the difference is recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This can be assessed at either the individual or collective level.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be calculated at either the individual or collective level.
Indexed LTV of the mortgage portfolio *	The mortgage portfolio weighted by balance and indexed using the Halifax House Price Index at a given date.
Interest rate hedging products (IRHP)	This incorporates: (i) standalone hedging products identified in the Financial Services Authority (FSA) 2012 notice; (ii) the voluntary inclusion of certain of the Group’s more complex tailored business loan (TBL) products; and (iii) the Group’s secondary review of all FRTBL complaints which were not in scope for the FSA notice.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group’s assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Investment grade	The highest possible range of credit ratings, from “AAA” to “BBB”, as measured by external credit rating agencies.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Group’s assessment and management of balance sheet risks relating to funding and liquidity.
Internal ratings-based approach (IRB)	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio*	This is a regulatory standard ratio proposed by the Basel III as a supplementary measure to the risk based capital requirements. It is intended to constrain the build-up of excess leverage in the banking sector and is calculated by dividing Tier 1 capital resources by a defined measure of on- and off-balance sheet items plus derivatives.
Liquidity coverage ratio (LCR) *	Measures the surplus (or deficit) of a bank’s high quality liquid assets relative to weighted net stressed cash outflows over a 30 day period. It assesses whether the bank has sufficient liquid assets to withstand a short term liquidity stress based on cash outflow assumptions provided by regulators.
Listing Rules	Regulations applicable to any company listed on a United Kingdom stock exchange, subject to the oversight of the UK Listing Authority (UKLA). The Listing Rules set out mandatory standards for any company wishing to list its shares or securities for sale to the public.
Loan to deposit ratio (LDR) *	Customer loans as a percentage of customer deposits at a given date.
Loan to value ratio (LTV)	A ratio that expresses the amount of a loan as a percentage of the value of the property on which it is secured.
Loss Share	The percentage of a provision raised or an increase in a provision which CYBG PLC will be responsible for under the “Conduct Indemnity Deed”. Fixed at 9.7% at the demerger date.
Loss Sharing Arrangement	The arrangement relating to the “Capped Indemnity” pursuant to which CYBG PLC will be responsible for the “Loss Share”.
Net interest income	The amount of interest received or receivable on assets, net of interest paid or payable on liabilities.
Net interest margin (NIM) *	Net interest income as a percentage of average interest earning assets. Net interest income is divided by average interest earning assets for a given period (excluding short term repos used for liquidity management purposes, amounts received under the Conduct Indemnity and not yet utilised, and any associated income). Comparative disclosures (2015: previously 2.20%) have been amended to conform with the current year’s presentation. As a result of the change in approach, average interest earning assets used as the denominator have reduced by £698m (2015: £464m) and the net interest income numerator by £2.6m (2015: £0.2m).
Net promoter score (NPS)	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Group, and a consumer.

GLOSSARY

Net stable funding ratio (NSFR) *	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.
Non-impaired assets 90+ DPD	Consist of well-secured assets that are more than 90 DPD and portfolio-managed facilities that are not well secured and are between 90 and 180 DPD.
Overall Liquidity Adequacy Rule (OLAR)	An FCA rule that firms must at all times maintain liquidity resources which are adequate both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This is included in the Group's "Risk Appetite" and subject to approval by the Board as part of the "ILAAP".
Past due loans and advances	Loans and advances on which repayments are overdue.
Pension risk	The risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.
Pre Covered provision amount	The amount of any provision(s) relating to "Conduct Matters" raised or increased by CYBG Group between 31 March 2015 and the "demerger date" in respect of which NAB has provided specific support at any time after 31 March 2015 but before the "demerger date". This was £465m at the "demerger date".
Probability of default (PD)	The probability that a customer will default (usually within a one-year time horizon) although the time horizon will change on 1 October 2018 in line with IFRS 9 requirements.
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA.
Residential mortgage-backed securities (RMBS)	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: <ul style="list-style-type: none"><li>- the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non-market extension of principal repayment period);</li><li>- the Group has previously made a specific provision for the customer and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap.</li></ul> See also "forbearance".
Retail loans	Lending to individuals rather than institutions. This includes both secured and unsecured lending such as personal loans, residential and BTL mortgages, overdrafts and credit card balances.
Risk-weighted assets (RWA)	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Risk appetite	The level and types of risk is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives.
Return on assets (ROA)	Net profit/(loss) attributable to equity holders as a percentage of total assets.
Sale and repurchase agreement ("repo")	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counter party (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Scheme of arrangement	A scheme of arrangement under Part 5.1 of the Australian Corporations Act between NAB and NAB shareholders to effect the demerger
Secured lending	Lending in which the borrower pledges some asset (e.g. property) as collateral for the lending.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically "AAA" rated securities secured by the underlying financial asset.
SME lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.

Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Specific provision to gross impaired assets *	The specific impairment provision on credit exposures as a percentage of gross impaired assets at a given date.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Statutory basic earnings per share *	Statutory profit/(loss) attributable to ordinary equity shareholders including tax relief on any distributions made to other equity holders divided by the weighted average number of ordinary shares in issue for a given period.
Statutory cost to income ratio *	Statutory total operating expenses as a percentage of total operating income for a given period.
Statutory return on assets *	Statutory profit/(loss) after tax as a percentage of average assets for a given period.
Statutory RoTE *	Statutory profit/(loss) after tax less AT1 distributions net of tax as a percentage of average tangible equity (total equity less intangible assets excluding AT1 for a given period).
Structured entities (SE)	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. May also be referred to as an SPV.
Subordinated debt	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.
Tier 1 ratio *	Tier 1 capital resources divided by risk-weighted assets at a given date. Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 capital	A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV.
Total capital ratio *	Total capital resources divided by risk-weighted assets at a given date.
Total provision to customer loans*	Total impairment provision on credit exposures as a percentage of total customer loans at a given date.
Underlying basic earnings per share *	Underlying profit/(loss) attributable to ordinary equity shareholders including tax relief on any distributions made to other equity holders divided by the weighted average number of ordinary shares in issue for a given period.
Underlying cost to income ratio *	Underlying total operating expenses as a percentage of underlying total operating income for a given period.
Underlying profit after tax attributable to ordinary equity holders	Underlying profit before tax of £221m less tax charge of £44m (or plus tax credit, as the case may be), less dividends and distributions of £34m and was equal to £143m (2015: £121m). The underlying tax credit/(charge) is calculated by applying the statutory tax rate of 20% for the relevant period to the taxable items adjusted on the underlying basis. Average tangible equity has been calculated using the tangible equity spot balances at each of the month ends of the applicable period.
Underlying return on assets *	Underlying profit after tax as a percentage of average assets for a given period.
Underlying RoTE	Underlying profit after tax less AT1 distributions net of tax as a percentage of average tangible equity (total equity less intangible assets excluding AT1) for a given period.
Unsecured lending	Lending in which the borrower pledges no assets as collateral for the lending (such as credit cards and current account overdrafts).
Value at risk (VaR)	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements.

\* Key Performance Indicators – page 55.



ABBREVIATIONS

ALCO	Assets and Liabilities Committee	FRC	Financial Reporting Council	MRT	Material Risk Taker
AML	Anti Money Laundering	FSCS	Financial Services Compensation Scheme	NAB	National Australia Bank
APRA	Australian Prudential Regulatory Authority	FTE	Full time equivalent	NIM	Net interest margin
ASX	Australian Securities Exchange	HMRC	Her Majesty's Revenue and Customs	NPS	Net promoter score
AT1	Additional Tier 1	IASB	International Accounting Standards Board	NSFR	Net stable funding ratio
BCA	Business current accounts	ICAAP	Internal Capital Adequacy Assessment Process	NYSE	New York Stock Exchange
BCBS	Basel Committee on Banking Supervision	IFRS	International Financial Reporting Standards	OLAR	Overall liquidity adequacy rule
BoE	Bank of England	ILAAP	Internal Liquidity Adequacy Assessment Process	PBT	Profit before tax
BTL	Buy-to-let mortgages	IPO	Initial Public Offering	PCA	Personal current accounts
CAGR	Compound Annual Growth Rate	IRB	Internal ratings-based	PPI	Payment protection insurance
CCB	Capital Conservation Buffer	IRHP	Interest rate hedging products	PRA	Prudential Regulation Authority
CCyB	Countercyclical Capital Buffer	IRRBB	Interest rate risk in the banking book	RMBS	Residential mortgage-backed securities
CET 1	Common Equity Tier 1 Capital	ISDA	International Swaps and Derivatives Association	ROA	Return on assets
CMA	Competition and Markets Authority	LCR	Liquidity coverage ratio	RoTE	Return on Tangible Equity
CRD	Capital Requirements Directive	LDR	Loan to deposit ratio	RWA	Risk weighted assets
CRE	Commercial Real Estate	LIBOR	London Interbank Offered Rate.	SE	Structured entity
CRR	Capital Requirements Regulation	LSE	London Stock Exchange	SME	Small or medium sized entities
DB	Defined benefit	LTIP	Long term incentive plan	SVR	Standard variable rate
DTR	Disclosure and Transparency Rules	LTV	Loan to value	TCC	Transactional Credit Committee
EBA	European Banking Authority	MREL	Minimum Requirement for Own Funds and Eligible Liabilities	TSA	Transitional Services Agreements
eCRS	electronic Customer Rating System	LTV	Loan to value		
EIR	Effective interest rate	MREL	Minimum Requirement for Own Funds and Eligible Liabilities		
EPS	Earnings per share				
FCA	Financial Conduct Authority				
FPC	Financial Policy Committee				

OTHER INFORMATION

Country by Country Reporting (CBCR)

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's Capital Requirements Directive (CRD IV). The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations.

The vast majority of entities that are consolidated within the Group's financial statements are UK registered entities. The activities of the Group are described in the Strategic Report.

The total operating income and the average number of full time equivalent employees during the year to 30 September 2016 were:

Audited	2016 UK
Average Full Time Equivalent Employees (number)	6,718
Total operating income (£m)	997
Profit before tax (£m)	77
Corporation tax paid/(repaid) (£m)	(4)
Public subsidies received (£m)	Nil

The only other non UK registered entities of the Group are two Trustee companies that are part of the Group's securitisation vehicles (Lanark and Lannraig). Both of these entities (Lanark Trustees Limited and Lannraig Trustees Limited) are registered in Jersey. These entities play a part in the overall securitisation process by having the beneficial interest in certain mortgage assets assigned to them. Both

entities have no assets or liabilities recognised in their financial statements with the securitisation activity taking place in other UK registered entities of the structures. These entities do not undertake any external economic activity and have no employees. The results of these entities as well as those of the entire Lanark and Lannraig securitisation structures are consolidated in the financial statements of the Group.

SHAREHOLDER  
INFORMATION

Annual General Meeting

The Annual General Meeting (AGM) of the Company will be held at 10am (Melbourne time – AEDT) on Tuesday, 31 January 2017 at the Melbourne Convention and Exhibition Centre, 1 Convention Centre Place, South Wharf, Melbourne, Victoria 3006, Australia. The Notice of AGM can also be found on the CYBG PLC website (www.cybg.com).

Shareholder Enquiries

The Company’s share register is maintained by the Company’s Registrar, Computershare. Shareholders with queries relating to their shareholding should contact Computershare directly using one of the methods below:

Registrar

Computershare UK  
Computershare Investor Services PLC  
The Pavilions  
Bridgwater Road  
Bristol  
England  
United Kingdom  
BS99 6ZZ

Tel within UK – 0370 707 1172  
Tel outside UK – +44 370 707 1172  
E-mail: www.investorcentre.co.uk/contactus  
Web: www.investorcentre.co.uk

Computershare Australia  
Computershare Investor Services Pty Limited  
Yarra Falls  
452 Johnston Street  
Abbotsford VIC 3067  
Australia

Tel within Australia – 1800764308  
Tel outside Australia – 03 9415 4142  
E-mail: www.investorcentre.com/contact  
Web: www.investorcentre.com/au

Duplicate shareholder accounts

If you receive more than one copy of Company mailings this may indicate that more than one account is held in your name on the register. This happens when the registration details of separate transactions differ slightly. If you believe more than one account exists in your name you may contact the Company’s Registrar, Computershare, to request that the accounts are combined. There is no charge for this service.

Electronic Communications

CYBG PLC uses its website (www.cybg.com) as its primary means of communication with its shareholders provided that the shareholder has agreed or is deemed to have agreed that communications may be sent or supplied in that manner. Electronic communications allow shareholders to access information instantly as well as helping the Company reduce its costs and its impact on the environment. Shareholders that have consented or are deemed to have consented to electronic communications can revoke their consent at any time by contacting the Company’s Registrar, Computershare.

Shareholders can sign up for electronic communications online via the following links:

Holders of shares on the London Stock Exchange:  
www.investorcentre.co.uk/ecomms

Holders of CDIs on the Australian Securities Exchange:  
www.investorcentre.com/au

Corporate Website

A wide range of information on the Company is available at the CYBG PLC website (www.cybg.com) including:

- Financial information – annual and half-yearly reports as well as trading updates;
- Share price information – current trading details and historical charts;
- Shareholder information – investor presentations and share register profile;
- News releases – current and historical.

Unsolicited telephone calls and communication

Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at a discount, or offers of free reports about the Company. These are typically from overseas based ‘brokers’ who target shareholders, offering to sell them what often turns out to be worthless or high risk shares. These operations are commonly known as ‘boiler rooms’ and the ‘brokers’ can be very persistent and extremely persuasive.

Shareholders are advised to deal with only financial services firms that are authorised by the FCA. You can check a firm is properly authorised by the FCA before getting involved by visiting www.fca.org.uk/register. If you do deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme if anything goes wrong. For more detailed information on how you can protect yourself from an investment scam, or to report a scam, go to www.fca.org.uk/consumers/report-scam-unauthorised-firm.

Shareholder interests as at 30 September 2016

By size of holding

Range	No. of Shareholders	%	No. of Shares	%
1 - 1,000	347,772	89.35	74,164,373	8.41
1,001 - 5,000	36,645	9.41	71,051,327	8.06
5,001 – 10,000	3,083	0.79	21,312,069	2.42
10,001 – 100,000	1,565	0.40	34,781,007	3.95
100,001 – 999,999,999	180	0.05	680,223,076	77.16
Totals	389,245	100.00	881,531,852	100.00

Financial Calendar

Q1 Trading update	31 January 2017
Annual General Meeting	31 January 2017
Q3 Trading update	27 July 2017
Preliminary Results	21 November 2017

## FORWARD LOOKING STATEMENTS

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The information in this document may include forward looking statements, which are based on assumptions, expectations, valuations, targets, estimates, forecasts and projections about future events. These can be identified by the use of words such as 'expects', 'aims', 'targets', 'seeks', 'anticipates', 'plans', 'intends', 'prospects', 'outlooks', 'projects', 'believes', 'estimates', 'potential', 'possible', and similar words or phrases. These forward looking statements are subject to risks, uncertainties and assumptions about the Group and its securities, investments and the environment in which it operates, including, among other things, the development of its business and strategy, trends in its operating industry, changes to customer behaviours and covenant, macroeconomic and/or geopolitical factors, changes to law and/or the policies and practices of the BoE, the FCA and/or other regulatory bodies, inflation, deflation, interest rates, exchange rates, changes in the liquidity, asset position and/or credit ratings of the Group, the status of the UK's membership of the European Union, and future capital expenditures and acquisitions.

In light of these risks, uncertainties and assumptions, the events in the forward looking statements may not occur. Forward looking statements involve inherent risks and uncertainties. Other events not taken into account may occur and may significantly affect the analysis of the forward looking statements.

Neither the Group nor its Directors give any assurance that any such projections or estimates will be realised or that actual returns or other results will not be materially lower than those set out in this document. All forward looking statements should be viewed as hypothetical. No representation or warranty is made that any forward looking statement will come to pass. No member of the Group or its Directors undertakes any obligation to update or revise any such forward looking statement following the publication of this document nor accepts any responsibility, liability or duty of care whatsoever for (whether in contract, tort or otherwise), or makes any representation or warranty, express or implied, as to the truth, fullness, fairness, merchantability, accuracy, sufficiency or completeness of, the information in this document.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation, nor an offer to sell, nor solicitation of any offer to buy any securities or financial instruments, nor any advice or recommendation with respect to such securities or other financial instruments.