# Virgin Money Holdings (UK) plc
# Pillar 3 Disclosures
## 31 December 2017

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# 1. Executive Summary

## Introduction

This document presents the consolidated Pillar 3 disclosures of Virgin Money Holdings (UK) plc (the Group, or Virgin Money) as at 31 December 2017.

Pillar 3 requirements are set out under the Capital Requirements Directive and Regulation (CRD IV) and are designed to promote market discipline through the disclosure of key information around capital, risk exposures and risk management. A table setting out how the Group complies with the CRD IV disclosure requirements is shown in table 59.

Where appropriate, cross references have been made to supporting disclosures that are included within the 2017 Virgin Money Group Annual Report and Accounts. As such, these disclosures should be read in conjunction with that document.

## Key ratios

*Table 1: Key ratios*

| | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| **Common Equity Tier 1 (CET1) ratio** | **13.8%** | 15.2% |
| **Tier 1 ratio** | **18.0%** | 20.2% |
| **Total capital ratio** | **18.1%** | 20.4% |
| **Leverage ratio** | **3.9%** | 4.4% |
| **Liquidity coverage ratio (LCR)** | **203.1%** | 153.7% |

During the year the Group generated capital, after distributions to Additional Tier 1 (AT1) holders and before investment and dividends, of £167.3 million, which was equivalent to 182 basis points of CET1 capital.

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

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

Lending growth resulted in a 19.3% increase in risk-weighted assets (RWAs) to £9.2 billion. In mortgages, growth in credit risk RWAs of 21.5% was higher than balance growth of 13.2% as the average mortgage risk weight density, as a percentage of balance sheet assets, increased to 17.2% from 16.0% in 2016, in line with expectations.

In credit cards, credit risk RWA growth was in line with asset growth as credit card RWAs are calculated using the standardised approach. Other RWAs increased by 2.1%. This reflected growth in operational risk RWAs in line with the standardised approach, where the growth in average income over the past three years is recognised in a higher level of operational RWAs, largely offset by a reduction in exposure to higher risk-weighted instruments and counterparties in the Group's liquid asset portfolio.

As a result of the above movements, the CET1 ratio reduced to 13.8% at 31 December 2017 compared with 15.2% at the end of 2016. This was in line with the expected development of the business and is in excess of the Group's internal minimum CET1 ratio of 12%. The total capital ratio of 18.1% also reduced in line with the movements described above, and remains significantly in excess of total regulatory requirements of 15.0%.

The capital requirement of 15.0% at 31 December 2017 comprised Pillar 1, Pillar 2A and the capital conservation buffer. At 31 December 2017, as per the Group's Individual Capital Guidance (ICG), the Basel I floor was the Group's binding constraint and equivalent to a Pillar 2A capital add-on requirement of 5.71%.

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

The Group's liquidity position remained strong throughout the period, with high quality liquid assets at £5.3 billion at 31 December 2017. This reflects an increase in cash and balances held at central bank. The Group held increased levels of liquidity at 31 December 2017, reflected in an increase in balances held at the central bank in part due to the repayment of £650 million of Funding for Lending Scheme (FLS) drawings which have been replaced by on balance sheet liquidity. As a result the Group's liquidity coverage ratio (LCR) of 203% was significantly above the regulatory minimum of 90%. From 1 January 2018 the regulatory minimum has increased to 100%. The high quality liquid asset portfolio represented more than six times the Group's wholesale funding with a maturity of less than one year.

All ratios above are within the Group's risk appetite, which is the amount and type of risk that the Group is prepared to seek, accept or tolerate. The Group's strategy is developed in conjunction with risk appetite.

# 2. Disclosure policy

## Basis of preparation

This document contains the consolidated Pillar 3 disclosures of the Group as at 31 December 2017, prepared in accordance with the requirements of Part Eight of the Capital Requirements Regulation (EU Regulation 575/2013, the CRR).

These disclosures may differ from similar information in the 2017 Virgin Money Group Annual Report and Accounts which is prepared in accordance with International Financial Reporting Standards (IFRS). The reconciliation between the Accounts and Pillar 3 is shown in tables 4 and 5 with significant differences summarised below:

- Virgin Money Giving Limited, a subsidiary within the statutory group, is included in the 2017 Virgin Money Group Annual Report and Accounts but excluded from the regulatory group for Pillar 3 (see section 3);
- Pillar 3 exposure values for mortgages are disclosed using the exposure at default (EAD) measure. This is a parameter used in the Advanced Internal Ratings Basis (AIRB) approach to estimate the amount outstanding at the time of default. The EAD calculation is defined as the aggregate of on balance sheet exposures, off-balance sheet commitments (including amounts where customers have contractual rights to draw down further balances and estimates of interest accruals to the point of default) after application of credit conversion factors, and other relevant regulatory adjustments.
- All other credit risk exposures, including credit cards and wholesale assets, are measured using the standardised approach. The exposure value is stated net of specific impairment provisions. General impairment provisions are not deducted from the exposure value but instead form part of Tier 2 capital.

Article 432 of the CRR on non-material, proprietary and confidential information permits institutions to omit one or more disclosures if the information provided by such a disclosure is not regarded as material or if the information is regarded as proprietary or confidential. The Group has not omitted any disclosures on this basis.

The implementation of CRD IV is subject to transitional arrangements, with full implementation in the UK required by 1 January 2022 as per Prudential Regulation Authority (PRA) policy statement PS7/13. There are no longer any transitional rules that impact the Group and so the capital positions shown for 2017 and 2016 are on a fully loaded basis.

## Frequency, media and location

The Group's policy is to publish the required disclosures on an annual basis in conjunction with the 2017 Virgin Money Group Annual Report and Accounts. The Pillar 3 disclosures are published within the Investor Relations section of the corporate website www.virginmoney.com.

The frequency of disclosure will be reviewed should there be a material change in any approach used for the calculation of capital, the business structure or regulatory requirements.

## Verification

The Group's Pillar 3 disclosures have been reviewed through the internal governance procedures applicable to all external reporting, including review and approval by the Audit Committee and the Board. In addition, the Group remuneration disclosures in Appendix 7 have been reviewed by the Remuneration Committee. The Pillar 3 disclosures are not subject to audit except where they are equivalent to those prepared under financial reporting requirements and disclosed in the 2017 Virgin Money Group Annual Report and Accounts.

## Risk profile disclosure

In accordance with Part Eight of the CRR, the Group is required to assess whether its external disclosures portray its risk profile comprehensively. The disclosures of risk management objectives and procedures within this Pillar 3 document are detailed fully within the Risk Management Report of the 2017 Virgin Money Group Annual Report and Accounts.

## Current developments

The disclosures follow largely the same format as 2016. In December 2016 the European Banking Authority (EBA) published final Guidelines on Pillar 3 disclosures following the 2015 recommendations of the Basel Committee. While these came into force at the end of 2017, the guidelines only apply to Global and Other Systemically Important Institutions (G-SIIs and O-SIIs).

In March 2017, the EBA published final guidelines on the disclosure of the LCR. Where the guidelines only apply to G-SIIs and O-SIIs they have not been adopted. The Group has adopted the disclosures where they apply to all institutions and included abbreviated disclosures of the LCR in section 13.

In April 2017, the PRA issued a supervisory statement on remuneration (SS2/17) which modified the disclosure requirements required within Pillar 3 based on total asset size. The level of remuneration disclosure within Appendix 7 has been revised in line with the relevant PRA guidance for the size of the Group.

Appendix 10 shows the mapping of the disclosure requirements of Part Eight of the Capital Requirements Regulation to the relevant pages and tables within this Pillar 3 document and the 2017 Virgin Money Group Annual Report and Accounts.

The new accounting requirements of IFRS 9 will apply from 1 January 2018. An explanation of the impact on the Group and its capital position is included on page 51 of the 2017 Virgin Money Group Annual Report and Accounts.

The Financial Services Banking Reform Act 2013 will result in the ring-fencing of retail banking operations to separate them from investment banking activities. The implications of this structural reform to the Group are discussed in more detail on page 35 of the 2017 Virgin Money Group Annual Report and Accounts.

# 3. Scope of consolidation

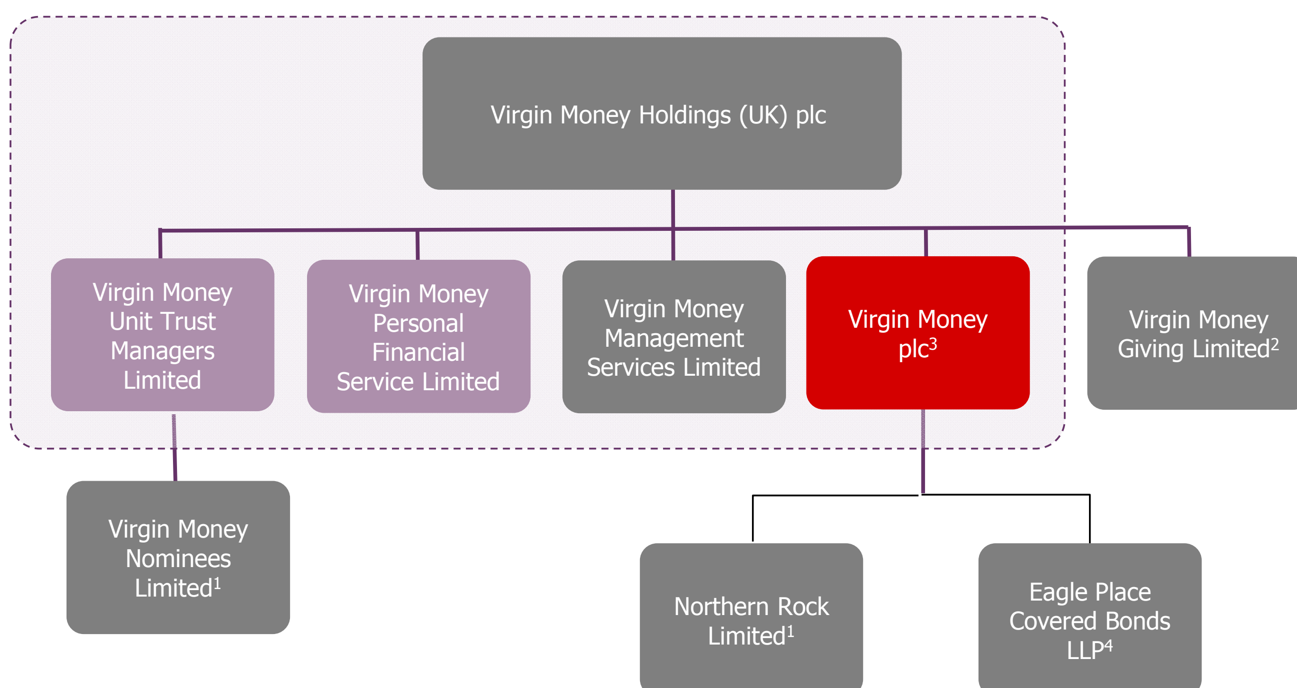
## Regulatory consolidation

The scope of consolidation for regulatory reporting purposes, including these Pillar 3 disclosures, differs from the scope of consolidation for statutory financial reporting. Virgin Money Giving Limited is excluded from the regulatory consolidation because it is not regulated. Other subsidiary undertakings included within the regulatory consolidation are fully consolidated. The Group holds a small number of low value equity investments, not meeting the accounting definition of a subsidiary, which are treated as investments and reflected in risk-weighted assets accordingly.

The legal and regulatory structure of the Group provides the capability for the prompt transfer of surplus capital resources over and above regulatory requirements or repayment of liabilities when due throughout the Group. There are no current or foreseen material practical impediments to the prompt transfer of own funds or repayment of liabilities among the Group companies.

The Group structure, including the make-up of the regulatory group, at 31 December 2017 is set out below.

*Table 2: Regulatory Group structure*




**Notes:**

1 Dormant Company
2 Not-for-profit organisation
3 Includes special purchase vehicles
4 Virgin Money plc also owns 20% of Eagle Place Covered Bonds Finance Limited, the other member of the LLP.

**Key:**

- FCA regulated
- FCA and PRA regulated
- Companies not regulated by the PRA or FCA
- UK consolidated group for regulatory return purposes

## Subsidiary disclosures

Additional disclosures surrounding the capital resources, leverage exposures and capital requirements of Virgin Money plc (VM plc) have been provided within Appendices 2, 3, 4, 5 and 8 of this document together with analysis of its credit risk exposures, credit risk mitigation and impairments. These disclosures are provided to satisfy the significant subsidiary disclosure requirements under CRR Article 13 (Application of disclosure requirements on a consolidated basis).

There are a number of special purpose vehicles (SPVs) established in connection with the Group's securitisation programme. Although VM plc has no direct or indirect ownership interest in these companies, they are accounted for as subsidiaries of VM plc. This is because they are principally engaged in providing a source of long term funding to the Group, which in substance means the Group is exposed to rights of variable returns from its involvement in the SPVs and has the ability to affect those returns through its power over the entities.

There is no significant risk transfer associated with the securitisations and therefore for the purposes of regulatory capital and Pillar 3 disclosures, the SPVs are consolidated within the VM plc disclosures.

*Table 3: Special purpose vehicles*

| **As at 31 December 2017:** | **Nature of business** |
|---|---|
| Gosforth Funding 2014-1 plc | Issue of securitised notes |
| Gosforth Funding 2015-1 plc | Issue of securitised notes |
| Gosforth Funding 2016-1 plc | Issue of securitised notes |
| Gosforth Funding 2016-2 plc | Issue of securitised notes |
| Gosforth Funding 2017-1 plc | Issue of securitised notes |
| Gosforth Mortgages Trustee 2014-1 Limited | Trust |
| Gosforth Mortgages Trustee 2015-1 Limited | Trust |
| Gosforth Mortgages Trustee 2016-1 Limited | Trust |
| Gosforth Mortgages Trustee 2016-2 Limited | Trust |
| Gosforth Mortgages Trustee 2017-1 Limited | Trust |
| Gosforth Holdings 2014-1 Limited | Holding company |
| Gosforth Holdings 2015-1 Limited | Holding company |
| Gosforth Holdings 2016-1 Limited | Holding company |
| Gosforth Holdings 2016-2 Limited | Holding company |
| Gosforth Holdings 2017-1 Limited | Holding company |

## Group balance sheet under regulatory consolidation

The table below provides a reconciliation of the Group's balance sheet on an accounting consolidation basis (which includes all Group companies) to the Group's balance sheet under the regulatory consolidation basis as at 31 December 2017.

*Table 4: Reconciliation of statutory balance sheet to regulatory balance sheet*

| As at 31 December 2017 | Accounting balance sheet as in published financial statements | Deconsolidation of entities outside the regulatory group | Regulatory balance sheet |
|---|---|---|---|
| | £m | £m | £m |
| **Assets** | | | |
| Cash and balances at central banks | 2,579.0 | - | 2,579.0 |
| Derivative financial instruments | 78.8 | - | 78.8 |
| Loans and receivables: | | | |
| - Loans and advances to banks | 359.4 | (0.1) | 359.3 |
| - Loans and advances to customers | 36,740.2 | - | 36,740.2 |
| - Debt securities | 0.3 | - | 0.3 |
| Available-for-sale financial assets | 1,051.8 | - | 1,051.8 |
| Intangible assets | 128.4 | - | 128.4 |
| Tangible fixed assets | 74.5 | - | 74.5 |
| Deferred tax assets | 11.5 | - | 11.5 |
| Other assets | 83.9 | (0.3) | 83.6 |
| **Total assets** | 41,107.8 | (0.4) | 41,107.4 |
| **Liabilities** | | | |
| Deposits from banks | 5,379.0 | - | 5,379.0 |
| Customer deposits | 30,808.4 | - | 30,808.4 |
| Derivative financial instruments | 93.5 | - | 93.5 |
| Debt securities in issue | 2,736.9 | - | 2,736.9 |
| Other liabilities | 241.5 | (0.1) | 241.4 |
| Current tax liabilities | 23.6 | - | 23.6 |
| **Total liabilities** | 39,282.9 | (0.1) | 39,282.8 |
| **Equity** | | | |
| Share capital and share premium | 654.6 | - | 654.6 |
| Other equity instruments | 384.1 | - | 384.1 |
| Other reserves | (18.1) | - | (18.1) |
| Retained earnings | 804.3 | (0.3) | 804.0 |
| **Total equity** | 1,824.9 | (0.3) | 1,824.6 |
| **Total liabilities and equity** | 41,107.8 | (0.4) | 41,107.4 |

## Reconciliation of regulatory balance sheet assets to credit risk exposures

A reconciliation of the consolidated regulatory balance sheet to credit risk exposures is presented below.

*Table 5: Reconciliation of regulatory balance sheet to credit risk exposures*

| As at 31 December 2017 | Regulatory balance sheet £m | Assets deducted from own funds £m | Derivative, central counterparty and repo adjustments £m | Provisions £m | Counterparty credit risk exposures £m | Securitisations £m | Total credit risk exposures £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | **2,579.0** | - | - | - | - | - | **2,579.0** |
| Derivative financial instruments | **78.8** | - | 31.2 | - | (110.0) | - | **-** |
| Loans and receivables: | | | | | | | |
| - Loans and advances to banks | **359.3** | - | (62.9) | - | (8.5) | - | **287.9** |
| - Loans and advances to customers | **36,740.2** | - | (43.7) | 26.5 | - | - | **36,723.0** |
| - Debt securities | **0.3** | - | - | - | - | - | **0.3** |
| Available-for-sale financial assets | **1,051.8** | - | 76.0 | - | (76.0) | (61.7) | **990.1** |
| Intangible assets | **128.4** | (128.4) | - | - | - | - | **-** |
| Tangible fixed assets | **74.5** | - | - | - | - | - | **74.5** |
| Deferred tax assets | **11.5** | (0.6) | - | - | - | - | **10.9** |
| Other assets | **83.6** | - | 355.8 | - | (364.3) | - | **75.1** |
| **Total assets** | **41,107.4** | (129.0) | 356.4 | 26.5 | (558.8) | (61.7) | **40,740.8** |
| AIRB off balance sheet exposures | | | | | | | **1,954.9** |
| Interest accrued to default | | | | | | | **459.3** |
| **Total regulatory capital exposures** | | | | | | | **43,155.0** |

Exposures relating to derivatives, central counterparties and repurchase transactions (repos or securities financing transactions) are disclosed within the counterparty credit risk section on pages 32 to 33. Exposures to third party securitisations are disclosed within the securitisation credit risk section on pages 30 to 31. All other exposures fall into the credit risk category and are analysed in more detail on pages 19 to 29.

# 4. Risk management

This section summarises the overall risk management policy of the Group. More detailed analyses of individual risks (credit risk, market risk, operational risk and funding and liquidity risk) are set out in later sections. Further detail including a statement on the Group's overall risk profile can be found in the Risk Management Report in the 2017 Virgin Money Group Annual Report and Accounts.

## The Group's approach to risk management

Risk management is at the heart of the Group's strategy to enable profitable, long-term growth. This is achieved through a clearly defined risk appetite and informed risk decision-making, supported by a consistent risk-focused culture across the Group.

## Risk culture and values

The Group has a customer-focused business model built on a risk culture that reinforces accountability. The Group's risk values describe how all colleagues, suppliers and partners are expected to operate.

## Risk appetite

Risk appetite is the amount and type of risk that the Group is prepared to seek, accept or tolerate. It is reflected in frameworks and policies that either limit or, where appropriate, prohibit activities that could be detrimental to the Group. The Group's strategy is developed in conjunction with risk appetite. A Risk Appetite Statement is approved by the Board with each strategic planning cycle.

## Governance and control

Delegation of authority from the Board to Executive Committees and Senior Management establishes governance and control. Issues are escalated promptly and remediation plans are initiated where required.

## Accountability

The Group uses a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities ensuring effective independent assurance activities over key business activities.

- line management (first line) have primary responsibility for risk decisions, measuring, monitoring and controlling risks within their areas of accountability;
- the Risk function (second line) provides proactive advice and constructive challenge on the effectiveness of risk decisions taken by management; and
- Internal Audit (third line) provides independent, objective assurance to improve operations.

## Risk decision-making and reporting

A current and forecast view of the Group's overall risk profile, key exposures and management actions is reported to the Risk Management Committee, the Board Risk Committee and the Board. The Chief Risk Officer is a member of the Executive and has direct access to the Chair of the Board Risk Committee.

## Stress testing

Stress testing is an essential risk management tool which examines the sensitivities of the strategic plan and business model and supports the development of management actions and contingency plans. It is overseen by the Board Risk Committee.

## Risk disclosure statement

The Board is responsible for reviewing the effectiveness of the Group's risk management arrangements and systems of financial and internal controls. The Board believes that the risk management framework in place is adequate for the Group's profile and strategy.

The Board focuses on ensuring alignment of business development and planning with risk appetite. A clearly defined risk appetite aids the Group in maintaining a high-quality capital base, targeting capital ratios which support business development and are in excess of regulatory minima. Capital is actively managed with regulatory ratios being a key factor in the Group's planning processes and stress analysis. The Group reviews the capital structure on an on-going basis to ensure it is well placed to react to prevailing economic and regulatory conditions. The CET1 ratio for the Group was 13.8% as at 31 December 2017, significantly above regulatory minimum requirements.

# 5. Regulatory capital framework

This section contains an outline of the capital regulations (as implemented in the UK by the PRA policy statement PS7/13) which define a framework of regulatory capital resources and requirements applicable to the Group. CRD IV came into force in the European Union on 1 January 2014.

## Regulatory capital

The capital resources of the Group are detailed in table 7. Resources are classified depending on the level of permanency and loss absorbency exhibited:

### Common Equity Tier 1 (CET1) capital

This represents the strongest form of capital consisting of ordinary share capital, share premium and allowable reserves. CET1 capital is stated after deducting regulatory adjustments such as intangible assets, expected losses in excess of provisions in respect of the AIRB mortgage portfolio and foreseeable distributions of current profits not accrued in the balance sheet. CET1 capital can be supplemented by certain subordinated debt liabilities and other capital securities classified as Additional Tier 1 or Tier 2 capital.

### Additional Tier 1 (AT1) capital

AT1 capital instruments are non-cumulative perpetual securities that contain a specific provision to write down the security or convert it to equity, should the CET1 ratio fall below a specified trigger limit. The Group's current AT1 securities contain a conversion trigger of 7%.

### Tier 2 capital

Tier 2 capital typically comprises certain other subordinated debt securities that do not qualify as AT1. While the Group has not issued any such instruments, it holds Tier 2 capital comprised of general provisions (under the CRD IV definition) on credit cards.

## Capital requirements

The capital and prudential requirements included within the capital regulations are categorised under three pillars:

## Pillar 1 capital requirements

Pillar 1 of the regulatory framework focuses on the determination of risk-weighted assets and expected losses in respect of the firm's exposure to credit, counterparty credit, operational and market risks.

The regulatory minimum amount of total capital is determined as 8% of the aggregate risk-weighted assets and the Pillar 1 capital requirements referenced in this document are calculated using this regulatory minimum value. At least 4.5% of risk-weighted assets must be covered by CET1 capital.

A range of approaches, varying in sophistication, are available under the CRD IV framework to use in measuring risk-weighted assets to determine the minimum level of capital required. Within the Group, mortgage risk-weighted assets are calculated using the AIRB approach which is subject to a number of internal controls and external approval by the PRA. Other risk-weighted assets are calculated using a simpler standardised approach.

### Credit risk

The Group is exposed to credit risk through its retail lending and wholesale investment activity.

The AIRB approach is applied to the Group's residential mortgage portfolio. Risk-weighted assets are calculated using a formula incorporating internal assessments of the probability of a customer defaulting (PD), loss given default (LGD) and exposure at default (EAD) (subject to certain floors).

The Group uses the standardised approach for all credit risk exposures apart from mortgages. The standardised approach is the most basic approach which applies a specified set of risk weights to exposures. Under this approach banks can utilise external ratings to determine risk weights for rated counterparties.

Further qualitative and quantitative disclosures on credit risk are provided in section 8. Further details on the Group's application of the AIRB approach (for mortgages) are provided in Appendix 1.

### Counterparty credit risk

The Group is exposed to counterparty credit risk through its use of derivatives for risk management purposes and for asset repurchase agreements (repos) used as a funding tool.

Under the mark-to-market method an add-on for potential future exposure is applied to the balance sheet value of derivatives to give an overall derivative exposure value.

The standardised method is used to determine the exposure value of repos. Exposures are measured by calculating the difference between the current market value of the asset repo'ed and the cash received plus interest accumulated, net of collateral posted or received. The risk-weighted exposures for derivatives and repos are calculated by applying standardised risk weights associated with the particular counterparty.

Also included within counterparty credit risk is the credit valuation adjustment (CVA). The CVA is an adjustment to the fair value of a derivative contract reflecting the value of counterparty credit risk inherent in that contract. The standardised approach takes account of the external credit ratings of derivative counterparties and incorporates the derivative exposure value and effective maturity of exposures using the calculation prescribed by the CRR.

Further qualitative and quantitative disclosures on counterparty credit risk and the CVA requirements are provided in section 10.

## Operational risk

The standardised approach measures the capital requirement as a percentage of the average net interest and non-interest income. This requires a firm's activities to be split into a number of defined business lines with a specific percentage applied to the income of each business line. The Group adopts this approach, deriving the requirement from the three year average of the aggregate adjusted income of the business.

Further qualitative and quantitative disclosures on operational risk are provided in section 11.

## Market risk

The standardised approach for market risk applies mainly to the trading book positions of institutions. As the Group has no trading activities these are not applicable.

While the Group has exposure to interest rate risk in the banking book, the CRR imposes no Pillar 1 requirement in relation to this. As such, the Group's only exposure to market risk is in relation to foreign currency exposure. However, as this is below the de minimis limit for CRD IV, the Group has no Pillar 1 market risk capital requirement.

Further qualitative and quantitative disclosures on market risk are provided in section 12.

## Pillar 2 capital requirements

Pillar 2 describes the supervisory review process and the assessment of additional capital resources required to cover specific risks faced by firms that have not been covered by the minimum regulatory requirements as set out in Pillar 1.

The PRA sets additional minimum requirements through the issuance of institution specific Individual Capital Guidance (ICG). Through the ICG, the PRA provides guidance on the Pillar 2A own funds requirement which is expressed as the higher of a variable component addressing additional risks faced by the Group and the Basel I floor, a transitional capital minimum requirement based on the Basel I framework. At 31 December 2017, the Group's ICG requirement was 5.71% of risk-weighted assets (3.87% of RWAs excluding the Basel I floor). From 1 January 2018 the Group will no longer measure the Basel I floor and Pillar 2A will be set as a capital requirement rather than PRA guidance. As such, the ICG will be replaced by the Total Capital Requirement (TCR).

The PRA may also set a further buffer requirement determining capital to be held against future periods of stress as described under Pillar 2B below.

### Pillar 2A

Key to the PRA's ICG setting process is the Group's assessment of the amount of capital needed, a process known as the Internal Capital Adequacy Assessment Process (ICAAP). The Group has been given an ICG by the PRA and maintains capital at a level which exceeds this requirement. At least 56.25% of Pillar 1 and Pillar 2A must be covered by CET1 capital.

The ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk, operational risk and market risk by assessing the material risks not covered or fully captured under Pillar 1. The ICAAP document is approved by the Board and submitted to the PRA every two years but conducts an ICAAP on an annual basis.

The ICAAP assesses all risk not captured by Pillar 1 but the material risks identified are:

- credit concentration risk – the risk of losses arising as a result of concentrations of exposures due to imperfect diversification. This imperfect diversification can arise from the small size of a portfolio or a large number of exposures to specific obligors (single name concentration) or from imperfect diversification with respect to economic sectors or geographical regions;
- credit risk – underestimation. There are asset classes for which the standardised approach is considered to underestimate the risk. Potential underestimation is quantified against benchmark internal ratings based approaches and included in Pillar 2 credit risk;
- interest rate risk in the banking book – the risk of losses arising from changes in the interest rates associated with banking book items;
- operational risk – to the extent not covered by Pillar 1, the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and including legal risk; and
- business risk – the risk arising from changes in the business, including the potential risk that the Group may not be able to execute its business plan and/or strategy including the impact of the competitive environment and adverse changes in customer behaviours. It also includes potential risks arising from a firm's remuneration policy.

### Pillar 2B

Forecast capital positions are subjected to extensive stress analyses to determine the adequacy of the Group's capital resources under stressed conditions. Under Pillar 2B the PRA uses the outputs from some of these stress analyses to inform the setting of the Group's PRA buffer assessment, defining a minimum level of capital buffers over and above the minimum regulatory requirements that should be maintained in non-stressed conditions as mitigation against potential future periods of stress. The PRA requires this buffer to remain confidential between the Group and the PRA.

The PRA buffer is discussed further in the regulatory capital buffers section below.

### Regulatory capital buffers

The requirement to maintain a countercyclical buffer of up to 2.5% was introduced on 1 January 2016. This buffer has been designed to require banks to hold additional capital to remove or reduce the build-up of systemic risk in times of excessive market wide credit expansion, providing additional loss absorbing capacity. The buffer is determined by reference to buffer rates for the individual countries where the Group has credit risk exposures.

The Financial Policy Committee (FPC) of the Bank of England is responsible for setting the UK countercyclical rate and for recognising rates set by other jurisdictions, or for recommending higher rates. The buffer is currently set at 0%, but in June 2017 the FPC announced an increase of the UK countercyclical rate to 0.5%, with binding effect from 27 June 2018. In November 2017, the FPC confirmed a further increase to 1.0%, with binding effect from 28 November 2018.

Foreign exposures qualifying for the countercyclical buffer make up less than the de minimis level of 2% of the total exposures, therefore the Group treats all exposures as arising in the UK. See Appendix 4 for further analysis.

The FPC can also set sectoral capital requirements which are temporary increases to institutions' capital requirements on exposures to specific sectors, if the FPC judges that excessive lending to those sectors poses risks to financial stability. No sectoral capital requirements currently apply to the Group.

There are two other CET1 capital buffers phased in over the period from 2016 to 1 January 2019. The capital conservation buffer is a general buffer of up to 2.5% of risk-weighted assets designed to build up capital buffers outside periods of stress. During 2017 the transitional regulations set this at 1.25%, rising to 1.875% on 1 January 2018, and 2.5% a year later.

The framework for a systemic risk buffer for ring-fenced banks will be applied to individual institutions by the PRA and will be introduced, like ring-fencing rules, from 2019.

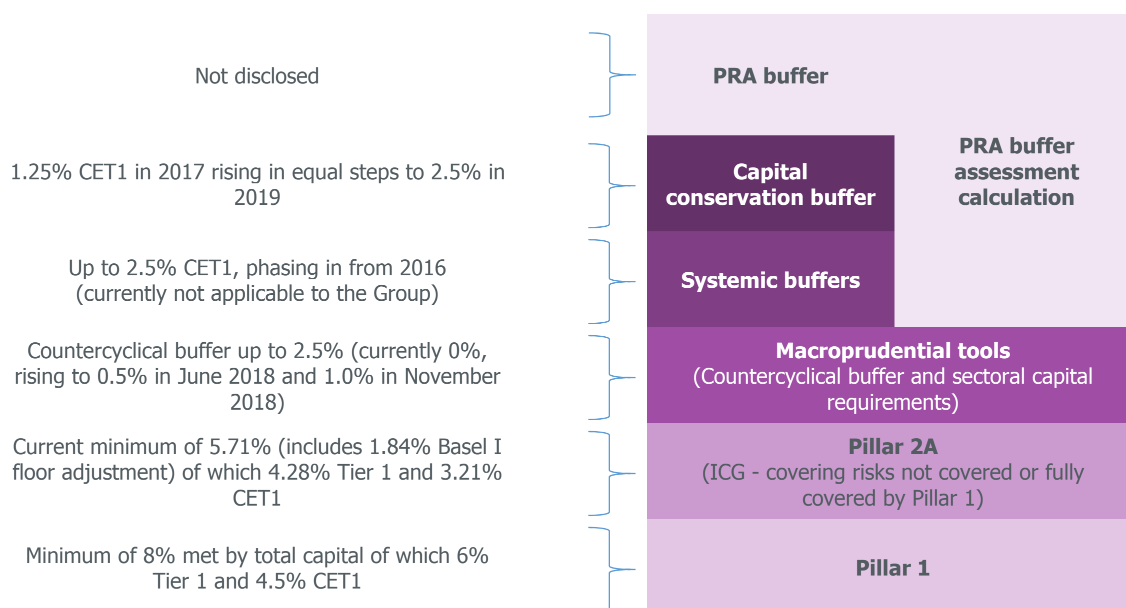
The PRA buffer takes into account the extent to which these CRD IV buffers already capture the risks identified in the PRA buffer assessment. The excess of the PRA buffer assessment over the capital conservation buffer and any systemic buffers is treated as the PRA buffer. Where the PRA buffer assessment is less than the capital conservation buffer and systemic buffers, no PRA buffer will be applied.

All buffers are required to be met with CET1 capital, with the exception of the PRA buffer. The requirement for the PRA buffer to be met by CET1 capital is being phased in up to 1 January 2019. For 2017, 50% of the PRA buffer must be met by CET1 capital, rising to 75% on 1 January 2018, and 100% a year later. Where there is a breach of the PRA buffer, this would trigger a discussion between the firm and the PRA to agree what action is required. Where the capital conservation buffer and systemic buffers are binding, a breach of these buffer requirements would give rise to automatic constraints upon any discretionary capital distributions or variable remuneration awards by the Group.

The following table summarises all regulatory capital requirements for the Group:

*Table 6: Summary of capital requirements*

| Requirement or buffer | Calculation method | Quality of capital | Impact on the Group |
|---|---|---|---|
| **CRD IV** | | | |
| Pillar 1 | Fixed percentage of RWAs based on Article 92 of the CRR | 4.5% of RWAs met by CET1 capital<br>6.0% of RWAs met by Tier 1 capital<br>8.0% of RWAs met by total capital | As shown in Pillar 1 capital requirements section |
| Pillar 2A | Percentage of RWAs or Basel I floor if higher (Basel I floor is not required from 1 January 2018) | 56.25% of Pillar 2A met by CET1 capital<br>75% of Pillar 2A met by Tier 1 capital<br>100% of Pillar 2A met by total capital | Total capital requirement of 3.87% of RWAs (5.71% including Basel I floor up to 31 December 2017) |
| Macroprudential tools (countercyclical buffer and sectoral capital requirements) | Expressed as a percentage of RWAs | All to be met by CET1 capital | Set by the PRA, currently 0%, rising to 0.5% in June 2018 and 1.0% in November 2018. |
| Systemic buffers | Expressed as a percentage of RWAs | All to be met by CET1 capital | Currently not applicable to the Group |
| Capital conservation buffer | Expressed as a percentage of RWAs | All to be met by CET1 capital | 1.25% in 2017, rising to 2.5% in 2019. |
| PRA buffer | Expressed as a percentage of RWAs | 50% met by CET1 in 2017 rising to 100% by 2019. | PRA buffer is set by the PRA and is confidential |
| **Bank of England** | | | |
| Minimum Requirements for Own Funds and Eligible Liabilities (MREL) | Determined by the risk-weighted capital regime – currently the Group is not part of the PRA leverage framework. | To be met by MREL eligible capital and debt. Any CET1 held for regulatory buffers must be deducted. | Currently equal to minimum capital requirements. 18% of RWAs from 1 January 2020. |




## Pillar 3

Pillar 3 aims to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes. CRD IV sets out the minimum disclosures required under Pillar 3.

## Leverage framework

At present the Group has no minimum UK leverage requirement as it is currently exempt from the UK Leverage Framework Regime, which only applies to institutions with retail deposit levels of £50 billion or more.

Under the EBA leverage requirements, the leverage ratio is calculated by dividing Tier 1 capital resources by a defined measure of on balance sheet assets and off-balance sheet items. In August 2016 the EBA recommended that a 3.0% minimum leverage ratio requirement should be introduced from 1 January 2018. The Group leverage ratio of 3.9% as at 31 December 2017 exceeds this minimum requirement.

Appendix 5 shows detailed leverage ratio disclosures made in accordance with the EBA's Implementing Technical Standard EBA/ITS/2014/04/rev1.

## Minimum requirements for own funds and eligible liabilities

Minimum requirements for own funds and eligible liabilities (MREL) were applicable from 1 January 2016 on a transitional basis with full implementation required by 1 January 2022. The Bank of England provided the Group's MREL guidance and transitional arrangements in late 2016.

This set an interim MREL requirement of 18% of risk-weighted assets from 1 January 2020 until 31 December 2021. The Group is working towards implementation of these requirements and has reflected requirements in strategic plans. The Group expects to issue further senior debt over the next four year period to ensure compliance with MREL obligations.

# 6. Capital management

## Risk appetite

The Group maintains a high-quality capital base, targeting capital ratios which support business development and the risks inherent in the strategic plan. The Group's capital planning approach is focused on maintaining capital in excess of regulatory requirements at all times.

## Mitigation

The Group has capital management procedures that are designed to ensure compliance with risk appetite and regulatory requirements and are positioned to meet anticipated future changes to capital requirements.

The Group is able to accumulate additional capital through profit retention, by raising equity through, for example, a rights issue or debt exchange and by raising Additional Tier 1 and Tier 2 capital. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting lending strategy, risk hedging strategies and through business disposals. If necessary, this could include limiting business growth.

## Monitoring

Capital is actively managed with regulatory ratios being a key factor in the Group's planning processes and stress analysis. A minimum of a three year forecast of the Group's capital position, based upon the strategic plan, is produced at least annually to inform the capital strategy. Shorter term forecasts are more frequently undertaken to understand and respond to variations in the Group's actual performance against the plan.

Regular reporting of actual and projected ratios is undertaken, including submissions to the Asset and Liability Committee, the Risk Management Committee and the Board.

## Analysis of capital resources

The following table sets out the capital resources of the Group.

*Table 7: Group capital resources*

| | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| **Common Equity Tier 1** | | |
| Share capital and share premium | **654.6** | 654.6 |
| Other equity instruments | **384.1** | 384.1 |
| Other reserves | **(18.1)** | (27.4) |
| Retained earnings | **804.3** | 659.2 |
| Total equity per balance sheet | **1,824.9** | 1,670.5 |
| **Regulatory capital adjustments** | | |
| Net (assets)/liabilities of companies outside the regulatory group[1] | **(0.3)** | 5.4 |
| Foreseeable distribution on Additional Tier 1 securities[2] | **(3.8)** | (4.9) |
| Foreseeable distributions on ordinary share capital[2] | **(18.1)** | (15.5) |
| Other equity instruments[3] | **(384.1)** | (384.1) |
| Cash flow hedge reserve[4] | **22.7** | 31.5 |
| Additional valuation adjustment[5] | **(1.2)** | (1.2) |
| Intangible assets[6] | **(128.4)** | (80.6) |
| Excess of expected loss over impairment[7] | **(46.9)** | (41.1) |
| Deferred tax on tax losses carried forward[8] | **(0.6)** | (7.3) |
| **Common Equity Tier 1 capital** | **1,264.2** | 1,172.7 |
| **Additional Tier 1 securities** | **384.1** | 384.1 |
| **Total Tier 1 capital** | **1,648.3** | 1,556.8 |
| **Tier 2 capital** | | |
| General credit risk adjustments | **14.3** | 11.9 |
| **Total Tier 2 capital** | **14.3** | 11.9 |
| **Total own funds** | **1,662.6** | 1,568.7 |
| **Pillar 1 risk-weighted assets** | | |
| Retail mortgages | **5,790.5** | 4,764.5 |
| Unsecured lending | **2,282.9** | 1,847.4 |
| Wholesale | **99.4** | 133.2 |
| Other assets | **180.3** | 201.7 |
| Counterparty credit risk | **47.1** | 59.5 |
| Credit valuation adjustments | **10.4** | 22.6 |
| Securitisation exposures in the banking book | **12.3** | 10.6 |
| Operational risk | **755.7** | 655.3 |
| **Total risk-weighted assets** | **9,178.6** | 7,694.8 |
| **Common Equity Tier 1 ratio** | **13.8%** | 15.2% |
| **Tier 1 ratio** | **18.0%** | 20.2% |
| **Total capital ratio** | **18.1%** | 20.4% |

1. Assets/liabilities of Virgin Money Giving Limited included within the statutory consolidated Group have been removed from reserves as this company is not part of the regulatory Group.
2. Foreseeable distributions on ordinary shares and AT1 securities are deducted from CET1 capital under CRD IV.
3. Other equity instruments have been excluded from CET1 capital but instead make up Additional Tier 1 capital.
4. Under CRD IV, fair value reserves related to gains or losses on cash flow hedges are excluded from CET1 capital.
5. Under CRD IV, an additional valuation adjustment is applied in relation to the prudent valuation of all assets measured at fair value.
6. Intangible assets are required to be deducted from capital resources for regulatory purposes.
7. The excess of regulatory expected losses calculated under the AIRB approach over accounting provisions are deducted from CET1 capital.
8. Deferred tax on tax losses carried forward are deducted from CET1 capital. Other deferred tax balances arising from temporary differences are below the threshold for deduction and are risk-weighted at 250%.

Please see Appendix 2 for the CRD IV disclosure template as published by the EBA in Implementing Technical Standard 2013/01.

*Table 8: Movements in capital resources*

| | Common Equity Tier 1 | Additional Tier 1 capital | Tier 2 capital | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **At 1 January 2017** | **1,172.7** | **384.1** | **11.9** | **1,568.7** |
| Movement in retained earnings | 145.1 | - | - | 145.1 |
| Movement in additional valuation adjustment | 0.0 | - | - | 0.0 |
| Movement in available-for-sale reserve | 0.5 | - | - | 0.5 |
| Distributions on ordinary shares paid in the year | 23.9 | - | - | 23.9 |
| Distributions on ordinary shares accrued in the year | (26.5) | - | - | (26.5) |
| AT1 coupons accrued at previous year end | 4.9 | - | - | 4.9 |
| AT1 coupons accrued at this year end | (3.8) | - | - | (3.8) |
| Movement in reserves of companies outside the regulatory Group | (5.7) | - | - | (5.7) |
| Movement in intangible assets | (47.8) | - | - | (47.8) |
| Movement in excess of expected loss over impairment | (5.8) | - | - | (5.8) |
| Movement in deferred tax on tax losses carried forward | 6.7 | - | - | 6.7 |
| Movement in general provisions | - | - | 2.4 | 2.4 |
| **At 31 December 2017** | **1,264.2** | **384.1** | **14.3** | **1,662.6** |

Capital resources increased as a result of strong profit generation offset by investment in intangible assets primarily arising from investment in developing the Group's digital banking platform. Tier 2 capital is comprised of general provisions (under the CRD IV definition) on unsecured lending.

## Capital securities

Virgin Money Holdings (UK) plc issued Additional Tier 1 securities of £160.0 million to investors in July 2014, which have a discretionary coupon of 7.875% per annum. A further £230.0 million of Additional Tier 1 securities were issued to investors in November 2016, which have a discretionary coupon of 8.75% per annum.

The main features of both securities can be found in Appendix 3 of this document and the full terms and conditions can be found on the Investor Relations section of the corporate website at www.virginmoney.com.

# 7. Pillar 1 capital requirements overview

## Group risk-weighted assets and Pillar 1 capital requirements

As described on pages 10 to 11 the Pillar 1 capital requirements of the Group are made up of credit risk, counterparty credit risk (including credit valuation adjustment) and operational risk elements.

The following table sets out the risk-weighted assets and Pillar 1 capital requirements of the Group.

*Table 9: Risk-weighted assets and capital requirements*

| | **Risk-weighted assets** | | **Pillar 1 capital requirements** |
|---|---|---|---|
| | **2017 £m** | 2016 £m | **2017 £m** |
| Credit risk (excluding counterparty credit risk) | **8,326.0** | 6,907.6 | **666.0** |
| *Of which standardised approach* | ***2,535.5*** | *2,143.1* | ***202.8*** |
| *Of which the AIRB approach* | ***5,790.5*** | *4,764.5* | ***463.2*** |
| Counterparty credit risk | **57.5** | 82.1 | **4.6** |
| *Of which mark-to-market* | ***15.3*** | *25.2* | ***1.3*** |
| *Of which the standardised approach* | ***31.8*** | *34.3* | ***2.5*** |
| *Of which CVA* | ***10.4*** | *22.6* | ***0.8*** |
| Securitisation exposures in banking book (standardised approach) | **12.3** | 10.6 | **1.0** |
| Operational risk (standardised approach) | **755.7** | 655.3 | **60.5** |
| Amounts below the thresholds for deduction (subject to 250% risk weight) | **27.1** | 39.2 | **2.2** |
| **Total** | **9,178.6** | 7,694.8 | **734.3** |

In the table above, amounts below the thresholds for deduction relate to deferred tax assets that do not relate to tax losses carried forward. As the value of these assets are below the CRR threshold, they are not deducted from own funds but instead are risk-weighted at 250%. In the credit risk section these exposures have been included within the 'other assets' category.

## Risk-weighted assets movement

The following table sets out the movements in the Group's risk-weighted assets split between book size, model changes and other movements.

*Table 10: Risk-weighted assets movement*

| **Risk-weighted assets** | **AIRB (mortgages)** | **Standardised (credit cards)** | **Other standardised assets[1]** | **Credit valuation adjustment** | **Operational risk** | **Total** |
|---|---|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| At 1 January 2017 | **4,764.5** | **1,847.4** | **405.0** | **22.6** | **655.3** | **7,694.8** |
| Change in book size | **1,179.7** | **435.6** | **-** | **-** | **-** | **1,615.3** |
| Other movements | **(153.7)** | **(0.1)** | **(65.9)** | **(12.2)** | **100.4** | **(131.5)** |
| **At 31 December 2017** | **5,790.5** | **2,282.9** | **339.1** | **10.4** | **755.7** | **9,178.6** |

1. This includes non-CVA counterparty credit risk.

Movements in the AIRB mortgage risk-weighted assets are described in table 34 in Appendix 1. Movements in other standardised assets reflect changes in the wholesale asset portfolio.

Operational risk is calculated using the standardised approach, based on the average Group income over the past three years. The year-on-year increase reflects the increasing income from 2013 to 2016.

# 8. Pillar 1 capital requirements - credit risk

## Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off-balance sheet).

## Risk appetite

The Group has appetite for high-quality credit exposures including affordable retail lending and liquid wholesale investments.

## Exposures

The principal sources of credit risk arise from loans and advances to customers, loans and advances to banks and debt securities. The credit risk exposures of the Group are set out on page 21.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Credit risk in the wholesale portfolio arises from loans and advances to banks and debt securities. Risks arising from derivatives and foreign exchange activities are classed as counterparty credit risk.

## Measurement

The Group uses models to measure credit risk exposures including statistical models for the mortgage AIRB approach. Models are supported by both internal and external data. For all other exposures the Group applies standardised risk weightings.

## Mitigation

### Credit policy

The Risk function uses the Group's risk appetite to set out the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, key risk indicators, and review and challenge exceptions to planned outcomes. They test the adequacy of credit risk infrastructure and governance processes throughout the Group. Counterparty exposures are regularly reviewed and appropriate interventions are used where necessary. Risk Assurance, within the Risk function, perform independent risk-based reviews and provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

### Controls over AIRB rating systems

The Group has an established Independent Model Validation team that sets common minimum standards for predictive modelling development and operations. The standards are designed to ensure risk models and associated AIRB rating systems are developed consistently and are of sufficient quality to support business decisions and meet regulatory requirements.

### Credit underwriting

The Group uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits on permitted indebtedness which take into account the debt customers hold with other lenders.

The Group rejects any application for a product where a customer is registered as bankrupt or insolvent or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group's approach to underwriting applications takes into account the total unsecured debt held by a customer and their ability to afford that debt.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value ratio (LTV) of less than 95%. The Group has maximum % LTV limits which depend upon the loan size.

*Table 11: Maximum LTVs*

| Loan size | Maximum LTV |
|---|---|
| **Residential** | |
| **£1 to £500,000** | **95% (purchase)** |
| **£1 to £500,000** | **90% (re-mortgage)** |
| **£500,001 to £1,000,000** | **80%** |
| **Residential interest only** | **70%** |
| **Buy-to-let** | **75%** |

## Monitoring

The Group produces regular portfolio monitoring reports for review by Senior Management. The Risk function in turn produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

- appropriate risk differentiation capability is provided;
- generated ratings remain as accurate and robust as practical; and
- appropriate risk estimates are assigned to grades and pools of accounts.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Details of the monitoring of rating models are provided in Appendix 1.

## Credit risk exposure by exposure class

For the purposes of these disclosures, credit exposure for the AIRB portfolios refers to the calculated EAD. As detailed on page 3, the EAD calculation includes amounts where customers have contractual rights to draw down further balances and estimates of interest accruals to the point of default.

The following table sets out the exposures for the various types of asset held by the Group and the average exposures during the year. The Group does not have any exposures to corporates or small and medium sized enterprises (SMEs).

*Table 12: Group exposures, risk weights and average exposures*

| As at 31 December 2017 | Exposure[1] | Risk-weighted assets | Minimum capital requirement | Average risk weight | Average exposure in period |
|---|---|---|---|---|---|
| | £m | £m | £m | % | £m |
| **AIRB** | | | | | |
| Retail exposures secured by real estate collateral | **36,097.6** | **5,790.5** | **463.2** | **16.0** | **35,019.1** |
| **Standardised** | | | | | |
| Credit cards and other retail exposures | **3,022.1** | **2,266.5** | **181.3** | **75.0** | **2,829.3** |
| Exposures in default | **16.4** | **16.4** | **1.3** | **100.0** | **14.5** |
| Central governments and central banks | **2,931.7** | **-** | **-** | **-** | **2,797.3** |
| Multilateral development banks | **234.1** | **-** | **-** | **-** | **192.6** |
| Institutions | **288.0** | **59.7** | **4.8** | **20.7** | **440.1** |
| Covered bonds | **396.5** | **39.7** | **3.2** | **10.0** | **406.6** |
| Equities | **3.1** | **3.1** | **0.2** | **100.0** | **5.5** |
| Other assets | **165.5** | **177.2** | **14.2** | **107.1** | **174.1** |
| **Total standardised** | **7,057.4** | **2,562.6** | **205.0** | **36.3** | **6,860.0** |
| **Total** | **43,155.0** | **8,353.1** | **668.2** | **19.4** | **41,879.1** |

| As at 31 December 2016 | Exposure[1] | Risk-weighted assets | Minimum capital requirements | Average risk weight | Average exposure in period |
|---|---|---|---|---|---|
| | £m | £m | £m | % | £m |
| **AIRB** | | | | | |
| Retail exposures secured by real estate collateral | 32,389.6 | 4,764.5 | 381.2 | 14.7 | 30,897.7 |
| **Standardised** | | | | | |
| Credit cards and other retail exposures | 2,446.8 | 1,835.1 | 146.8 | 75.0 | 2,138.9 |
| Exposures in default | 12.3 | 12.3 | 1.0 | 100.0 | 12.0 |
| Central governments and central banks | 1,098.5 | - | - | - | 1,073.3 |
| Multilateral development banks | 129.3 | - | - | - | 211.6 |
| Institutions | 492.5 | 100.5 | 8.0 | 20.4 | 667.9 |
| Covered bonds | 327.1 | 32.7 | 2.6 | 10.0 | 443.1 |
| Equities | 7.9 | 7.9 | 0.6 | 100.0 | 7.1 |
| Other assets | 175.5 | 193.8 | 15.5 | 110.4 | 190.4 |
| **Total standardised** | 4,689.9 | 2,182.3 | 174.5 | 46.5 | 4,744.3 |
| **Total** | 37,079.5 | 6,946.8 | 555.7 | 18.7 | 35,642.0 |

1. Exposures are stated net of specific credit risk adjustments and before credit risk mitigation.

The Group participated in the Term Funding Scheme (TFS) during the year, using drawings to fund growth, provide liquidity and manage down drawings under the previous FLS. By the year end FLS drawings had reduced by £650 million to £2.0 billion. This had the effect of increasing exposures with central governments and central banks as off-balance sheet FLS funding has been replaced by TFS, which is on balance sheet.

# Credit risk exposure by industry or counterparty type

The tables below give details of the distribution of exposures by industry or counterparty type.

*Table 13: Credit risk exposures by industry or counterparty type*

| As at 31 December 2017 | Lending – individuals £m | Financial/ Sovereign £m | Other assets £m | Total £m |
|---|---|---|---|---|
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | **36,097.6** | **-** | **-** | **36,097.6** |
| **Standardised** | | | | |
| Credit cards and other retail exposures | **3,022.1** | **-** | **-** | **3,022.1** |
| Exposures in default | **16.4** | **-** | **-** | **16.4** |
| Central governments and central banks | **-** | **2,931.7** | **-** | **2,931.7** |
| Multilateral development banks | **-** | **234.1** | **-** | **234.1** |
| Institutions | **-** | **288.0** | **-** | **288.0** |
| Covered bonds | **-** | **396.5** | **-** | **396.5** |
| Equities | **-** | **-** | **3.1** | **3.1** |
| Other assets | **-** | **-** | **165.5** | **165.5** |
| **Total** | **39,136.1** | **3,850.3** | **168.6** | **43,155.0** |

| As at 31 December 2016 | Lending – individuals £m | Financial/ Sovereign £m | Other assets £m | Total £m |
|---|---|---|---|---|
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | 32,389.6 | - | - | 32,389.6 |
| **Standardised** | | | | |
| Credit cards and other retail exposures | 2,446.8 | - | - | 2,446.8 |
| Exposures in default | 12.3 | - | - | 12.3 |
| Central governments and central banks | - | 1,098.5 | - | 1,098.5 |
| Multilateral development banks | - | 129.3 | - | 129.3 |
| Institutions | - | 492.5 | - | 492.5 |
| Covered bonds | - | 327.1 | - | 327.1 |
| Equities | - | - | 7.9 | 7.9 |
| Other assets | - | - | 175.5 | 175.5 |
| **Total** | 34,848.7 | 2,047.4 | 183.4 | 37,079.5 |

## Credit risk exposure by geographical area

The tables below give details of the geographical distribution of exposures.

*Table 14: Credit risk exposures by geographical area*

| As at 31 December 2017 | UK £m | Europe £m | Rest of the world £m | Total £m |
|---|---|---|---|---|
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | **36,097.6** | **-** | **-** | **36,097.6** |
| **Standardised** | | | | |
| Credit cards and other retail exposures | **3,022.1** | **-** | **-** | **3,022.1** |
| Exposures in default | **16.4** | **-** | **-** | **16.4** |
| Central governments and central banks | **2,931.7** | **-** | **-** | **2,931.7** |
| Multilateral development banks | **-** | **121.8** | **112.3** | **234.1** |
| Institutions | **72.3** | **16.1** | **199.6** | **288.0** |
| Covered bonds | **396.5** | **-** | **-** | **396.5** |
| Equities | **1.7** | **-** | **1.4** | **3.1** |
| Other assets | **165.5** | **-** | **-** | **165.5** |
| **Total** | **42,703.8** | **137.9** | **313.3** | **43,155.0** |

| As at 31 December 2016 | UK £m | Europe £m | Rest of the world £m | Total £m |
|---|---|---|---|---|
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | 32,389.6 | - | - | 32,389.6 |
| **Standardised** | | | | |
| Credit cards and other retail exposures | 2,446.8 | - | - | 2,446.8 |
| Exposures in default | 12.3 | - | - | 12.3 |
| Central governments and central banks | 1,098.5 | - | - | 1,098.5 |
| Multilateral development banks | - | 46.1 | 83.2 | 129.3 |
| Institutions | 114.2 | 116.6 | 261.7 | 492.5 |
| Covered bonds | 327.1 | - | - | 327.1 |
| Equities | 6.4 | - | 1.5 | 7.9 |
| Other assets | 175.5 | - | - | 175.5 |
| **Total** | 36,570.4 | 162.7 | 346.4 | 37,079.5 |

## Credit risk exposure by residual maturity

The following tables give details of the contractual residual maturities of exposures.

*Table 15: Credit risk exposures by residual maturity*

| As at 31 December 2017 | < 1 year £m | Residual maturity 1-5 yrs £m | > 5 years £m | Total £m |
|---|---|---|---|---|
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | **150.4** | **959.3** | **34,987.9** | **36,097.6** |
| **Standardised** | | | | |
| Credit cards and other retail exposures | **3,022.1** | **-** | **-** | **3,022.1** |
| Exposures in default | **16.4** | **-** | **-** | **16.4** |
| Central governments and central banks | **2,724.4** | **-** | **207.3** | **2,931.7** |
| Multilateral development banks | **-** | **132.9** | **101.2** | **234.1** |
| Institutions | **288.0** | **-** | **-** | **288.0** |
| Covered bonds | **28.9** | **182.1** | **185.5** | **396.5** |
| Equities | **3.1** | **-** | **-** | **3.1** |
| Other assets | **165.5** | **-** | **-** | **165.5** |
| **Total** | **6,398.8** | **1,274.3** | **35,481.9** | **43,155.0** |

| As at 31 December 2016 | < 1 year £m | Residual maturity 1-5 yrs £m | > 5 years £m | Total £m |
|---|---|---|---|---|
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | 183.5 | 855.7 | 31,350.4 | 32,389.6 |
| **Standardised** | | | | |
| Credit cards and other retail exposures | 2,446.8 | - | - | 2,446.8 |
| Exposures in default | 12.3 | - | - | 12.3 |
| Central governments and central banks | 781.2 | - | 317.3 | 1,098.5 |
| Multilateral development banks | - | 80.3 | 49.0 | 129.3 |
| Institutions | 492.5 | - | - | 492.5 |
| Covered bonds | - | 202.9 | 124.2 | 327.1 |
| Equities | 7.9 | - | - | 7.9 |
| Other assets | 175.5 | - | - | 175.5 |
| **Total** | 4,099.7 | 1,138.9 | 31,840.9 | 37,079.5 |

## Exposures in equities

The Group holds a small quantity of equity exposures.

*Table 16: Exposures in equities*

| | **2017** £m | 2016 £m |
|---|---|---|
| Other equities | **3.1** | 7.9 |

The Group accounts for equities as available-for-sale financial assets. They are measured at fair value, or cost, where their fair value cannot be reliably measured. The Group made realised gains on sales of equities of £6.1 million recognised in CET1 capital during the year. As at 31 December 2017 the unrealised gains on equities was £0.5 million.

# Exposures subject to the standardised approach

The Group uses the standardised approach to calculate risk-weighted assets on all exposures apart from retail mortgages.

The allocation of capital to credit risk within wholesale investments is calculated under the standardised approach as per CRD IV. For exposures to institutions and covered bonds, the Group uses credit ratings provided by the recognised credit rating agencies Standard and Poor's, Moody's and Fitch.

The following table shows the risk weights applied to credit risk exposures subject to the standardised approach, by exposure class, together with the risk-weighted asset value.

*Table 17: Standardised exposures by risk weight*

| **As at 31 December 2017** | | | | | **Risk Weight** | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Exposure Class** | **0%** | **10%** | **20%** | **50%** | **75%** | **100%** | **250%** | **Total** | **Unrated[1]** |
| Credit cards and other retail exposures | - | - | - | - | 3,022.1 | - | - | 3,022.1 | 3,022.1 |
| Exposures in default | - | - | - | - | - | 16.4 | - | 16.4 | 16.4 |
| Central governments and central banks | 2,931.7 | - | - | - | - | - | - | 2,931.7 | - |
| Multilateral development banks | 234.1 | - | - | - | - | - | - | 234.1 | - |
| Institutions | - | - | 281.1 | 6.9 | - | - | - | 288.0 | - |
| Covered bonds | - | 396.5 | - | - | - | - | - | 396.5 | - |
| Equities | - | - | - | - | - | 3.1 | - | 3.1 | 3.1 |
| Other items | 4.6 | - | - | - | - | 150.1 | 10.8 | 165.5 | 165.5 |
| **Total** | **3,170.4** | **396.5** | **281.1** | **6.9** | **3,022.1** | **169.6** | **10.8** | **7,057.4** | **3,207.1** |

| **As at 31 December 2016** | | | | | Risk Weight | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Exposure Class** | 0% | 10% | 20% | 50% | 75% | 100% | 250% | Total | Unrated[1] |
| Credit cards and other retail exposures | - | - | - | - | 2,446.8 | - | - | 2,446.8 | 2,446.8 |
| Exposures in default | - | - | - | - | - | 12.3 | - | 12.3 | 12.3 |
| Central governments and central banks | 1,098.5 | - | - | - | - | - | - | 1,098.5 | - |
| Multilateral development banks | 129.3 | - | - | - | - | - | - | 129.3 | - |
| Institutions | - | - | 485.8 | 6.7 | - | - | - | 492.5 | - |
| Covered bonds | - | 327.1 | - | - | - | - | - | 327.1 | - |
| Equities | - | - | - | - | - | 7.9 | - | 7.9 | 7.9 |
| Other items | 5.2 | - | - | - | - | 154.6 | 15.7 | 175.5 | 175.5 |
| **Total** | 1,233.0 | 327.1 | 485.8 | 6.7 | 2,446.8 | 174.8 | 15.7 | 4,689.9 | 2,642.5 |

1. Unrated balances refer to those exposures not rated by credit rating agencies.

## Wholesale credit risk exposures by credit rating

The following tables give details of the credit grading of the Group's wholesale exposures.

*Table 18: Standardised wholesale exposures by credit rating*

| **As at 31 December 2017** | **Exposure by external rating[1]** | | | |
|---|---|---|---|---|
| | **AAA to AA- £m** | **A+ to A- £m** | **BBB+ to BBB- £m** | **Total £m** |
| Central governments and central banks | **2,931.7** | **-** | **-** | **2,931.7** |
| Multilateral development banks | **234.1** | **-** | **-** | **234.1** |
| Institutions | **89.7** | **191.4** | **6.9** | **288.0** |
| Covered bonds | **396.5** | **-** | **-** | **396.5** |
| **Total** | **3,652.0** | **191.4** | **6.9** | **3,850.3** |

| **As at 31 December 2016** | Exposure by external rating[1] | | | |
|---|---|---|---|---|
| | AAA to AA- £m | A+ to A- £m | BBB+ to BBB- £m | Total £m |
| Central governments and central banks | 1,098.5 | - | - | 1,098.5 |
| Multilateral development banks | 129.3 | - | - | 129.3 |
| Institutions | 361.8 | 124.0 | 6.7 | 492.5 |
| Covered bonds | 327.1 | - | - | 327.1 |
| Total | 1,916.7 | 124.0 | 6.7 | 2,047.4 |

1. There is no credit risk mitigation applicable.

## Collateral for secured retail and wholesale exposures

The sole collateral type for secured loans and advances to customers is residential property. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement.

A large proportion of derivative exposure is cleared at Qualifying Central Counterparties (QCCPs) which replaces exposure to individual counterparties with an exposure against the Central Counterparty (CCP). Where derivatives are directly with a wholesale counterparty, these are collateralised under a Credit Support Annex (CSA) in conjunction with the International Swaps and Derivatives Association (ISDA) Master Agreement.

The CSA allows margin calls to be made on the net mark-to-market value of derivative exposures with a particular counterparty. All interest rate derivative relationships are subject to margin calls on a daily basis. Collateral held or paid under the CSAs is in the form of cash and government securities in GBP, USD and Euros. As permitted under the standardised approach, the Group recognises the risk mitigating effect of these CSAs in its Pillar 1 capital calculations.

In order to minimise credit loss the Group will receive additional collateral from certain counterparties in the event their credit rating falls below contractually set triggers.

It is the Group's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

## Fair value of collateral

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the table below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

*Table 19: Fair value of collateral against secured loans, capped at loan value*

| **As at 31 December 2017** | **Collateral value of residential mortgage loans** | | **Collateral value of residential buy-to-let mortgage loans** | | **Total collateral value** | |
|---|---|---|---|---|---|---|
| | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| Neither past due nor impaired | **27,025.9** | **100.0** | **6,336.5** | **100.0** | **33,362.4** | **100.0** |
| *- of which in receipt of forbearance* | ***133.8*** | ***100.0*** | ***15.8*** | ***100.0*** | ***149.6*** | ***100.0*** |
| Past due and not impaired | **168.2** | **100.0** | **18.7** | **100.0** | **186.9** | **100.0** |
| Impaired | **122.8** | **100.0** | **12.1** | **100.0** | **134.9** | **100.0** |
| *- of which in possession* | ***0.5*** | ***100.0*** | ***0.1*** | ***100.0*** | ***0.6*** | ***100.0*** |
| **Total** | **27,316.9** | **100.0** | **6,367.3** | **100.0** | **33,684.2** | **100.0** |

| **As at 31 December 2016** | Collateral value of residential mortgage loans | | Collateral value of residential buy-to-let mortgage loans | | Total collateral value | |
|---|---|---|---|---|---|---|
| | £m | % | £m | % | £m | % |
| Neither past due nor impaired | 24,046.6 | 100.0 | 5,441.7 | 100.0 | 29,488.3 | 100.0 |
| *- of which in receipt of forbearance* | *108.6* | *100.0* | *12.2* | *100.0* | *120.8* | *100.0* |
| Past due and not impaired | 151.3 | 100.0 | 17.6 | 100.0 | 168.9 | 100.0 |
| Impaired | 83.7 | 99.8 | 9.0 | 100.0 | 92.7 | 99.8 |
| *- of which in possession* | *0.3* | *100.0* | *0.1* | *100.0* | *0.4* | *100.0* |
| **Total** | 24,281.6 | 100.0 | 5,468.3 | 100.0 | 29,749.9 | 100.0 |

Forbearance disclosures in the table above exclude routine term extensions captured as part of the mortgage review process, where there is no forbearance. The 2016 table has been restated accordingly. Some segments may appear fully collateralised however contain some immaterial balances in negative equity.

At 31 December 2017 cash collateral in relation to derivatives and repos of £93.0 million (2016: £181.1 million) had been pledged by the Group and £49.4 million (2016: £10.7 million) has been received as cash collateral by the Group. As at 31 December 2017 £76.0 million (2016: £75.7 million) has been received as collateral in the form of securities by the Group.

## Credit risk impairments

The categorisation of credit risk is detailed in the table below:

*Table 20: Categorisation of credit risk by impairment level*

| Credit risk categorisation | Description |
|---|---|
| Arrears | For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due. |
| Neither past due nor impaired | Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions. |
| Neither past due nor impaired and in receipt of forbearance | Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions. |
| Past due and not impaired | Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets, as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending. |
| Impaired assets | Loans that are in arrears and where the carrying amount of the loan exceeds the expected recoverable amount. All mortgage expired terms, fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due. |

## Impairment provisioning

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses behavioural scoring to assess customers' credit risk and the models take into account a range of potential indicators of customer financial distress.

Impaired assets are reviewed on an ongoing basis. Regular detailed analysis of impairment provisions is undertaken recognising the impact of forbearance activities. The table below indicates the level of impaired and past due exposures by exposure class, and of the levels of provisions against them. All exposures are located in the UK.

*Table 21: Analysis of past due and impaired loans and advances to customers*

| **As at 31 December 2017** | **Impaired exposures** | **Past due but not impaired** | **General impairment provisions** | **Specific impairment provisions** |
|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** |
| Retail mortgages | **134.9** | **186.9** | **10.9** | **1.2** |
| Credit cards | **42.6** | **-** | **14.3** | **32.9** |
| Other retail exposures | **-** | **-** | **0.1** | **-** |
| **Total** | **177.5** | **186.9** | **25.3** | **34.1** |

| **As at 31 December 2016** | Impaired exposures | Past due but not impaired | General impairment provisions | Specific impairment provisions |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| Retail mortgages | 92.9 | 168.9 | 9.9 | 0.7 |
| Credit cards | 32.4 | - | 11.8 | 27.6 |
| Other retail exposures | - | - | 0.1 | - |
| **Total** | 125.3 | 168.9 | 21.8 | 28.3 |

Secured impairment provisions have increased by £1.5 million, in line with book growth, representing 0.04% as a proportion of gross balances as at 31 December 2017 and as at 31 December 2016.

Unsecured impairment provisions increased by £7.8 million during the period and have reduced as a percentage of gross balances from 1.59% at 31 December 2016 to 1.54% at 31 December 2017. Impairment provisions as a proportion of

impaired balances decreased, from 121.9% to 111.0% during the year. The reduction in impairment provision coverage is a result of improved debt recovery rates, which reduces the expected credit loss attributable to these assets.

*Table 22: Analysis of movements in impairment provisions*

| | Retail mortgages | Credit cards | Other retail exposures | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **General impairment provisions** | | | | |
| At 1 January 2017 | **9.9** | **11.8** | **0.1** | **21.8** |
| Increase in provision during year | **1.0** | **2.5** | **-** | **3.5** |
| Amounts written off during the year | **-** | **-** | **-** | **-** |
| **At 31 December 2017** | **10.9** | **14.3** | **0.1** | **25.3** |
| | | | | |
| **Specific impairment provisions** | | | | |
| At 1 January 2017 | **0.7** | **27.6** | **-** | **28.3** |
| Increase in provision during year | **1.2** | **39.5** | **-** | **40.7** |
| Amounts written off during the year | **(0.7)** | **(34.2)** | **-** | **(34.9)** |
| **At 31 December 2017** | **1.2** | **32.9** | **-** | **34.1** |

# 9. Pillar 1 capital requirements – credit risk – securitisation

The Group is a participant in the securitisation market, operating as an originator and an investor in third party securitisations. As an originator, the Group undertakes securitisation activities principally to provide funding diversification, giving access to a wide range of investors in different geographic areas. Securitisation also serves to generate liquidity from residential mortgage loans. As an investor, the Group invests directly in third party asset backed securities as part of its liquidity management activity.

## Originated securitisations

The Group has securitised certain mortgage loans by transferring the loans to special purpose vehicles (SPVs) controlled but not legally owned by the Group. Only residential mortgages have been included within originated securitisations.

The Group administers the SPV and the originating Group company receives fees from the SPV for continuing to service the loans. The Group also acts as the cash manager for the transactions, operates as the basis rate swap provider and the start-up loan provider and provides a guaranteed investment contract bank account.

Notes issued as part of a securitisation are divided into separate tranches depending upon their level of subordination. The most junior tranches are retained by the Group. This means that any shortfall in income would firstly be borne by any reserve funds within the structure and would then be borne as losses by the Group as junior noteholders. This means there is effectively no significant risk transfer of credit risk away from the Group, as a result the Group does not benefit from lower regulatory capital requirements in respect of these securitised assets.

Within the Group's financial statements, the treatment of SPVs is assessed in accordance with International Financial Reporting Standard 10. The accounting policies are described in more detail in Note 1 to the consolidated financial statements in the 2017 Virgin Money Group Annual Report and Accounts.

### Securitisation programmes and activity

*Table 23: Securitisation activity during the year*

| As at 31 December 2017 | Securities issued | Of which retained | Currency |
|---|---|---|---|
| | £m | £m | |
| Gosforth Funding 2017-1 plc | **1,151.8** | **406.0** | **US Dollar, Sterling** |
| **Total** | **1,151.8** | **406.0** | |

| As at 31 December 2016 | Securities issued | Of which retained | Currency |
|---|---|---|---|
| | £m | £m | |
| Gosforth Funding 2016-1 plc | 1,553.2 | 750.1 | Euro, US Dollar, Sterling |
| Gosforth Funding 2016-2 plc | 1,026.1 | 551.9 | Euro, Sterling |
| **Total** | 2,579.3 | 1,302.0 | |

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

As at 31 December 2017 the total outstanding externally issued securitisation debt was £2,439.3 million (2016: £2,299.9 million) and the total outstanding retained securitisation debt was £2,698.6 million (2016: £2,322.5 million). There were no assets awaiting securitisation at 31 December 2017 (2016: nil).

The Group utilises the services of two External Credit Assessment Institutions (ECAIs), Moody's and Fitch, to rate the securitisation transactions in issue. The ratings assigned assess the ability of the structure to allow for the timely payment of interest and the ultimate payment of principal of each of the rated notes. As part of the ratings process each of the agencies is committed to ongoing transaction monitoring to ensure that, in their view, the assigned ratings remain an appropriate reflection of the issued notes' credit risk.

### Risks inherent in securitised assets

The Group's securitisation programmes are made up of residential mortgages, where credit risk is the primary risk driver to the underlying asset pool. The processes undertaken by the Group to monitor changes in the credit risk of securitised mortgages are the same as unsecuritised mortgages and are described in Appendix 1.

Both the notes in issue and the underlying asset pool are exposed to market risk in the form of interest rate risk. The notes in issue may also be exposed to foreign exchange market risk. In order to mitigate interest rate and market risk to which the securitised assets may be exposed, the Group enters into interest rate swap agreements and cross currency swap agreements.

Liquidity risk arises where insufficient funds are received by the SPVs to service payments to the noteholders as they fall due. The Group is under no obligation to support any losses that may be incurred by the securitisation transactions or holders of the notes issued and do not intend to provide such further support. The parties holding the notes in issue are entitled to obtain payment of the principal and interest only to the extent that the resources of the securitisation transactions are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form.

### Securitised exposure

The following table shows the total balance sheet value of loans securitised, the impaired and past due amounts of those loans and the losses recognised during the year.

*Table 24: Total and impaired securitised assets*

| **As at 31 December 2017** | **Balance sheet value** | **Impaired and past due** | **Losses** |
|---|---|---|---|
| | **£m** | **£m** | **£m** |
| Retail mortgages | **5,438.5** | **24.2** | **-** |

| **As at 31 December 2016** | Balance sheet value | Impaired and past due | Losses |
|---|---|---|---|
| | £m | £m | £m |
| Retail mortgages | 4,907.8 | 9.5 | 0.1 |

## Purchased securitisations

All investments in securitisation exposures are held within the non-trading book of the Group. Risk-weighted exposures reported for purchased securitised assets at 31 December 2017 are calculated in line with the CRR under the standardised approach.

The following table gives details of the positions in the securitised exposures of other issuers purchased by the Group.

*Table 25: Purchased securitisation positions*

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Exposures** | **Risk-weighted assets** | Exposures | Risk-weighted assets |
| | **£m** | **£m** | £m | £m |
| Exposures risk-weighted at 20% (Credit Rating of AA- or higher) | **61.7** | **12.3** | 52.9 | 10.6 |

Where appropriate, the Group utilises the services of Moody's, Fitch and Standard and Poor's to rate purchased positions for risk weight allocation purposes.

# 10. Pillar 1 capital requirements - counterparty credit risk

Counterparty credit risk is the risk that the counterparty to a transaction could default during the life of the transaction. For the Group, this applies to derivative, central counterparty and asset repurchase agreements (repos).

Counterparty credit risk is monitored daily and reported to Treasury Risk Committee (TRC) monthly. TRC is a sub-committee of the Risk Management Committee (RMC) and receives monthly updates on counterparty credit risk.

The duration of the derivative and the credit quality of the counterparty are both factored into the internal capital and credit limits for counterparty credit exposures.

A ratings downgrade could result in the Group being required to post additional collateral under derivative CSA contracts.

The Group measures derivative counterparty credit exposure value under the counterparty credit risk mark-to-market method. This exposure value is derived by adding the gross positive fair value of the contract (replacement cost) to the contract's potential future credit exposure, which is derived by applying a standardised multiple based on the contract's residual maturity to the notional value of the contract.

The exposure of repos is measured by calculating the difference between the value of the asset repo'ed and the cash received from the counterparty plus interest accumulated, net of collateral posted or received.

Wrong way risk occurs where exposure to a counterparty is adversely correlated with the credit quality of that counterparty. The Group has no such exposure, as it has no appetite for credit derivative positions which are the key drivers of such a risk.

The table below details non-centrally cleared derivative exposures.

*Table 26: Derivative exposures*

| | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| Gross positive fair values of derivative contracts | **78.8** | 104.2 |
| Netting with gross negative fair value of derivative contracts | **(11.5)** | (25.4) |
| Potential future incremental exposure | **47.3** | 61.2 |
| Collateral received (deposits from banks) | **(84.4)** | (86.4) |
| **Net derivative exposures** | **30.2** | 53.6 |

Total credit risk exposures in relation to counterparty credit risk are shown below.

*Table 27: Standardised approach counterparty credit risk exposures*

| **As at 31 December 2017** | | | | | **Risk Weight** | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Exposure class | 0% | 2% | 10% | 20% | 50% | 75% | 100% | 150% | 250% | Unrated | **Total** |
| Institutions | - | 88.4 | - | 4.4 | 25.7 | - | - | - | - | - | **118.5** |
| Central governments and central banks | - | - | 76.0 | - | - | - | - | - | - | - | **76.0** |
| Other items | 316.2 | - | - | - | 48.1 | - | - | - | - | - | **364.3** |
| **Total exposure** | **316.2** | **88.4** | **76.0** | **4.4** | **73.8** | **-** | **-** | **-** | **-** | **-** | **558.8** |
| **Total risk-weighted assets** | | | | | | | | | | | **47.1** |

| **As at 31 December 2016** | | | | | Risk Weight | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Exposure class | 0% | 4% | 10% | 20% | 50% | 75% | 100% | 150% | 250% | Unrated | Total |
| Institutions | - | 76.4 | - | 8.8 | 44.8 | - | - | - | - | - | 130.0 |
| Central governments and central banks | - | - | 75.7 | - | - | - | - | - | - | - | 75.7 |
| Other items | 173.0 | - | - | - | 49.4 | - | - | - | - | - | 222.4 |
| **Total exposure** | 173.0 | 76.4 | 75.7 | 8.8 | 94.2 | - | - | - | - | - | 428.1 |
| **Total risk-weighted assets** | | | | | | | | | | | 59.5 |

*Table 28: Analysis by contract type*

| | **Exposures** | | **Risk-weighted assets** | |
|---|---|---|---|---|
| | **2017 £m** | 2016 £m | **2017 £m** | 2016 £m |
| Interest rate contracts | **103.4** | 102.3 | **8.3** | 14.5 |
| Equity contracts | **1.4** | 4.7 | **0.3** | 1.2 |
| Foreign exchange contracts | **89.7** | 98.7 | **14.5** | 19.1 |
| Securities financing transactions (repos) | **364.3** | 222.4 | **24.0** | 24.7 |
| **Sub-total** | **558.8** | 428.1 | **47.1** | 59.5 |
| Credit valuation adjustment | - | - | **10.4** | 22.6 |
| **Total** | **558.8** | 428.1 | **57.5** | 82.1 |
| **Of which central counterparties** | **88.4** | 76.4 | **1.8** | 3.1 |

During the year, the central counterparties risk weight reduced from 4% to 2%, following the use of a second clearing member.

# 11. Pillar 1 capital requirements - operational risk

## Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

## Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

## Exposures

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;
- external fraud arising from an act of deception or omission;
- cyber risk arising from malicious attacks on the Group via technology, networks and systems;
- service disruption;
- failure of a third party corporate partner or strategic supplier; and
- normal business operational risk including transaction processing, information capture and implementation of change.

## Measurement

A variety of measures is used such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root causes of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

## Mitigation

The Group's control environment is regularly reviewed. Reporting on material risks is discussed monthly by Senior Management. Risks are managed through a range of strategies – such as mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

- investment in IT to ensure continued availability, security and resilience of infrastructure;
- investment in information security capability to protect customers and the Group;
- investing in protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the financial crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. Through Group-wide policies and operational control frameworks, the Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and
- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

## Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive Committees. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and considered by Senior Management.

Key operational risks are appropriately insured, where possible. The insurance programme is monitored and reviewed regularly, with recommendations made to Senior Management prior to each renewal.

## Operational risk capital requirement

The standardised approach measures the capital requirement as a percentage of the average net interest and non-interest income. The Group adopts this approach, deriving from the three year average of the aggregate risk-weighted income of the underlying business. This requires a firm's activities to be split into a number of defined business lines with a specific risk weight applied to the income of each business line.

At 31 December 2017, as a result of this approach, the Group Pillar 1 capital requirement for operational risk was £60.5 million (2016: £52.5 million) represented by risk-weighted assets of £755.7 million (2016: £655.3 million).

# 12. Capital requirements - market risk

## Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets and transacts foreign exchange for limited operational purposes only. As a result, interest rate risk in the banking book (IRRBB) is the only material market risk for the Group.

## Risk appetite

The Group has limited risk appetite for exposures to IRRBB, in terms of both potential changes to economic value, and changes to expected net interest income or earnings.

## Capital requirement

The Group's Pillar 1 market risk capital requirement is limited to its foreign exchange exposure which is immaterial and falls below the de minimis limit within CRD IV. As such it has no Pillar 1 market risk capital requirement. The rest of this section therefore relates to market risk measured through the Group's Pillar 2 add on.

## Exposures

Term mismatch risk in the Group's portfolio arises from the different re-pricing characteristics of the Group's assets, liabilities and off-balance sheet exposures. Term mismatch risk arises predominantly from the mismatch between assets and liabilities either maturing or the amount resetting in any given time period, and the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The Group is exposed to the Bank Base Rate and LIBOR. If the spread between these rates moves adversely, the Group may experience a reduction in income on unhedged exposures.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates unfavourable to those that were expected. Variations in business volume outturn to forecast arise from changes in customer behaviour and relative product competitiveness. Product optionality risk arises as customer balances reduce more quickly or slowly than anticipated due to economic conditions or customers' response to changes in interest rates or other economic conditions which differ from expectations.

Swap spread risk arises through the hedging of the repricing risk of fixed rate securities (e.g. gilt securities) with derivatives. The yields in securities and markets for swaps, for a given tenor may not change simultaneously. Such differences cause spread risk to arise.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. The Group has minimal exposure to foreign currency risk.

## Measurement

The Group uses stress scenarios to quantify the impact to economic value and earnings arising from a shift to interest rates. These include interest rate re-pricing gaps, earnings sensitivity analysis and open foreign exchange positions.

Interest rate risk exposure is measured as follows:

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

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

CaR measurements are based on a 2% parallel stress over the balance sheet horizon, for term mismatch. EaR measurements are based on a 1% parallel stress over a 12 month period. The stress scenarios capture the risk of negative interest rates. The magnitude of stress used within the Group's internal risk appetite differs from the standardised regulatory stress, based

on observed rate movements and internally defined exposure holding periods. In the case of basis risk. The Group uses an internal stress test outcome for CaR and EaR.

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

## Mitigation

The Group uses derivative financial instruments to bring its residual net exposure within risk appetite. The residual net exposure takes account of natural offsets between assets and liabilities.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour.

Where possible, the Group mitigates basis risk by creating natural offsets. When required, the Group uses basis derivatives to maintain the residual exposure within risk appetite.

## Monitoring

The Asset and Liability Committee and the Risk Management Committee regularly review market risk exposure as part of the wider risk management framework.

*Table 29: Capital at Risk[1]*

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Positive 2% rate shock £m** | **Negative 2% rate shock[2] £m** | Positive 2% rate shock £m | Negative 2% rate shock[2] £m |
| Interest rate mismatch risk | **(6.3)** | **0.4** | 1.6 | 0.7 |
| Basis risk | **(1.4)** | **(1.4)** | - | - |
| Pipeline risk | **(4.7)** | **(5.5)** | (5.7) | (7.1) |
| Optionality risk | **(39.8)** | **(19.0)** | (30.1) | (7.7) |
| **Total interest rate risk – Capital at Risk** | **(52.2)** | **(25.5)** | (34.2) | (14.1) |

1. Negative values in the table represent an adverse impact.
2. Market rate (BBR, LIBOR and swaps) stresses are subject to a floor of 0%.

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

*Table 30: Earnings at Risk[1]*

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Positive 1% rate shock £m** | **Negative 1% rate shock[2] £m** | Positive 1% rate shock £m | Negative 1% rate shock[2] £m |
| Interest rate mismatch risk | **21.3** | **2.2** | (1.7) | (1.4) |
| Basis risk | **(0.1)** | **(9.0)** | (10.4) | (17.6) |
| Pipeline risk | **(2.5)** | **(1.3)** | (3.0) | (2.3) |
| Optionality risk | **(6.3)** | **(1.6)** | (8.6) | (0.3) |
| **Total interest rate risk – Earnings at Risk** | **12.4** | **(9.7)** | (23.7) | (21.6) |

1. Negative values in the table represent an adverse impact.
2. Market rate (BBR, LIBOR and swaps) stresses are subject to a floor of 0%.

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

# 13. Funding and liquidity risk

## Definition

Funding risk is defined as the inability to raise and maintain sufficient cost-effective funding in quality and quantity to support the delivery of the business plan.

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

## Risk appetite

The Group funds before it lends, and has a clear framework for balance sheet structure in order to control funding, refinancing and liquidity risk. The Group operates an investment strategy for wholesale investments which prioritises liquidity and ensures that the Group holds a liquid asset buffer in excess of both regulatory and internally assessed requirements.

## Exposures

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows.

The Group's primary liquidity risk exposure arises through the redemption of retail deposits where customers are permitted to withdraw funds with limited or no notice. Additional exposures exist in relation to pipeline mortgage business, undrawn card balances and wholesale funding.

The Group is exposed to refinancing risk at the point of contractual maturity. The risk arises from both wholesale and retail funding sources.

## Measurement

A series of measures is used across the Group to monitor both short and long-term liquidity requirements including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival periods. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

The measurement framework has two other important components:

- the volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Group ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

  Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

- the Group maintains a Liquidity Contingency Plan which is designed to provide an early warning indicator for liquidity concerns and a list of potential actions to address a liquidity shortfall. As a result, mitigating actions can be taken to avoid a more serious situation developing.

## Mitigation

The most material component of the Group's funding and liquidity position is the customer deposit base, which is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. Where funding concentrations exist, for example refinancing at maturity, these are managed within the appropriate internal risk appetite, to control the size of the exposure. Refinancing is planned in advance of maturity with liquidity held to mitigate the potential exposure. Longer term funding is used to manage the Group's strategic liquidity profile in line with limits.

The Group operates a Funds Transfer Pricing (FTP) mechanism which supports customer pricing and the overall Group balance sheet strategy.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group. In addition to central bank reserves, the Group holds sizeable balances of high-quality marketable debt securities. Such securities can be sold to provide, or used to secure, additional cash inflows from market counterparties or central bank facilities (Bank of England), should the need arise.

## Monitoring

Liquidity is actively monitored by the Group. Reporting is conducted through the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

*Table 31: Liquidity coverage ratio (LCR)*

| | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| Liquidity buffer | **5,136.6** | 4,101.0 |
| Total net cash outflows | **2,529.4** | 2,668.1 |
| Liquidity coverage ratio | **203.1%** | 153.7% |

During 2017, the Group maintained a strong funding and liquidity position in excess of risk appetite and the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Group's LCR as at 31 December 2017 was 203.1%, representing a material surplus above the UK regulatory minimum requirement of 90%. The LCR improved from 153.7% at 31 December 2016 due to strong deposit raising activity throughout the year, net TFS drawings made during the year, and an RMBS issuance in September, increasing high quality liquid assets.

# Appendix 1. Advanced Internal Ratings Based (AIRB) approach

## Scope of the AIRB permission

The Group's AIRB Waiver Application Pack was approved by the FSA on 1 January 2010 for capital adequacy monitoring and reporting from 1 January 2010 onwards. The scope of this permission covers retail exposures secured by real estate collateral (mortgage portfolio). None of these exposures have an external credit assessment. Asset classes not falling within the scope of the Group's AIRB permission are treated under the standardised approach.

### Overview of the AIRB models

The Group's AIRB approach provides risk sensitive modelling to generate an internal estimate for the credit risk capital requirement. The requirements specified by the AIRB approach require the Group to use an internal assessment of the probability of a customer defaulting (PD), the loss given default (LGD) and the exposure at default (EAD). These approaches are subject to regulatory floors in addition to the internal model assessments.

The PD, LGD and EAD of credit risk exposures form the base inputs to the regulatory risk weight calculation used to derive the Pillar 1 risk-weighted assets at an account level. From this, the minimum capital requirements are calculated (being 8% of the RWA), reflecting the credit risk capital required to cover any unexpected losses across the portfolio.

An expected loss (EL) is derived by multiplying the PD, LGD and EAD risk components together, aligning to long run average PDs and downturn LGDs. As such, the EL calculated represents an estimate of the monetary amount the business expects to lose from a customer defaulting within a 12 month outcome window, irrespective of current economic conditions. Where expected losses exceed accounting impairment provisions linked to the underlying credit risk exposures the resultant excess expected loss (EEL) is deducted from CET1 capital.

The Group uses the AIRB model outputs to inform both credit risk management and day-to-day credit related decision making within the business (the Use Test). Application of an AIRB approach requires PRA approval in the form of a waiver permission.

### Development and monitoring of AIRB models

The predictive modelling function is responsible for the development, validation, implementation, monitoring and use of credit rating models for the AIRB approach. In order to ensure the integrity and independence of these models, the credit risk control function has clearly segregated duties from those responsible for originating exposures. The Credit Risk Committee has been established as the principal forum for independently overseeing the Group's credit rating models, to ensure that the systems are producing consistent and accurate results in line with the Group's objectives and PRA minimum requirements. The Group's independent model validation team provides review and challenge of the credit rating models and is independent from the credit risk control function.

### Internal application of the AIRB approach

Scorecards are used to assess customer performance at application and subsequently via behavioural scores. Bureau data is utilised at application and a combination of bureau and internal performance data is used for ongoing behavioural scoring. Behavioural scores are grouped into score ranges and used to assign a point-in-time PD across the portfolio. The point-in-time PDs are transformed through a variable scalar model to derive a long run average (LRA) regulatory PD. The EAD model calculates outstanding drawings available to the customer up to the point of default. The LGD model accounts for recoveries, addressing house price volatility, distressed sale discount, associated costs and time to recovery.

The ratings system uses a through the cycle approach. The models determine long run average PD, downturn LGD and EAD for each segment in order to calculate expected losses and risk-weighted assets. In addition, the models are used to inform risk appetite, influence lending strategy and support determination of the level of impairment provisions.

The rating models group customers into segments differentiated by a number of factors, which include product type, LTV and measures of affordability. For each segment a long run average PD, downturn LGD and EAD are estimated from a combination of recent and historic data. Data covering the period back to the early 1990s is utilised in the derivation of the PD, LGD and EAD. All models incorporate an appropriate level of conservatism to account for uncertainty around model estimates over an economic cycle or in downturn conditions. The adequacy of this conservatism is robustly challenged through the Group's internal governance process.

## Analysis of AIRB exposures by exposure class

*Table 32: AIRB exposures and risk-weighted assets by exposure class*

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | **Exposures £m** | **Risk-weighted assets £m** | Exposures £m | Risk-weighted assets £m |
| **Retail AIRB** | | | | |
| Retail exposures secured by real estate collateral | | | | |
| Buy-to-let | **6,853.0** | **758.4** | 5,912.3 | 649.3 |
| Standard residential lending | **29,244.7** | **5,032.1** | 26,477.3 | 4,115.2 |
| **Total** | **36,097.7** | **5,790.5** | 32,389.6 | 4,764.5 |

The following tables detail the Group's exposures for its sole AIRB exposure class of retail exposures secured by real estate collateral. These relate to EAD, and include all on and off-balance sheet exposures. The risk bands are segmented based upon three characteristics: mortgage type (residential buy-to-let and standard residential), borrower type (single or joint) and LTV.

*Table 33: AIRB exposures by risk band*

**As at 31 December 2017**

| Risk band | LRA PD | Exposure | Downturn LGD | Risk-weighted assets | Risk-weighted assets | Undrawn commitments |
|---|---|---|---|---|---|---|
| | % | £m | % | % | £m | £m |
| Buy-to-let 1a | 0.45% | 2,449.5 | 8.27% | 5.35% | 131.0 | 152.0 |
| Buy-to-let 2a | 1.01% | 1,540.8 | 14.57% | 17.73% | 273.2 | 46.1 |
| Buy-to-let 3a | 1.80% | 20.7 | 8.38% | 16.18% | 3.3 | 3.1 |
| Buy-to-let 4a | 2.73% | 31.8 | 8.36% | 19.75% | 6.3 | 2.6 |
| Buy-to-let 1b | 0.80% | 1,733.5 | 8.22% | 6.54% | 113.3 | 116.6 |
| Buy-to-let 2b | 1.70% | 1,025.6 | 14.41% | 21.09% | 216.3 | 37.1 |
| Buy-to-let 3b | 3.66% | 18.6 | 8.73% | 22.68% | 4.2 | 2.8 |
| Buy-to-let 4b | 5.55% | 29.6 | 7.74% | 24.84% | 7.3 | 2.3 |
| Buy-to-let default | 100% | 2.9 | 10.25% | 116.06% | 3.5 | 0.2 |
| **Total buy-to-let** | 0.94% | 6,853.0 | | | 758.4 | 362.8 |
| | | | | | | |
| Standard 1a | 0.88% | 3,929.1 | 5.46% | 5.85% | 230.0 | 288.0 |
| Standard 2a | 0.94% | 7,280.0 | 9.04% | 9.63% | 701.2 | 328.4 |
| Standard 3a | 1.48% | 4,467.9 | 12.97% | 18.07% | 807.1 | 222.9 |
| Standard 4a | 1.78% | 2,833.6 | 16.70% | 27.39% | 776.1 | 126.4 |
| Standard 5a | 2.17% | 3,407.9 | 19.54% | 36.64% | 1,248.7 | 180.5 |
| Standard 1b | 1.19% | 1,410.7 | 5.49% | 6.68% | 94.2 | 111.2 |
| Standard 2b | 1.30% | 2,180.8 | 8.93% | 10.87% | 237.0 | 132.2 |
| Standard 3b | 1.55% | 1,524.6 | 12.80% | 16.95% | 258.5 | 91.3 |
| Standard 4b | 1.83% | 955.9 | 15.93% | 23.01% | 220.0 | 64.3 |
| Standard 5b | 2.41% | 1,208.4 | 18.97% | 33.67% | 406.8 | 75.7 |
| Standard default | 100% | 45.8 | 10.16% | 114.59% | 52.5 | 4.1 |
| **Total standard** | 1.55% | 29,244.7 | | | 5,032.1 | 1,625.0 |
| | | | | | | |
| **Total** | | 36,097.7 | | | 5,790.5 | 1,987.8 |

**As at 31 December 2016**

| Risk band | LRA PD | Exposure | Downturn LGD | Risk-weighted assets | Risk-weighted assets | Undrawn commitments |
|---|---|---|---|---|---|---|
| | % | £m | % | % | £m | £m |
| Buy-to-let 1a | 0.44% | 2,019.4 | 8.40% | 5.06% | 102.8 | 145.2 |
| Buy-to-let 2a | 1.01% | 1,457.3 | 15.13% | 16.68% | 244.6 | 82.7 |
| Buy-to-let 3a | 1.82% | 23.0 | 9.39% | 16.91% | 3.9 | 3.5 |
| Buy-to-let 4a | 2.61% | 39.0 | 9.14% | 16.92% | 6.6 | 3.9 |
| Buy-to-let 1b | 0.80% | 1,394.7 | 8.19% | 6.42% | 90.1 | 92.9 |
| Buy-to-let 2b | 1.68% | 921.7 | 14.59% | 20.11% | 186.6 | 49.8 |
| Buy-to-let 3b | 3.81% | 23.1 | 8.94% | 21.75% | 5.1 | 2.6 |
| Buy-to-let 4b | 5.52% | 33.2 | 8.20% | 22.16% | 7.4 | 2.7 |
| BTL default | 100% | 0.9 | 23.61% | 240.56% | 2.2 | - |
| Total buy-to-let | | 5,912.3 | | | 649.3 | 383.3 |
| | | | | | | |
| Standard 1a | 0.56% | 3,652.9 | 5.58% | 3.88% | 141.7 | 338.1 |
| Standard 2a | 0.93% | 6,760.7 | 9.05% | 8.83% | 596.2 | 401.4 |
| Standard 3a | 1.47% | 4,218.6 | 12.72% | 17.03% | 717.6 | 220.1 |
| Standard 4a | 1.77% | 2,538.4 | 16.53% | 25.32% | 642.1 | 127.2 |
| Standard 5a | 2.20% | 2,747.3 | 20.05% | 36.93% | 1,013.4 | 240.0 |
| Standard 1b | 0.79% | 1,318.3 | 5.60% | 4.81% | 63.3 | 125.5 |
| Standard 2b | 1.30% | 2,033.9 | 8.84% | 10.00% | 203.2 | 137.5 |
| Standard 3b | 1.56% | 1,420.4 | 12.36% | 15.92% | 225.8 | 97.6 |
| Standard 4b | 1.84% | 833.7 | 15.41% | 20.54% | 171.0 | 60.0 |
| Standard 5b | 2.47% | 937.8 | 18.86% | 33.31% | 312.0 | 94.2 |
| Standard default | 100% | 15.3 | 18.11% | 188.41% | 28.9 | - |
| Total standard | | 26,477.3 | | | 4,115.2 | 1,841.6 |
| | | | | | | |
| Total | | 32,389.6 | | | 4,764.5 | 2,224.9 |

## Movements in AIRB risk-weighted assets

*Table 34: Risk-weighted assets flow statements of credit risk exposures under AIRB*

| | Risk-weighted assets amounts | Capital requirements |
|---|---|---|
| | £m | £m |
| **Risk-weighted assets as at 1 January 2017** | **4,764.5** | **381.2** |
| Asset size | **1,179.7** | **94.3** |
| Asset quality | **(219.8)** | **(17.6)** |
| Model updates | **66.1** | **5.3** |
| **Risk-weighted assets as at 31 December 2017** | **5,790.5** | **463.2** |

In the table above, asset size is defined as changes in book size and composition (including the origination of new business and maturing loans).

Asset quality is defined as changes in the assessed quality of the institution's assets due to changes in borrower risk, such as rating grade migration or similar effects.

The Group's mortgage portfolio exposure increased during 2017 which resulted in an increase in risk-weighted assets of £1,179.7m. This has been offset by a reduction in risk-weighted assets of £219.8m associated with an improvement in asset quality caused by increased property values linked to growth in HPI.

During the year, the AIRB model was updated to take into account a revised definition of default, to include forbearance and past term interest only triggers, and point-in-time PDs were recalibrated to align with observed realised default rates. A level of prudence remains in the new modelled point-in-time PD estimates.

## AIRB model performance – regulatory expected loss versus accounting actual loss

Risk and capital management practices are informed and evaluated by analysis of credit loss experience and the quantitative assessment of portfolio behaviour. This analysis includes a comparison of the expected loss (EL) calculated by the AIRB risk rating models with the impairment allowance reported within financial statements.

It is important to consider the difference in definition and scope of regulatory EL with measures of impairment under IFRS when comparing these metrics. Examples of such differences are summarised below:

- EL is based on long run estimates of PD over a one year outcome horizon, determined via statistical analysis of historical default experience. Impairment allowances are recognised for incurred losses at the balance sheet date. Point-in-time estimates of default are used in the determination of impairment allowances;
- EL uses the economic downturn calibration of the LGD component of the capital models. Impairment allowances are measured using point-in-time estimates of future cash flows; and
- EL is based on estimates of EAD and therefore it incorporates expected future drawings of committed credit lines, while impairment allowances are recognised in respect of financial assets recognised on the balance sheet and in respect of committed credit lines where a loss is probable.

The following table shows the regulatory EL measure, compared with impairment provision by AIRB exposure class.

*Table 35: AIRB expected loss and impairment provision*

| **As at 31 December 2017** | **Regulatory expected loss** | **Impairment provision** |
|---|---|---|
| | **£m** | **£m** |
| Retail exposures secured by real estate collateral | **59.0** | **12.1** |

| **As at 31 December 2016** | Regulatory expected loss | Impairment provision |
|---|---|---|
| | £m | £m |
| Retail exposures secured by real estate collateral | 51.7 | 10.6 |

## AIRB model performance

Back-testing methodologies are applied to assess model performance. Results from these exercises have shown that models continue to perform satisfactorily. During 2017, the majority of modelled outcomes have been higher than actual outcomes and evidence an appropriately prudent calibration. The PD and LGD values are outputs from the Group's point-in-time calibrations. In conducting the PD back-testing process the model estimate is compared to the total defaults observed during the year that have emerged from the population not in default at 1 January 2017. The actual LGD value is calculated from recorded losses following repossession and subsequent sale of the property during the year. In addition, the actual LGD value is augmented with the latest LGD estimate for those defaulted accounts which are still in the workout process at the end of the period. The EAD ratio is calculated by comparing the exposure of new defaults with the EAD estimate 12 months prior to defaulting. Where the estimated EAD is greater than the actual exposure at the point of default, the ratio will be greater than one.

The following table shows the estimated and actual PD and LGD as well as the ratio of estimated to actual EAD by AIRB exposure class.

*Table 36: AIRB model performance*

| | **PD of total portfolio** | | **LGD of defaulted assets** | | **EAD of defaulted assets** |
|---|---|---|---|---|---|
| **As at 31 December 2017** | **Estimated[1]** | **Actual[2]** | **Estimated[3]** | **Actual[4]** | **Ratio of estimated to actual** |
| | **%** | **%** | **%** | **%** | |
| Retail exposures secured by real estate collateral | **0.42%** | **0.32%** | **3.11%** | **3.83%** | **1.03** |

| | PD of total portfolio | | LGD of defaulted assets | | EAD of defaulted assets |
|---|---|---|---|---|---|
| **As at 31 December 2016** | Estimated[1] | Actual[2] | Estimated[3] | Actual[4] | Ratio of estimated to actual |
| | % | % | % | % | |
| Retail exposures secured by real estate collateral | 0.46% | 0.09% | 3.09% | 3.26% | 1.04 |

1 This estimate is the output from the Group's point-in-time model as at 1 January 2017 (comparative 1 January 2016) and is based on the total number of accounts not in default.

2 Actual default is calculated as the total of emergent defaults during 2017 (comparative 2016) measured as a proportion of the total number of accounts not in default at 1 January 2017 (comparative 1 January 2016).

3 This estimate is the exposure weighted output from the Group's point-in-time model as at 1 January 2017 (comparative 1 January 2016) and is based on the total default population at that time.

4 This value is calculated from accounts in default at 1 January 2017 (comparative 1 January 2016). The observed loss is defined as the loss following repossession and subsequent sale of the property within the year. This value uses the latest LGD estimate to determine the percentage of loss for those defaulted accounts which are still in the workout process at the end of the period.

The continued growth of the Group's mortgage portfolio has not been at the expense of asset quality. Mortgage asset quality has been maintained – arrears rates have fallen over the year and the indexed LTV of the book has remained relatively static, increasing from 55.4% to 55.8%.

The AIRB models are calibrated to hold an appropriate level of conservatism. During 2017 there have been two model changes which have impacted PD, a recalibration of the Group's point-in-time PD estimates to align to current observed realised default rates and an enhancement to the Group's definition of default. The point-in-time recalibration has reduced the estimated PD of the total portfolio during 2017, whilst the change to the definition of default, increased actual PDs on the portfolio.

Despite these model changes, observed default rates remain lower than the point-in-time calibrations and levels of defaults and subsequent repossessions in the portfolio remain low.

The observed LGD is higher than estimated as a result of the very low volume of defaults in the year leading to volatility.

# Appendix 2. EBA own funds template

The following table shows the make-up of own funds of the Group and Virgin Money plc in the format prescribed in Regulation (EU) 1423/2013. Any blank cells in the template have been removed from this disclosure.

*Table 37: Own funds disclosure template*

| As at 31 December 2017 | | Virgin Money Holdings (UK) plc regulated group £m | Virgin Money plc £m |
|---|---|---|---|
| | **Common Equity Tier 1 capital: instruments and reserves** | | |
| 1 | Capital instruments and the related share premium accounts | **654.6** | **1,400.0** |
| 2 | Retained earnings | **782.1** | **261.7** |
| 3 | Accumulated other comprehensive income (and other reserves) | **(18.1)** | **4.5** |
| 6 | Common Equity Tier 1 capital before regulatory adjustments | **1,418.6** | **1,666.2** |
| | **Common Equity Tier 1 capital: regulatory adjustments** | | |
| 7 | Additional value adjustments (negative amount) | **(1.2)** | **(1.2)** |
| 8 | Intangible assets (net of related tax liability) (negative amount) | **(128.4)** | **(128.4)** |
| 10 | Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount) | **(0.6)** | **(0.6)** |
| 11 | Fair value reserves related to gains or losses on cash flow hedges | **22.7** | **-** |
| 12 | Negative amounts resulting from the calculation of expected loss amounts | **(46.9)** | **(46.9)** |
| 28 | Total regulatory adjustments to Common Equity Tier 1 | **(154.4)** | **(177.1)** |
| 29 | Common Equity Tier 1 capital | **1,264.2** | **1,489.1** |
| | **Additional Tier 1 capital: instruments** | | |
| 30 | Capital instruments and the related share premium accounts | **384.1** | **230.0** |
| 31 | of which: classified as equity under applicable accounting standards | **384.1** | **230.0** |
| 36 | Additional Tier 1 capital before regulatory adjustments | **384.1** | **230.0** |
| 44 | Additional Tier 1 capital | **384.1** | **230.0** |
| 45 | Tier 1 capital | **1,648.3** | **1,719.1** |
| | **Tier 2 capital: instruments and provisions** | | |
| 50 | Credit risk adjustments | **14.3** | **14.3** |
| 51 | Tier 2 capital before regulatory adjustments | **14.3** | **14.3** |
| 58 | Tier 2 capital | **14.3** | **14.3** |
| 59 | Total capital | **1,662.6** | **1,733.4** |
| 60 | Total risk-weighted assets | **9,178.6** | **9,093.4** |

| | Capital ratios and buffers | | |
|---|---|---|---|
| 61 | Common Equity Tier 1 (as a percentage of total risk exposure amount) | **13.8%** | **16.4%** |
| 62 | Tier 1 (as a percentage of total risk exposure amount) | **18.0%** | **18.9%** |
| 63 | Total capital (as a percentage of total risk exposure amount) | **18.1%** | **19.1%** |
| 64 | Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount) | **5.8%** | **5.8%** |
| 65 | of which: capital conservation buffer requirement | **1.3%** | **1.3%** |
| 66 | of which: countercyclical buffer requirement | **0.0%** | **0.0%** |
| 67 | of which: systemic risk buffer requirement | **0.0%** | **0.0%** |
| 67a | of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer | **0.0%** | **0.0%** |
| 68 | Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount) | **13.8%** | **15.6%** |
| | **Applicable caps on the inclusion of provisions in Tier 2 (T2)** | | |
| 75 | Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38(3) are met) | **10.8** | **9.8** |
| | **Applicable caps on the inclusion of provisions in Tier 2 (T2)** | | |
| 76 | Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap) | **14.3** | **14.3** |
| 77 | Cap on inclusion of credit risk adjustments in T2 under standardised approach | **31.7** | **31.5** |

# Appendix 3. Capital instrument key features

*Table 38: Capital instruments' main features template*

| | | | | |
|---|---|---|---|---|
| 1 | Issuer | **Virgin Money Holdings (UK) plc** | **Virgin Money Holdings (UK) plc** | **Virgin Money Holdings (UK) plc** |
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | **GB00BQ8P0644** | **XS1090191864** | **XS1516312409** |
| 3 | Governing law(s) of the instrument | **English** | **English** | **English** |
| | **Regulatory treatment** | | | |
| 4 | Transitional CRR rules | **Common Equity Tier 1** | **AT1** | **AT1** |
| 5 | Post-transitional CRR rules | **Common Equity Tier 1** | **AT1** | **AT1** |
| 6 | Eligible at solo/(sub-)consolidated/ solo & (sub-)consolidated | **Consolidated** | **Consolidated** | **Consolidated** |
| 7 | Instrument type (types to be specified by each jurisdiction) | **Ordinary shares** | **AT1** | **AT1** |
| 8 | Amount recognised in regulatory capital (currency in million, as of most recent reporting date) | **£654.6m comprising nominal and premium** | **£156.5m** | **£227.6m** |
| 9 | Nominal amount of instrument (£) | **£44,494** | **£160,000,000** | **£230,000,000** |
| 9a | Issue price (£) | **0.0001** | **100.00** | **100.00** |
| 9b | Redemption price (£) | **n/a** | **100.00** | **100.00** |
| 10 | Accounting classification | **Shareholders' equity** | **Shareholders' equity** | **Shareholders' equity** |
| 11 | Original date of issuance | **18 Nov 2014: £44,160<br>19 Dec 2014: £33<br>12 Nov 2015: £178<br>8 Mar 2016: £95<br>15 Dec 2016: £28** | **31 July 2014** | **10 November 2016** |
| 12 | Perpetual or dated | **Perpetual** | **Perpetual** | **Perpetual** |
| 13 | Original maturity date | **No maturity** | **n/a** | **n/a** |
| 14 | Issuer call subject to prior supervisory approval | **No** | **Yes** | **Yes** |
| 15 | Optional call date, contingent call dates and redemption amount | **n/a** | **31 July 2019 at par or at any time upon a Tax Event or a Capital Disqualification Event (full exclusion) at par** | **10 November 2021 at par or at any time upon a Tax Event or a Capital Disqualification Event (whole or any part) at par** |
| 16 | Subsequent call dates, if applicable | **n/a** | **Following the First Call date any Interest Payment Date thereafter: 31 January, 30 April, 31 July and 31 October** | **Following the First Call date any Interest Payment Date thereafter: 10 May and 10 November** |
| | **Coupons / dividends** | | | |
| 17 | Fixed or floating dividend/coupon | **Floating** | **Fixed** | **Fixed** |
| 18 | Coupon rate and any related index | **n/a** | **7.875%** | **8.75%** |
| 19 | Existence of a dividend stopper | **No** | **No** | **No** |
| 20 a | Fully discretionary, partially discretionary or mandatory (in terms of timing) | **Fully discretionary** | **Fully discretionary** | **Fully discretionary** |
| 20 b | Fully discretionary, partially discretionary or mandatory (in terms of amount) | **Fully discretionary** | **Fully discretionary** | **Fully discretionary** |
| 21 | Existence of step up or other incentive to redeem | **No** | **No** | **No** |
| 22 | Non-cumulative or cumulative | **Non-cumulative** | **Non-cumulative** | **Non-cumulative** |
| 23 | Convertible or non-convertible | **Non-convertible** | **Convertible** | **Convertible** |
| 24 | If convertible, conversion trigger(s) | **n/a** | **Group's Common Equity Tier 1 ratio falls below 7%** | **Group's Common Equity Tier 1 ratio falls below 7%** |
| 25 | If convertible, fully or partially | **n/a** | **Always Fully** | **Always Fully** |
| 26 | If convertible, conversion rate | **n/a** | **£3.50** | **£2.96** |

| | | | | |
|---|---|---|---|---|
| 27 | If convertible, mandatory or optional conversion | **n/a** | **Mandatory** | **Mandatory** |
| 28 | If convertible, specify instrument type convertible into | **n/a** | **Common Equity Tier 1** | **Common Equity Tier 1** |
| 29 | If convertible, specify issuer of instrument it converts into | **n/a** | **Virgin Money Holdings (UK) plc** | **Virgin Money Holdings (UK) plc** |
| 30 | Write-down features | **No** | **No** | **No** |
| 31 - 34 | If write-down, write-down trigger(s), full/partial, PWD/TWD | **n/a** | **n/a** | **n/a** |
| 32 | If write-down, full or partial | **n/a** | **n/a** | **n/a** |
| 33 | If write-down, permanent or temporary | **n/a** | **n/a** | **n/a** |
| 34 | If temporary write-down, description of write-up mechanism | **n/a** | **n/a** | **n/a** |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | **AT1** | **Medium Term Notes and other unsecured creditors** | **Medium Term Notes and other unsecured creditors** |
| 36 | Non-compliant transitioned features | **No** | **No** | **No** |
| 37 | If yes, specify non-compliant features | **n/a** | **n/a** | **n/a** |

| | | | |
|---|---|---|---|
| 1 | Issuer | **Virgin Money plc** | **Virgin Money plc** |
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | **Private Placement** | **n/a** |
| 3 | Governing law(s) of the instrument | **English** | **English** |
| | **Regulatory treatment** | | |
| 4 | Transitional CRR rules | **Common Equity Tier 1** | **AT1** |
| 5 | Post-transitional CRR rules | **Common Equity Tier 1** | **AT1** |
| 6 | Eligible at solo/(sub-)consolidated/ solo & (sub-)consolidated | **Solo & Consolidated** | **Solo & Consolidated** |
| 7 | Instrument type (types to be specified by each jurisdiction) | **Ordinary shares** | **AT1** |
| 8 | Amount recognised in regulatory capital (currency in million, as of most recent reporting date) | **£1,400.0m** | **£230.0m** |
| 9 | Nominal amount of instrument (£) | **£1,400,000,000** | **£230,000,000** |
| 9a | Issue price (£) | **1.00** | **100.00** |
| 9b | Redemption price (£) | **n/a** | **100.00** |
| 10 | Accounting classification | **Shareholders' equity** | **Shareholders' equity** |
| 11 | Original date of issuance | **3 July 2009** | **10 November 2016** |
| 12 | Perpetual or dated | **Perpetual** | **Perpetual** |
| 13 | Original maturity date | **No maturity** | **n/a** |
| 14 | Issuer call subject to prior supervisory approval | **No** | **Yes** |
| 15 | Optional call date, contingent call dates and redemption amount | **n/a** | **10 November 2021 at par or at any time upon a Tax Event or a Capital Disqualification Event (whole or any part) at par** |
| 16 | Subsequent call dates, if applicable | **n/a** | **Following the First Call date any Interest Payment Date thereafter: 10 May and 10 November** |
| | **Coupons / dividends** | | |
| 17 | Fixed or floating dividend/coupon | **Floating** | **Fixed** |
| 18 | Coupon rate and any related index | **n/a** | **8.75%** |
| 19 | Existence of a dividend stopper | **No** | **No** |

| | | | |
|---|---|---|---|
| 20 a | Fully discretionary, partially discretionary or mandatory (in terms of timing) | **Fully discretionary** | **Fully discretionary** |
| 20 b | Fully discretionary, partially discretionary or mandatory (in terms of amount) | **Fully discretionary** | **Fully discretionary** |
| 21 | Existence of step up or other incentive to redeem | **No** | **No** |
| 22 | Non-cumulative or cumulative | **Non-cumulative** | **Non-cumulative** |
| 23 | Convertible or non-convertible | **Non-convertible** | **Non-convertible** |
| 24 | If convertible, conversion trigger(s) | **n/a** | **n/a** |
| 25 | If convertible, fully or partially | **n/a** | **n/a** |
| 26 | If convertible, conversion rate | **n/a** | **n/a** |
| 27 | If convertible, mandatory or optional conversion | **n/a** | **n/a** |
| 28 | If convertible, specify instrument type convertible into | **n/a** | **n/a** |
| 29 | If convertible, specify issuer of instrument it converts into | **n/a** | **n/a** |
| 30 | Write-down features | **No** | **Yes** |
| 31 - 34 | If write-down, write-down trigger(s), full/partial, PWD/TWD | **n/a** | **Group's or Virgin Money plc CET1 ratio falls below 7%** |
| 32 | If write-down, full or partial | **n/a** | **Full** |
| 33 | If write-down, permanent or temporary | **n/a** | **Permanent** |
| 34 | If temporary write-down, description of write-up mechanism | **n/a** | **n/a** |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | **AT1** | **Medium Term Notes and other unsecured creditors** |
| 36 | Non-compliant transitioned features | **No** | **No** |
| 37 | If yes, specify non-compliant features | **n/a** | **n/a** |

# Appendix 4. Disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical buffer

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates (based on the geographical distribution of relevant exposures) to the overall capital requirement of the Group. The following tables disclose information relevant for the calculation of the countercyclical buffer as at 31 December 2017 in accordance with Regulation (EU) 2015/1555.

*Table 39: Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer – consolidated group*

| | General credit exposures | | Trading book exposures | | Securitisation exposures | | Own funds requirements | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| As at 31 December 2017 | Exposure value for standardised approach | Exposure value for IRB | Sum of long and short positions of trading book exposures for standardised approach | Value of trading book exposures for internal models | Exposure value for standardised approach | Exposure value for IRB | Of which: general credit exposures | Of which: trading book exposures | Of which: sec'n exposures | Total | Own funds req'ts weights | Counter-cyclical capital buffer rate |
| | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m | % | % |
| **Breakdown by country:** | | | | | | | | | | | | |
| UK | **3,603.6** | **36,097.6** | **-** | **-** | **61.7** | **-** | **663.5** | **-** | **1.0** | **664.5** | **100%** | **0%** |
| **Total** | **3,603.3** | **36,097.6** | **-** | **-** | **61.7** | **-** | **663.5** | **-** | **1.0** | **664.5** | **100%** | **0%** |

Credit exposures relevant to the calculation of the countercyclical buffer consist of exposures to retail lending (including mortgages and credit cards), covered bonds, securitisation exposures and other assets. All other exposures are excluded.

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Group's aggregate risk-weighted exposures, all exposures have been allocated to the UK.

*Table 40: Amount of institution specific countercyclical capital buffer – consolidated group*

| | |
|---|---|
| **Total risk exposure amount** | **£664.5m** |
| **Institution specific countercyclical buffer rate** | **0%** |
| **Institution specific countercyclical buffer requirement** | **-** |

*Table 41: Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer – Virgin Money plc*

| | General credit exposures | | Trading book exposures | | Securitisation exposures | | Own funds requirements | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| As at 31 December 2017 | Exposure value for standardised approach | Exposure value for IRB | Sum of long and short positions of trading book exposures for standardised approach | Value of trading book exposures for internal models | Exposure value for standardised approach | Exposure value for IRB | Of which: general credit exposures | Of which: trading book exposures | Of which: sec'n exposures | Total | Own funds req'ts weights | Counter-cyclical capital buffer rate |
| | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m | % | % |
| **Breakdown by country:** | | | | | | | | | | | | |
| UK | 3,685.5 | 36,097.6 | - | - | 61.7 | - | 662.9 | - | 1.0 | 663.9 | 100% | 0% |
| **Total** | 3,683.7 | 36,097.6 | - | - | 61.7 | - | 662.9 | - | 1.0 | 663.9 | 100% | 0% |

Credit exposures relevant to the calculation of the countercyclical buffer consist of exposures to retail lending (including mortgages and credit cards), covered bonds, securitisation exposures and other assets. All other exposures are excluded.

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Virgin Money plc's aggregate risk-weighted exposures, all exposures have been allocated to the UK.

*Table 42: Amount of institution specific countercyclical capital buffer – Virgin Money plc*

| | |
|---|---|
| **Total risk exposure amount** | £663.9m |
| **Institution specific countercyclical buffer rate** | 0% |
| **Institution specific countercyclical buffer requirement** | - |

# Appendix 5. Analysis of leverage ratio

The following tables show the Group and Virgin Money plc detailed leverage ratio disclosures made in accordance with the Commission Implementing Regulation (EU) 2016/200. Any blank cells in the template have been removed from this disclosure.

*Table 43: Summary reconciliation of accounting assets and leverage ratio exposures*

| As at 31 December 2017 | | Virgin Money Holdings (UK) plc regulated group £m | Virgin Money plc £m |
|---|---|---|---|
| 1 | Total assets as per published financial statements | **41,107.8** | **41,018.9** |
| 2 | Adjustments for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation | **(0.4)** | **156.2** |
| 4 | Adjustment for derivative financial instruments | **14.1** | **16.7** |
| 5 | Adjustments for securities financing transactions (SFTs) | **364.3** | **364.3** |
| 6 | Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures) | **776.8** | **776.8** |
| EU-6a | Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No 575/2013 | **-** | **(88.0)** |
| 7 | Other adjustments | **(154.4)** | **(177.1)** |
| **8** | **Total leverage ratio exposure** | **42,108.2** | **42,067.8** |

*Table 44: Leverage ratio common disclosures*

| As at 31 December 2017 | | £m | £m |
|---|---|---|---|
| **On balance sheet exposures (excluding derivatives and SFTs)** | | | |
| 1 | On balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) | **41,028.6** | **41,075.2** |
| 2 | Asset amounts deducted in determining Tier 1 capital | **(154.4)** | **(242.5)** |
| **3** | **Total on balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)** | **40,874.2** | **40,832.7** |
| **Derivative exposures** | | | |
| 4 | Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin | **104.1** | **102.6** |
| 5 | Add on amounts for PFE associated with all derivatives transactions (mark-to-market method) | **131.3** | **129.2** |
| 7 | (Deductions of receivables assets for cash variation margin provided in derivatives transactions) | **(142.5)** | **(137.8)** |
| **11** | **Total derivative exposures** | **92.9** | **94.0** |
| **Securities financing transaction exposures** | | | |
| 14 | Counterparty credit risk exposure for SFT assets | **364.3** | **364.3** |
| **16** | **Total securities financing transaction exposures** | **364.3** | **364.3** |
| **Other off-balance sheet exposures** | | | |
| 17 | Off-balance sheet exposures at gross notional amount | **6,193.4** | **6,193.4** |
| 18 | Adjustments for conversion to credit equivalent amounts | **(5,416.6)** | **(5,416.6)** |
| **19** | **Other off-balance sheet exposures** | **776.8** | **776.8** |
| **Capital and total exposures** | | | |
| **20** | **Tier 1 capital** | **1,648.3** | **1,719.1** |
| **21** | **Total leverage ratio exposures** | **42,108.2** | **42,067.8** |
| **Leverage ratio** | | | |
| **22** | **Leverage ratio** | **3.9%** | **4.1%** |
| **Choice on transitional arrangements and amount of derecognised fiduciary items** | | | |
| EU-23 | Choice on transitional arrangements for the definition of the capital measure | | **Fully phased in** |

*Table 45: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)*

| | | CRR leverage ratio exposures | |
|---|---|---|---|
| | | **Virgin Money Holdings (UK) plc** | **Virgin Money plc** |
| **As at 31 December 2017** | | **(Consolidated)** | **(Solo)** |
| | | **£m** | **£m** |
| EU-1 | Total on balance sheet exposures (excluding derivatives, SFTs and exempted exposures), of which: | **41,028.6** | **41,075.2** |
| EU-3 | Banking book exposures, of which: | **41,028.6** | **41,075.2** |
| EU-4 | Covered bonds | **396.5** | **396.5** |
| EU-5 | Exposures treated as sovereigns | **2,931.7** | **2,931.7** |
| EU-6 | Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns | **234.1** | **234.1** |
| EU-7 | Institutions | **367.8** | **332.5** |
| EU-8 | Secured by mortgages of immovable properties | **33,716.1** | **33,716.1** |
| EU-9 | Retail exposures | **3,007.8** | **3,007.8** |
| EU-11 | Exposures in default | **16.4** | **16.4** |
| EU-12 | Other exposures (e.g. equity, securitisations, and other non-credit obligation assets) | **358.2** | **440.1** |

*Table 46: Disclosure on qualitative items*

| | |
|---|---|
| 1 | **Description of the processes used to manage the risk of excessive leverage** |
| Leverage is actively managed with the leverage ratio being a key factor in the Group's planning processes and stress analysis. A minimum of a three year forecast of the Group's leverage position, based on the strategic plan, is produced at least annually. Shorter term forecasts are more frequently undertaken to understand and respond to variations in the Group's actual performance against plan. | |
| 2 | **Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers** |
| The main factor impacting the leverage ratio during 2017 was increased total assets arising from the increased lending activities of the Group, offset by increased retained earnings. | |

# Appendix 6. Analysis of encumbered assets

The following tables show the Group analysis of encumbered assets in accordance with the EBA Guidelines on disclosure of encumbered and unencumbered assets (EBA/GL/2014/03). Any blank cells in these templates have been removed from this disclosure.

*Table 47: Asset encumbrance – assets*

| As at 31 December 2017 | Carrying amount of encumbered assets | Fair value of encumbered assets | Carrying amount of unencumbered assets | Fair value of unencumbered assets |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Assets of the reporting institution** | **12,957.9** | **n/a** | **26,172.7** | **n/a** |
| Equity instruments | - | - | 5.5 | 5.5 |
| Debt securities | 36.8 | 36.8 | 879.4 | 879.4 |
| Other assets | - | n/a | 479.9 | n/a |

No collateral has been received by the Group for the purposes of the EBA asset encumbrance disclosure guidelines.

*Table 48: Asset encumbrance – encumbered assets/collateral received and associated liabilities*

| As at 31 December 2017 | Matching liabilities, contingent liabilities or securities lent | Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered |
|---|---|---|
| | £m | £m |
| **Carrying amount of selected financial liabilities** | **7,557.3** | **9,592.8** |

## Asset encumbrance – Information on importance of encumbrance

Asset values reported in the tables above are median values based on twelve months of data. The Group's assets are used to support collateral requirements for central bank operations, third-party repurchase agreements, swap transactions, securitisation, the FLS and the TFS. Assets that have been set aside for such purposes are classified as encumbered and cannot be used for other purposes.

Under the terms and conditions of collateralisation agreements entered into for securing liabilities, assets are deemed encumbered if they cannot be freely withdrawn. Cash reserves and securities supporting secured funding structures are also not available for encumbrance due to legal reasons. All assets included in the "Other Assets" category above, although classed as unencumbered, are deemed not available for encumbrance in the normal course of business due to the nature of these assets.

Any excess collateral provided above the minimum collateral required is deemed unencumbered unless it cannot be freely withdrawn. No assets are encumbered through transactions between entities of the Group. All remaining assets are deemed available for encumbrance.

During 2017, both the value and proportion of encumbered assets increased due primarily to using the TFS to support increased lending. This was partly offset by a reduction in the use of the FLS. Encumbrance arising from securitisation transactions remained stable with one new securitisation transaction in the year.

# Appendix 7. Group remuneration disclosures

## Approach to remuneration

Virgin Money's Group Remuneration Policy is designed to support the delivery of the Group's long term corporate strategy in a manner that is compliant with the PRA's Remuneration Code (the Code). The Group Remuneration Policy is based on principles which are applicable to all employees within the Group and in particular the principle that the remuneration framework should support the delivery of the Group's wider strategic goals. The Policy supports Virgin Money's aim of building a bank that makes everyone better off by motivating colleagues to secure the long term success of the business and create a valuable return for shareholders in a meaningful and well balanced way. The Group ensures its approach to remuneration, and in particular variable pay, is aligned with clear risk principles which aim to drive sustainable growth, with absolutely no reward for inappropriate risk taking.

The Group is mindful of the views of shareholders and engagement with shareholders is a key part of the process for determining a fair and appropriate remuneration policy.

## Material Risk Takers

The Remuneration Code and European Regulatory Technical Standards require the Group to identify 'Material Risk Takers'. Material Risk Takers are deemed to have, or potentially have, a material impact on the risk profile of the Group or a significant entity within the Group. The Material Risk Taker population in 2017 totalled 62 including all Directors.

The following groups of individuals have been identified as meeting the criteria for Material Risk Takers:

- Executive Directors and Non-Executive Directors;
- all members of the Virgin Money Executive Committee (ExCo);
- senior risk colleagues;
- senior finance and treasury colleagues;
- those colleagues who sit on a Committee responsible for specific risk categories and/or product development; and
- other colleagues whose activities could have an impact on the Group's risk profile, including those that are highly remunerated.

The remuneration for these colleagues is governed under the Group Remuneration Policy.

## The Remuneration Committee

The Remuneration Committee (the Committee) is responsible for determining and recommending to the Board a Group Remuneration Policy that aligns with the Group's risk principles and is consistent with the Group's corporate strategy. It determines the remuneration of the Chair and members of the Executive Committee, including payments and awards under annual bonus plans, share incentive schemes, pension schemes and any other compensation arrangements (including terms for departing Material Risk Takers). The Committee undertakes periodic reviews of the Remuneration Policy (at least annually) to ensure continued compliance and alignment with the Remuneration Code.

The Group has a clear governance structure, with the Committee reviewing all reward decisions for Executive Directors, members of the Executive Committee, senior risk and compliance officers and any other Material Risk Takers or high earners.

The Committee's Terms of Reference, last updated in November 2017, are on the Virgin Money website.

The Committee members during the year were:

- Marilyn Spearing (Chair to 3 May 2017 on which date she retired from the Board);
- Norman McLuskie (Chair from 3 May 2017);
- Geeta Gopalan;
- Eva Eisenschimmel (appointed to the Committee on 25 January 2017);and
- Darren Pope (appointed to the Committee on 1 March 2017).

Only members of the Committee have the right to attend and vote at Committee meetings. However, other individuals (such as the Chief Executive Officer and the People Director) may be invited to attend meetings when appropriate or necessary, but are excluded from discussions relating to their own remuneration arrangements.

During 2017, the Remuneration Committee took external advice from Deloitte, the Committee's independent consultants in relation to Directors' remuneration. Deloitte are members of the Remuneration Consultants Group and comply with the professional body's code of conduct. This supports the Remuneration Committee's view that the advice received was objective and independent.

The Committee meets at least four times a year and at such other times as the Committee Chair or any member of the Committee may request. The Committee met on four occasions during 2017.

During 2017, the Committee considered the following remuneration matters:

- Final performance conditions for the annual bonus and long term incentive plan (LTIP) for the 2017 financial year;
- annual bonus and LTIP design and performance measures for the 2018 financial year;
- executive awards vesting in 2017; and
- review of the Directors' Remuneration Report.

## Design characteristics of the remuneration system

The Group regularly reviews its approach to senior remuneration to ensure the overall package is fair, competitive and supportive of the Group's strategy. The Group ensures it remains competitive in the financial services market through regular market reviews. The Group's remuneration strategy aims to motivate individual out-performance against objectives. Risk considerations are a material factor in the determination of pay.

Remuneration is delivered in a proportion of fixed and variable components. The variable elements are subject to appropriate limits (capped at 2:1 variable to fixed ratio) as approved by shareholders. Variable pay awards for senior colleagues and Material Risk Takers are subject to deferral in line with the Code to promote longer term risk awareness.

## Base salary

All Material Risk Takers receive salaries (except for Non-Executive Directors who receive fees), determined to reflect the role of the individual, taking account of responsibilities and experience. Base salaries are reviewed annually, taking into account individual performance and market information.

## Fixed allowance

A fixed allowance, delivered in cash and/or shares on a monthly basis, is paid to certain senior executives. The fixed allowance ensures that total fixed remuneration is commensurate with role and provides a competitive reward package in line with regulatory requirements and with an appropriate balance of fixed and variable remuneration.

## Annual Bonus and Deferred Bonus Share Plan

All Material Risk Takers (excluding Non-Executive Directors) are eligible to be considered for an annual bonus. Annual bonuses are discretionary and are based on Group and individual performance within the year. The determination of measures and their weighting are set annually and awards are determined by the Remuneration Committee at the end of the financial year. The annual bonus opportunity is based on performance against key financial measures determined at the beginning of each financial year as well as performance against non-financial measures.

In line with regulatory requirements a proportion of any bonus is deferred (as per the 'deferral and vesting' section below). The mechanism for making the bonus deferral is the Deferred Bonus Share Plan (DBSP). Deferral levels are set at the time of award and in line with regulatory requirements (see below).

## Long-term incentives

The Group's LTIP, awarded to certain senior colleagues, is designed to reward delivery of the Group's strategy and growth in shareholder value over a multi-year period and aligns participants' interests with those of shareholders while supporting the long-term success of the Group.

Performance conditions are normally tested over a period of three financial years and, subject to the achievement of any performance conditions, awards will vest according to timetables designed to comply with regulatory requirements. The performance conditions will be aligned to the Group's long term strategy.

## Deferral and vesting

Variable pay deferral levels are set at the time of award and in line with regulatory requirements. For 2017 this means that for Material Risk Takers receiving a variable pay award that exceeds 33% of total pay:

- at least 40% of total variable pay is deferred;
- at least 50% of variable pay is paid in shares; and
- vested shares are subject to retention periods.

The ultimate release of deferred amounts is governed by a robust risk assessment framework. Both clawback and malus provisions can be applied by the Committee both during and after any relevant performance period to adjust (including to nil) any variable pay awarded, paid or deferred. A performance adjustment may include, but is not limited to:

- reducing an employee's bonus outcome for the current year;
- reducing the amount of any unvested deferred variable remuneration (including LTIP awards) to which an employee is entitled;
- requiring the repayment on demand of any cash and share awards received at any time during the seven year period after the date of the awards; and
- requiring a bonus which has been awarded but not yet paid to be forfeited.

In the case of firm-wide adjustment, measures may also include:

- reducing the overall annual bonus pool; and/or
- reducing overall unvested/unpaid awards.

The following non-exhaustive list outlines the circumstances in which malus and/or clawback measures will be triggered:

- where an employee has participated in or was responsible for conduct which resulted in significant losses to the firm, as determined by the Remuneration Committee;
- where an employee has significantly failed to meet appropriate standards of fitness and propriety, taking into account their seniority, experience, remuneration and level of responsibility;
- where the firm or the relevant business unit has suffered a material downturn in the financial performance;
- where the firm or the relevant business unit has suffered a material failure of risk management;
- where the firm has reasonable evidence of fraud or material dishonesty by the employee;
- where the firm becomes aware of any material wrongdoing on the part of the employee that would have resulted in the relevant award not being made had it known about such material wrongdoing at the time the relevant award was made;
- where the firm becomes aware of a material error in assessing the employee's performance against the relevant performance conditions at the time that the award was made; and
- where an employee has acted in any manner which in the opinion of the Remuneration Committee has brought or is likely to bring the firm into material disrepute or is materially adverse to the interests of the firm.

The above principles apply to all variable pay for all Virgin Money Material Risk Takers.

The Committee has discretion, in exceptional circumstances, to amend targets, measures, or number of shares under award if an event happens (for example, a major transaction or capital raising) that, in the opinion of the Committee, causes the original targets or measures to be no longer appropriate or such adjustment to be reasonable. The Committee also has the discretion to reduce the vesting level of any award if it deems that the outcome is not consistent with performance delivered.

## Link between pay and performance and the performance criteria used

The Group's approach to reward is to ensure that all elements of pay are aligned with the long-term interests of the Group and a prudent approach to risk management while being sufficiently competitive to attract, retain and motivate the most talented individuals in the financial services sector.

Colleagues are appraised annually for their entire role, the behaviours they exhibit, the achievement of the objectives they are set and their competencies. This holistic appraisal drives variable pay awards and any future pay increases.

For variable pay, performance is measured against financial and non-financial targets (functional where appropriate). The financial scorecard is the same for all senior executives thus ensuring a Group oriented view on performance and risk. Non-financial performance metrics include effective risk management.

The following metrics and criteria were used by the Committee to determine the size of the overall variable remuneration pool:

- the Committee considered the key financial performance measures, including profit before tax, and other non-financial measures;
- the Committee reviewed underlying business performance against the corporate scorecard to ensure that the outcomes are appropriate;
- the Chief Risk Officer provided the Committee (via the Board Risk Committee) with an independent risk assessment report to consider whether and to what extent the variable remuneration pool should be subject to risk adjustment; and
- the Chief Financial Officer and the People Director also provided the Committee with an assessment of financial and individual performance to identify any significant instances when the operation of the malus provisions might be appropriate.

## Remuneration for Material Risk Takers

The following table displays the 2017 fixed and variable remuneration for Virgin Money's Executive Directors, Non-Executive Directors, Executive Committee members and senior colleagues whose professional activities may have a material impact on the risk profile of the Group. This is broken down between Senior Management and Other Material Risk Takers. The data has not been broken down by business area because the Group has only one business area as its product lines are managed under a single centralised commercial function.

## Fixed and variable remuneration

*Table 49: Remuneration of Material Risk Takers*

**2017**

| | Senior Management | Material Risk Takers | Total |
|---|---|---|---|
| Number of Material Risk Takers | **12** | **50** | **62** |
| **Remuneration of Material Risk Takers[1]** | **£m** | **£m** | **£m** |
| Total fixed | **2.8** | **11.4** | **14.2** |
| Total variable | **3.3** | **9.8** | **13.1** |
| Total remuneration | **6.1** | **21.2** | **27.3** |

1. Values for 2017 LTIP awards are based on the face value of awards.

Further details on the remuneration policies and practices of the Group, including the key components of the Group's remuneration structure for Directors' remuneration can be found in the Directors' Remuneration Report contained in the 2017 Virgin Money Group Annual Report and Accounts.

## Recruitment policy for the selection of members of the management body

The Remuneration Committee will take into account all relevant factors, including the calibre and experience of the individual and the market from which they are recruited, while being mindful of the best interests of the Group and its shareholders and seeking not to pay more than is necessary. This would normally be determined in line with the following principles:

- where practicable, the Remuneration Committee will look to align the remuneration package for any new appointments with the Group remuneration policy;
- to facilitate a recruitment, the Remuneration Committee may need to 'buy-out' remuneration arrangements forfeited or forgone on leaving a previous employer, including long-term awards, deferred awards, in year and prior year annual bonuses and other contractual entitlements; and
- the value of the buy-out awards will broadly be the equivalent of or less than the value of the award being bought-out in accordance with regulatory requirements, these buy-out awards will take into consideration relevant factors including, but not limited to:
  - the form of the award;
  - any performance conditions to those awards; and
  - the vesting profile of the awards and the likelihood of vesting.

The Group has developed and agreed a Board Diversity and Inclusion Policy which sets out the approach to diversity for each of the main boards within the Group. In respect of gender diversity, the Group's objective is for a balanced Board with representation of either gender making up no less than 33% of the Board. In addition, the Group has a stated goal that by 2020 the Board's gender diversity should be 50/50. Further details are provided on page 85 of the 2017 Virgin Money Group Annual Report and Accounts.

# Appendix 8. Virgin Money plc Pillar 3 disclosures

## Virgin Money plc capital resources

In accordance with Article 13 of the CRR, this Appendix sets out the reduced Pillar 3 disclosures of Virgin Money plc (the Company, in this Appendix 8), the significant subsidiary of the Virgin Money Group. The Company's capital is managed in the same way as the Group. For a discussion of capital management, the ICAAP process and Pillar 2 capital for the Company, see pages 10 to 14 in the main body of this report.

*Table 50: Virgin Money plc capital resources*

| | 2017 £m | 2016 £m |
|---|---|---|
| **Common Equity Tier 1** | | |
| Share capital | **1,400.0** | 1,400.0 |
| Other equity instruments | **230.0** | 230.0 |
| Other reserves | **4.5** | 4.1 |
| Retained earnings | **244.7** | 57.1 |
| Total equity per balance sheet | **1,879.2** | 1,691.2 |
| **Regulatory capital adjustments** | | |
| Net assets of SPVs[1] | **19.1** | 28.6 |
| Foreseeable distribution on Additional Tier 1 securities[2] | **(2.1)** | (2.8) |
| Other equity instruments[3] | **(230.0)** | (230.0) |
| Additional valuation adjustment[4] | **(1.2)** | (1.2) |
| Intangible assets[5] | **(128.4)** | (80.6) |
| Excess of expected loss over impairment[6] | **(46.9)** | (41.1) |
| Deferred tax on tax losses carried forward (after consolidation of SPVs)[7] | **(0.6)** | (7.3) |
| **Common Equity Tier 1 capital** | **1,489.1** | 1,356.8 |
| **Additional Tier 1 securities** | **230.0** | 230.0 |
| **Total Tier 1 capital** | **1,719.1** | 1,586.8 |
| **Tier 2 capital** | | |
| General credit risk adjustments | **14.3** | 11.9 |
| **Total Tier 2 capital** | **14.3** | 11.9 |
| **Total own funds** | **1,733.4** | 1,598.7 |
| **Pillar 1 risk-weighted assets** | | |
| Retail mortgages | **5,790.5** | 4,764.5 |
| Unsecured lending | **2,282.9** | 1,847.4 |
| Wholesale | **103.7** | 132.8 |
| Other assets | **172.5** | 183.7 |
| Counterparty credit risk | **46.4** | 57.8 |
| Credit valuation adjustments | **9.9** | 21.7 |
| Operational risk | **687.5** | 595.1 |
| **Total risk-weighted assets** | **9,093.4** | 7,603.0 |
| **Common Equity Tier 1 ratio** | **16.4%** | 17.8% |
| **Tier 1 ratio** | **18.9%** | 20.9% |
| **Total capital ratio** | **19.1%** | 21.0% |

1. Net assets/liabilities of SPVs are included within regulatory capital.
2. Foreseeable distributions on AT1 securities are deducted from CET1 capital under CRD IV.
3. Other equity instruments have been excluded from CET1 capital but instead make up Additional Tier 1 capital.
4. Under CRD IV, an additional valuation adjustment is applied in relation to the prudent valuation of all assets measured at fair value.
5. Intangible assets are required to be deducted from capital resources for regulatory purposes.
6. The excess of regulatory expected losses calculated under the AIRB approach over accounting provisions are deducted from CET1 capital.
7. Deferred tax on tax losses carried forward (after consolidation of SPVs) are deducted from CET1 capital. Other deferred tax balances arising from temporary differences are below the threshold for deduction and are risk-weighted at 250%.

Please see Appendix 2 for the CRD IV disclosure template as published by the EBA in Implementing Technical Standard 2013/01.

*Table 51: Virgin Money plc movements in capital resources*

| | Common Equity Tier 1 | Additional Tier 1 | Tier 2 capital | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **At 1 January 2017** | **1,356.8** | **230.0** | **11.9** | **1,598.7** |
| Movements in retained earnings | 187.6 | - | - | 187.6 |
| Movement in additional valuation adjustment | 0.0 | - | - | 0.0 |
| Movement in available-for-sale reserve | 0.4 | - | - | 0.4 |
| AT1 coupons accrued at previous year end | 2.8 | - | - | 2.8 |
| AT1 coupons accrued at this year end | (2.1) | - | - | (2.1) |
| Movement in net assets of SPVs | (9.5) | - | - | (9.5) |
| Movement in intangible assets | (47.8) | - | - | (47.8) |
| Movement in excess of expected loss over impairment | (5.8) | - | - | (5.8) |
| Movement in deferred tax on tax losses carried forward | 6.7 | - | - | 6.7 |
| Movement in general provisions | - | - | 2.4 | 2.4 |
| **At 31 December 2017** | **1,489.1** | **230.0** | **14.3** | **1,733.4** |

Capital resources increased as a result of strong profit generation offset by investment in intangible assets primarily arising from investment in developing the Group's digital banking platform. Tier 2 capital is comprised of general provisions (under the CRD IV definition) on unsecured lending.

## Capital securities

Virgin Money plc issued Additional Tier 1 securities of £230.0 million to Virgin Money Holdings (UK) plc in November 2016, which have a discretionary coupon of 8.75% per annum.

The main features of these securities as set out in Implementing Technical Standard 2013/01 and can be found in Appendix 3. The full terms and conditions of the AT1 notes are equivalent to those issued by Virgin Money Holdings (UK) plc on 10 November 2016, with the exception that notes are not convertible, but are written off if a trigger event occurs.

# Virgin Money plc Pillar 1 capital requirements

## Company risk-weighted assets and Pillar 1 capital requirements

As described on pages 10 to 11 the Pillar 1 capital requirements of the Company are made up of credit risk, counterparty credit risk (including credit valuation adjustment) and operational risk elements.

The following table sets out the risk-weighted assets and Pillar 1 capital requirements of the Company.

*Table 52: Virgin Money plc risk-weighted assets and capital requirements*

| As at 31 December 2017 | Risk-weighted assets | | Pillar 1 capital requirements |
|---|---|---|---|
| | **2017** | 2016 | **2017** |
| | **£m** | £m | **£m** |
| Credit risk (excluding counterparty credit risk) | **8,312.8** | 6,881.6 | **665.0** |
| *Of which standardised approach* | ***2,522.3*** | *2,117.1* | ***201.8*** |
| *Of which the AIRB approach* | ***5,790.5*** | *4,764.5* | ***463.2*** |
| Counterparty credit risk | **56.3** | 79.6 | **4.5** |
| *Of which mark-to-market* | ***14.6*** | *22.5* | ***1.2*** |
| *Of which the standardised approach* | ***31.8*** | *35.4* | ***2.5*** |
| *Of which CVA* | ***9.9*** | *21.7* | ***0.8*** |
| Securitisation exposures in banking book (standardised approach) | **12.3** | 10.6 | **1.0** |
| Operational risk (standardised approach) | **687.5** | 595.1 | **55.0** |
| Amounts below the thresholds for deduction (subject to 250% risk weight) | **24.5** | 36.1 | **2.0** |
| **Total** | **9,093.4** | 7,603.0 | **727.5** |

In the table above, amounts below the thresholds for deduction relate to deferred tax assets that do not relate to tax losses carried forward. As the value of these assets are below the CRR threshold, they are not deducted from own funds, but instead are risk-weighted at 250%. In tables 54 to 57 these exposures have been included within the 'other assets' category.

## Risk-weighted assets movement

The following table sets out the movements in the Company's credit risk-weighted assets split between book size, model changes and other movements.

*Table 53: Virgin Money plc risk-weighted assets movement*

| Risk-weighted assets | AIRB (mortgages) | Standardised (credit cards) | Other standardised assets[1] | Credit valuation adjustment | Operational risk | Total |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| At 1 January 2017 | 4,764.5 | 1,847.4 | 374.3 | 21.7 | 595.1 | 7,603.0 |
| Change in book size | 1,179.7 | 435.6 | - | - | - | 1,615.3 |
| Other movements | (153.7) | (0.1) | (51.7) | (11.8) | 92.4 | (124.9) |
| **At 31 December 2017** | **5,790.5** | **2,282.9** | **322.6** | **9.9** | **687.5** | **9,093.4** |

1 This includes non-CVA counterparty credit risk.

Movements in the AIRB mortgage risk-weighted assets are described in table 34 in Appendix 1. Movements in other standardised assets reflect changes in the wholesale asset portfolio.

Operational risk is calculated using the standardised approach, based on the average Company income over the past three years. The year-on-year increase reflects the increasing income from 2013 to 2016.

## Virgin Money plc credit risk

For the purposes of these disclosures, credit exposure for the AIRB portfolios refers to the calculated EAD. The EAD calculation includes amounts where customers have contractual rights to draw down further balances and estimates of interest accruals to the point of default.

The following table sets out the exposures for the various types of asset held by the Company at 31 December, and the average exposures during the year.

*Table 54: Virgin Money plc credit risk exposures, risk weights and average exposures*

| **As at 31 December 2017** | **Exposure[1]** | **Risk-weighted assets** | **Minimum capital requirement** | **Average risk weight** | **Average exposure in period** |
|---|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **%** | **£m** |
| **AIRB** | | | | | |
| Retail exposures secured by real estate collateral | **36,097.6** | **5,790.5** | **463.2** | **16.0** | **35,019.1** |
| **Standardised** | | | | | |
| Credit cards and other retail exposures | **3,022.1** | **2,266.5** | **181.3** | **75.0** | **2,829.3** |
| Exposures in default | **16.4** | **16.4** | **1.3** | **100.0** | **14.5** |
| Central governments and central banks | **2,931.7** | **-** | **-** | **-** | **2,797.3** |
| Multilateral development banks | **234.1** | **-** | **-** | **-** | **192.6** |
| Institutions | **252.7** | **51.6** | **4.1** | **20.4** | **404.3** |
| Covered bonds | **396.5** | **39.7** | **3.2** | **10.0** | **406.6** |
| Equities | **3.1** | **3.1** | **0.2** | **100.0** | **5.5** |
| Other assets | **247.4** | **169.5** | **13.6** | **68.5** | **247.1** |
| **Total standardised** | **7,104.0** | **2,546.8** | **203.7** | **35.9** | **6,897.2** |
| **Total** | **43,201.6** | **8,337.3** | **666.9** | **19.3** | **41,916.3** |

| As at 31 December 2016 | Exposure[1] | Risk-weighted assets | Minimum capital requirement | Average risk weight | Average exposure in period |
|---|---|---|---|---|---|
| | £m | £m | £m | % | £m |
| **AIRB** | | | | | |
| Retail exposures secured by real estate collateral | 32,389.6 | 4,764.5 | 381.2 | 14.7 | 30,897.7 |
| **Standardised** | | | | | |
| Credit cards and other retail exposures | 2,446.8 | 1,835.1 | 146.8 | 75.0 | 2,138.9 |
| Exposures in default | 12.3 | 12.3 | 1.0 | 100.0 | 12.0 |
| Central governments and central banks | 1,098.5 | - | - | - | 1,073.3 |
| Multilateral development banks | 129.3 | - | - | - | 211.6 |
| Institutions | 442.9 | 89.3 | 7.1 | 20.2 | 640.4 |
| Covered bonds | 327.1 | 32.7 | 2.6 | 10.0 | 443.1 |
| Equities | 7.9 | 7.9 | 0.6 | 100.0 | 7.1 |
| Other assets | 237.4 | 175.9 | 14.1 | 74.1 | 205.9 |
| Total standardised | 4,702.2 | 2,153.2 | 172.2 | 45.8 | 4,732.3 |
| **Total** | 37,091.8 | 6,917.7 | 553.4 | 18.7 | 35,630.0 |

1. Exposures are stated net of specific credit risk adjustments and before credit risk mitigation.

## Credit risk exposure by industry or counterparty type

The tables below give details of the distribution of exposures by industry or counterparty type.

*Table 55: Virgin Money plc credit risk exposures by industry or counterparty type*

| **As at 31 December 2017** | **Lending – individuals** | **Financial/ Sovereign** | **Other assets** | **Total** |
|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** |
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | **36,097.6** | **-** | **-** | **36,097.6** |
| **Standardised** | | | | |
| Credit cards and other retail exposures | **3,022.1** | **-** | **-** | **3,022.1** |
| Exposures in default | **16.4** | **-** | **-** | **16.4** |
| Central governments and central banks | **-** | **2,931.7** | **-** | **2,931.7** |
| Multilateral development banks | **-** | **234.1** | **-** | **234.1** |
| Institutions | **-** | **252.7** | **-** | **252.7** |
| Covered bonds | **-** | **396.5** | **-** | **396.5** |
| Equities | **-** | **-** | **3.1** | **3.1** |
| Other assets | **-** | **-** | **247.4** | **247.4** |
| **Total** | **39,136.1** | **3,815.0** | **250.5** | **43,201.6** |

| **As at 31 December 2016** | Lending – individuals | Financial/ Sovereign | Other assets | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | 32,389.6 | - | - | 32,389.6 |
| **Standardised** | | | | |
| Credit cards and other retail exposures | 2,446.8 | - | - | 2,446.8 |
| Exposures in default | 12.3 | - | - | 12.3 |
| Central governments and central banks | - | 1,098.5 | - | 1,098.5 |
| Multilateral development banks | - | 129.3 | - | 129.3 |
| Institutions | - | 442.9 | - | 442.9 |
| Covered bonds | - | 327.1 | - | 327.1 |
| Equities | - | - | 7.9 | 7.9 |
| Other assets | - | - | 237.4 | 237.4 |
| **Total** | 34,848.7 | 1,997.8 | 245.3 | 37,091.8 |

## Credit risk exposure by geographical area

The tables below give details of the geographical distribution of exposures.

*Table 56: Virgin Money plc credit risk exposures by geographical area*

| **As at 31 December 2017** | **UK** | **Europe** | **Rest of the world** | **Total** |
|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** |
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | **36,097.6** | **-** | **-** | **36,097.6** |
| **Standardised** | | | | |
| Credit cards and other retail exposures | **3,022.1** | **-** | **-** | **3,022.1** |
| Exposures in default | **16.4** | **-** | **-** | **16.4** |
| Central governments and central banks | **2,931.7** | **-** | **-** | **2,931.7** |
| Multilateral development banks | **-** | **121.8** | **112.3** | **234.1** |
| Institutions | **37.0** | **16.1** | **199.6** | **252.7** |
| Covered bonds | **396.5** | **-** | **-** | **396.5** |
| Equities | **1.7** | **-** | **1.4** | **3.1** |
| Other | **247.4** | **-** | **-** | **247.4** |
| **Total** | **42,750.4** | **137.9** | **313.3** | **43,201.6** |

| **As at 31 December 2016** | UK | Europe | Rest of the world | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | 32,389.6 | - | - | 32,389.6 |
| **Standardised** | | | | |
| Credit cards and other retail exposures | 2,446.8 | - | - | 2,446.8 |
| Exposures in default | 12.3 | - | - | 12.3 |
| Central governments and central banks | 1,098.5 | - | - | 1,098.5 |
| Multilateral development banks | - | 46.1 | 83.2 | 129.3 |
| Institutions | 64.6 | 116.6 | 261.7 | 442.9 |
| Covered bonds | 327.1 | - | - | 327.1 |
| Equities | 6.4 | - | 1.5 | 7.9 |
| Other assets | 237.4 | - | - | 237.4 |
| **Total** | 36,582.7 | 162.7 | 346.4 | 37,091.8 |

## Credit risk exposure by residual maturity

The following tables give details of the contractual residual maturities of exposures.

*Table 57: Virgin Money plc credit risk exposures by residual maturity*

| **As at 31 December 2017** | | **Residual maturity** | | |
|---|---|---|---|---|
| | **< 1 year** | **1-5 years** | **> 5 years** | **Total** |
| | **£m** | **£m** | **£m** | **£m** |
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | **150.4** | **959.3** | **34,987.9** | **36,097.6** |
| **Standardised** | | | | |
| Credit cards and other retail exposures | **3,022.1** | **-** | **-** | **3,022.1** |
| Exposures in default | **16.4** | **-** | **-** | **16.4** |
| Central governments and central banks | **2,724.4** | **-** | **207.3** | **2,931.7** |
| Multilateral development banks | **-** | **132.9** | **101.2** | **234.1** |
| Institutions | **252.7** | **-** | **-** | **252.7** |
| Covered bonds | **28.9** | **182.1** | **185.5** | **396.5** |
| Equities | **3.1** | **-** | **-** | **3.1** |
| Other assets | **247.4** | **-** | **-** | **247.4** |
| **Total** | **6,445.4** | **1,274.3** | **35,481.9** | **43,201.6** |

| **As at 31 December 2016** | | Residual maturity | | |
|---|---|---|---|---|
| | < 1 year | 1-5 years | > 5 years | Total |
| | £m | £m | £m | £m |
| **AIRB** | | | | |
| Retail exposures secured by real estate collateral | 183.5 | 855.7 | 31,350.4 | 32,389.6 |
| **Standardised** | | | | |
| Credit cards and other retail exposures | 2,446.8 | - | - | 2,446.8 |
| Exposures in default | 12.3 | - | - | 12.3 |
| Central governments and central banks | 781.2 | - | 317.3 | 1,098.5 |
| Multilateral development banks | - | 80.3 | 49.0 | 129.3 |
| Institutions | 442.9 | - | - | 442.9 |
| Covered bonds | - | 202.9 | 124.2 | 327.1 |
| Equities | 7.9 | - | - | 7.9 |
| Other assets | 237.4 | - | - | 237.4 |
| **Total** | 4,112.0 | 1,138.9 | 31,840.9 | 37,091.8 |

## Impairment provisioning

All Group provisions arise from the Company, so for a discussion of credit impairment for the Company see pages 28 to 29 in the main body of the narrative. Tables showing the level of impaired and past due exposures by exposure class, the levels of provisions against them and the movements in those provisions are shown in the Group section of these disclosures within tables 21 and 22.

## Virgin Money plc remuneration disclosures

There is a Group-wide remuneration policy that applies to all colleagues, and so for the individual Company disclosures please see Appendix 7.

# Appendix 9. Supplementary information – analysis of directorships

The following table shows the number of directorships held by the members of the management body of Virgin Money plc.

*Table 58: Analysis of directors as at 31 December 2017*

| | **Number of directorships** |
|---|---|
| Glen Moreno | **3** |
| Peter Bole | **1** |
| Eva Eisenschimmel | **2** |
| Jayne-Anne Gadhia | **2** |
| Geeta Gopalan | **3** |
| Colin Keogh | **4** |
| Marian Martin | **3** |
| Norman McLuskie | **1** |
| Darren Pope | **2** |

In the table above, in line with the CRD IV rules, multiple directorships within the same Group are treated as a single role and directorships with bodies that do not predominantly pursue commercial objectives are also excluded.

Further details of the Directors and other members of the management body of the Group can be found on pages 64 to 70 of the 2017 Virgin Money Group Annual Report and Accounts. Details of the recruitment policy for Directors can be found in the Nominations Committee Report in the Corporate Governance section of the 2017 Virgin Money Group Annual Report and Accounts.

# Appendix 10. CRR mapping

The following table shows how the Group have complied with the disclosure requirements of Part Eight of the CRR this year.

*Table 59: CRR Mapping*

| CRR Ref | High level summary | Compliance Reference |
|---|---|---|
| **Scope of disclosure requirements** | | |
| 431(1) | Requirement to publish Pillar 3 disclosures | Virgin Money Group publishes Pillar 3 disclosures |
| 431(2) | Firms with permission to use specific operational risk methodologies must disclose operational risk information | Not applicable |
| 431(3) | Institution must have a policy covering frequency of disclosures, their verification, comprehensiveness and appropriateness<br>Institution must also have policies for assessing whether their disclosures convey their risk profile comprehensively to market participants | Pillar 3 – page 3 (Risk profile disclosure) |
| 431(4) | Explanation of ratings decisions on request | Not applicable |
| **Non-material, proprietary and confidential information** | | |
| 432(1) | Institutions may omit information that is not material if certain conditions are respected | Pillar 3 – page 3 (Basis of preparation) – Not applicable |
| 432(2) | Institutions may omit information that is proprietary or confidential if certain conditions are met | Pillar 3 – page 3 (Basis of preparation) - Not applicable |
| 432(3) | Where 432(2) applies this must be stated in the disclosures, and more general information must be disclosed | Not applicable |
| 432(4) | Use of 431(1), (2) or (3) is without prejudice to scope of liability for failure to disclose material information | Not applicable |
| **Frequency of disclosure** | | |
| 433 | Disclosures must be published once a year at a minimum and more frequently if necessary | Pillar 3 – page 3 (Frequency, media and location) |
| **Means of disclosure** | | |
| 434(1) | To include all disclosures in one appropriate medium, or provide clear cross-references | All required disclosures are published on the VM Investor Relations website. This table provides clear cross referencing to all disclosures. |
| 434(2) | Disclosures made under other requirements (e.g. accounting) can be used to satisfy Pillar 3 if appropriate | All cross references to the ARA are signposted within this table and throughout the Pillar 3 document. |
| **Risk management objectives and policies** | | |
| 435(1) | Disclose information on: | |
| 435(1)(a) | The strategies and processes to manage risks | Pillar 3 – page 9 (Risk management) – summary<br>ARA – pages 126-188 (Risk Management Report) |
| 435(1)(b) | Structure and organisation of the risk management function | ARA – pages 127-129 (Risk Management Report) |
| 435(1)(c) | Risk reporting and measurement systems | ARA – pages 126-188 (Risk Management Report) |
| 435(1)(d) | Hedging and mitigating risk – policies and processes | ARA – pages 126-188 (Risk Management Report) |
| 435(1)(e) | A declaration of adequacy of risk management arrangements approved by the Board | Pillar 3 – page 9 (Risk disclosure statement)<br>ARA – pages 71-94 (Corporate Governance Report) |
| 435(1)(f) | Concise risk statement approved by the Board | Pillar 3 – page 2 (Key ratios) |
| 435(2) | Disclose information on: | |
| 435(2)(a) | Number of directorships held by Board members | Pillar 3 – page 68 (Appendix 9: Analysis of Directorships) |
| 435(2)(b) | Recruitment policy for selection of Board members, their actual knowledge, skills and expertise | ARA – pages 82-85 (Nomination Committee Report) |
| 435(2)(c) | Policy on diversity of Board membership and results against targets | ARA – page 85 |
| 435(2)(d) | Disclosure of whether a dedicated risk committee is in place and number of meetings in the year | ARA – page 77 |
| 435(2)(e) | Description of information flow on risk to Board | ARA – page 128 |
| **Scope of application** | | |
| 436(a) | Name of institution | Pillar 3 – page 2 (Introduction) |

| | | |
|---|---|---|
| 436(b) | Difference in basis of consolidation for accounting and prudential purposes, describing entities that are fully consolidated, proportionally consolidated, deducted from own funds or neither consolidated nor deducted. | Pillar 3 – page 5 (Regulatory Consolidation) |
| 436(c) | Impediments to transfer of own funds between subsidiaries | Pillar 3 – page 5 (Regulatory Consolidation) |
| 436(d) | Capital shortfalls in any subsidiaries outside the scope of consolidation | Not applicable |
| 436(e) | Making use of articles on derogations from (a) prudential requirements or (b) liquidity requirements for individual subsidiaries or entities | Not applicable |
| **Own funds** | | |
| 437(1) | Disclose the following information regarding own funds: | |
| 437(1)(a) | A full reconciliation of CET1 items, AT1 items, Tier 2 items and filters and deductions applied to own funds of the institution and the balance sheet in the audited financial statements of the institution | Group – Pillar 3 – page 16 (table 7: Group capital resources) and page 46 (Appendix 2: EBA reconciliation table)<br>VMplc – Pillar 3 – page 61 (table 50: Group capital resources) and page 46 (Appendix 2: EBA reconciliation table) |
| 437(1)(b) | A description of the main features of the CET1, AT1 and Tier 2 instruments issued by the institution | Group and VMplc – Pillar 3 – page 48 (Appendix 3) |
| 437(1)(c) | The full terms and conditions of all CET1, AT1 and Tier 2 instruments | Group and VMplc – separately disclosed on Group website: https://uk.virginmoney.com/virgin/investor-relations/ |
| 437(1)(d) | Disclosure of the nature and amounts of the prudential filters and deductions made against own funds and items not deducted | Group – Pillar 3 – page 16 (table 7: Group capital resources) and page 46 (Appendix 2: EBA own funds template)<br>VMplc – Pillar 3 – page 61 (table 50: Group capital resources) and page 46 (Appendix 2: EBA own funds template) |
| 437(1)(e) | A description of all restrictions applied to the calculation of own funds in accordance with this regulation and the instruments, prudential filters and deductions to which those restrictions apply | Not applicable |
| 437(1)(f) | An explanation where institutions disclose capital ratios calculated using elements of own funds determined on a different basis | Not applicable |
| 437(2) | EBA shall develop draft implementing technical standards to specify uniform templates for disclosure | Not applicable – EBA responsibility |
| **Capital requirements** | | |
| 438(a) | Summary of institution's approach to assessing adequacy of capital levels | Pillar 3 – page 15 (Capital management) |
| 438(b) | Result of ICAAP on demand from authorities | Not applicable |
| 438(c) | Capital requirements for each standardised approach credit risk exposure class | Pillar 3 – page 21 (table 12) |
| 438(d) | Capital requirements for each IRB approach credit risk exposure class | Pillar 3 – page 21 (table 12) |
| 438(e) | Capital requirements for market risk or settlement risk | Pillar 3 – page 18 (table 9) – not applicable |
| 438(f) | Capital requirements for operational risk | Pillar 3 – page 18 (table 9) |
| 438(end note) | Requirement to disclose specialised lending exposures and equity exposures in the banking book falling under the simple risk weight approach | Not applicable |
| **Exposure to counterparty credit risk (CCR)** | | |
| 439(a) | Description of process to assign internal capital and credit limits to CCR exposures | Pillar 3 – pages 32-33 (Pillar 1 capital requirements – counterparty credit risk) |
| 439(b) | Discussion of policies for securing collateral and establishing credit reserves | Pillar 3 – page 32 (Pillar 1 capital requirements – counterparty credit risk) |
| 439(c) | Discussion of management or wrong-way risk exposures | Not applicable |
| 439(d) | Discussion of collateral to be provided (outflows) in the event of a ratings downgrade | Pillar 3 – page 32 (Pillar 1 capital requirements – counterparty credit risk) |
| 439(e) | Derivation of net derivative credit exposure | Pillar 3 – pages 32-33 (Pillar 1 capital requirements – counterparty credit risk) |
| 439(f) | Exposure values for mark-to-market, original exposure, standardised and internal model methods | Pillar 3 – pages 32-33 (Pillar 1 capital requirements – counterparty credit risk) |
| 439(g) | Notional value of credit derivative hedges and current credit exposure by type of exposure | Not applicable |
| 439(h) | Notional value of credit derivative transactions | Not applicable |

| | | |
|---|---|---|
| 439(i) | Estimate of alpha, if applicable | Not applicable |
| **Capital buffers** | | |
| 440(1)(a) | Geographical distribution of relevant credit exposures for calculation of countercyclical buffer | Pillar 3 – pages 51-52 (Appendix 4) |
| 440(1)(b) | Amount of the institution specific countercyclical capital buffer | Pillar 3 – pages 51-52 (Appendix 4) |
| **Indicators of global systemic importance** | | |
| 441(1) | Disclosures of the indicators of global systemic importance | Not applicable |
| **Credit risk adjustments** | | |
| 442(a) | Disclosure of institution's definitions of past due and impaired | Pillar 3 – page 28 (Credit risk impairments) |
| 442(b) | Approaches for calculating specific and general credit risk adjustments | Pillar 3 – page 28 (Impairment provisioning) |
| 442(c) | Disclosure of pre-CRM EAD by exposure class | Pillar 3 – page 21 (table 12) |
| 442(d) | Disclosure of pre-CRM EAD by geography and exposure class | Pillar 3 – page 23 (table 14) |
| 442(e) | Disclosure of pre-CRM EAD by industry and exposure class | Pillar 3 – page 22 (table 13) |
| 442(f) | Disclosure of pre-CRM EAD by residual maturity and exposure class | Pillar 3 – page 24 (table 15) |
| 442(g) | Breakdown of impaired, past due, specific and general credit risk adjustments and impairment charges for the period | Pillar 3 – page 29 (table 22) |
| 442(h) | Impaired, past due exposures, by geographical area and amounts of specific and general impairment for each geographical area | Pillar 3 – page 28 (table 21)<br>All impaired and past due exposures are located in the UK |
| 442(i) | Reconciliation of changes in specific and general credit risk adjustments for impaired exposures | Pillar 3 – page 29 (table 22) |
| 442(end note) | Specific credit risk adjustments recorded to income statement are disclosed separately | All specific credit risk adjustments are recorded to the income statement |
| **Unencumbered assets** | | |
| 443 | Disclosures on unencumbered assets | Pillar 3 – page 55 (Appendix 6) |
| **Use of ECAIs** | | |
| 444(a) | Names of the ECAIs used in the calculation of standardised approach risk-weighted assets and reasons for any changes | Pillar 3 – page 25 |
| 444(b) | Exposure classes associated with each ECAI | Pillar 3 – page 25 |
| 444(c) | Description of the process used to transfer credit assessments to non-trading book items | Pillar 3 – page 25 |
| 444(d) | Mapping of external rating to CQS | Not applicable – the Group complies with the standard association published on the EBA website |
| 444(e) | Exposure value pre and post-credit risk mitigation by CQS | Pillar 3 – page 26 (table 18) |
| **Exposure to market risk** | | |
| 445 | Disclosure of position risk, large exposures exceeding limits, FX settlement and commodities risk | The Group has no Pillar 1 exposure to market risk – Pillar 3 – page 36 (Capital requirements – market risk) |
| **Operational risk** | | |
| 446 | Scope of approaches used to calculate operational risk. | Pillar 3 – pages 34-35 (Pillar 1 capital requirements – operational risk) |
| **Exposure in equities not included in the trading book** | | |
| 447(a) | Differentiation of exposures based on objectives and an overview of accounting techniques and valuation methodologies | Pillar 3 – page 24 (Exposures in equities)<br>No changes in practices affecting valuation were made in the year |
| 447(b) | The balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the market value | Pillar 3 – page 24 (Exposures in equities)<br>No equities are exchange traded |
| 447(c) | The types, nature and amounts of exchange-traded exposures, private equity exposures in sufficiently diversified portfolios and other exposures | Not applicable |
| 447(d) | Realised gains or losses arising from sales and liquidations in the period | Pillar 3 – page 24 (Exposures in equities) |
| 447(e) | Total unrealised gains or losses, the total latent revaluation gains or losses and any of those amounts included in the original or additional own funds | Pillar 3 – page 24 (Exposures in equities) |

| | | |
|---|---|---|
| **Exposure to interest rate risk on positions not included in the trading book** | | |
| 448(a) | Nature of the interest rate risk and the key assumptions and frequency of measurement of the interest rate risk | ARA – pages 157-161 (Market risk) |
| 448(b) | Variation in earnings, or economic value or other measures used by the institution from upward and downward rate shocks, by currency | ARA – pages 157-161 (Market risk) |
| **Exposure to securitisation positions** | | |
| 449(a) | Objectives in relation to securitisation activity | Pillar 3 – page 30 (Pillar 1 capital requirement – credit risk – securitisation) |
| 449(b) | Nature of other risks in securitised assets, including liquidity | Pillar 3 – page 31 (Risks inherent in securitised assets) |
| 449(c) | Risks in re-securitisation activity stemming from seniority of underlying securitisations and ultimate underlying assets | Not applicable |
| 449(d) | The roles played by the institution in the securitisation process | Pillar 3 – page 30 (Originated securitisations) |
| 449(e) | Indication of the extent of involvement in roles | Pillar 3 – page 30 (Originated securitisations) |
| 449(f) | Processes in place to monitor changes in credit and market risks of securitisation exposures and how the processes differ for re-securitisation exposures | Pillar 3 – page 31 (Risks inherent in securitised assets) |
| 449(g) | Description of the institution’s policies on hedging and unfunded protection and identification of material hedge counterparties | Not applicable |
| 449(h) | Approaches to the calculation of risk-weighted assets for securitisations mapped to types of exposures | Pillar 3 – page 30 (Originated securitisations), page 31 (Purchased securitisations) |
| 449(i) | Types of securitisation special purchase entities used to securitise third-party exposures as a sponsor | Pillar 3 – page 6 (table 3: Special purpose vehicles) |
| 449(j) | Summary of accounting policies for securitisations, including: | ARA – page 213 (note 1) and page 232 (note 18) |
| 449(j)(i) | Whether the transactions are treated as sales or financings | ARA – page 232 (note 18) |
| 449(j)(ii) | The recognition of gains on sales | ARA – page 232 (note 18) |
| 449(j)(iii) | Methods, key assumptions, inputs and changes from the previous period in valuing securitisation positions | ARA – page 232 (note 18) |
| 449(j)(iv) | The treatment of synthetic securitisations | Not applicable – no synthetic securitisations |
| 449(j)(v) | How assets awaiting securitisation are valued, and whether they are recorded as trading or non-trading | Not applicable – no assets awaiting securitisation |
| 449(j)(vi) | Policies for recognising liabilities on the balance sheet for arrangements that could require the institution to provide financial support | Not applicable – no such arrangements can arise with VM’s securitisation agreements. |
| 449(k) | Names of ECAIs used for securitisation and type | Pillar 3 – page 30 (Securitisation programmes and activity) |
| 449(l) | Full description of Internal Assessment Approach | Not applicable |
| 449(m) | Explanation of significant changes in quantitative disclosure | No significant changes |
| 449(n) | As appropriate, separately for the banking and trading book securitisation exposures: | |
| 449(n)(i) | Amount of outstanding exposures securitised | Pillar 3 – page 30 (Originated securitisations) |
| 449(n)(ii) | On balance sheet securitisation retained or purchased, and off balance sheet exposures | Pillar 3 – page 30 (table 23), page 31 (Purchased securitisations) |
| 449(n)(iii) | Amount of assets awaiting securitisation | Not applicable |
| 449(n)(iv) | Early amortisation treatment, aggregate drawn exposures, capital requirements | Not applicable |
| 449(n)(v) | Deducted or 1,250%-weighted securitisation positions | Not applicable |
| 449(n)(vi) | Securitisation activity including the amount of exposures securitised and recognised gains or losses on sales | Pillar 3 – page 30 (Originated securitisations) |
| 449(o) | Banking and trading book securitisations | All securitisations are in the banking book |
| 449(o)(i) | Retained and purchased positions and associated capital requirements, broken down by risk weight bands | Retained positions are not risk-weighted separately. Pillar 3 – page 31 (Purchased securitisations) |
| 449(o)(ii) | Retained and purchased re-securitisation positions before and after hedging and insurance, exposure to financial guarantors broken down by guarantor creditworthiness | Not applicable |
| 449(p) | Impaired assets and recognised losses related to banking book securitisations by exposure type | Pillar 3 – page 31 (table 24: total and impaired securitised assets) |
| 449(q) | Exposure and capital requirements for trading book securitisations | Not applicable |

| | | |
|---|---|---|
| 449(r) | Whether the institution has provided non-contractual financial support to securitisation vehicles | Not applicable |
| **Remuneration disclosures** | | |
| 450 | Remuneration | Pillar 3 – pages 56-60 (Appendix 7) |
| **Leverage** | | |
| 451(1)(a),(b),(c) | Leverage ratio and breakdown of total exposure measure including reconciliation to financial statements and derecognised fiduciary items | Pillar 3 – pages 53-54 (Appendix 5) |
| 451(1)(d),(e) | Description of the processes used to manage the risk of excessive leverage and factors that impacted the leverage ratio during the year | Pillar 3 – page 54 (table 46) |
| **Use of the IRB approach to credit risk** | | |
| 452(a) | Permission for use of the IRB approach from the competent authority | Pillar 3 – page 40 (Scope of the AIRB permission) |
| 452(b) | Explanation of: | |
| 452(b)(i) | The structure of internal ratings scales | Pillar 3 – page 40 (Internal application of the AIRB approach) |
| 452(b)(ii) | Use of internal ratings for purposes other than capital requirement calculations | Pillar 3 – page 40 (Overview of the AIRB models) |
| 452(b)(iii) | Management and recognition of credit risk mitigation | Pillar 3 – page 40 (Internal application of the AIRB approach) |
| 452(b)(iv) | Controls around rating systems | Pillar 3 – page 40 (Development and monitoring of AIRB models) |
| 452(c) | Description of ratings processes for each IRB asset class provided separately | Pillar 3 – page 40 (Internal application of the AIRB approach) |
| 452(d) | Exposure values by IRB exposure class, separately for Advanced and Foundation IRB | Pillar 3 – page 41 (Analysis of AIRB exposures by exposures class) |
| 452(e)-(f) | For each exposure class, disclosed by obligor grade, total exposure, separating loans and undrawn exposures where applicable and exposure-weighted average risk weight | Pillar 3 – pages 42-43 (table 33: AIRB exposures by risk band) model performance – regulated expected loss versus accounting actual loss) |
| 452(g) | Actual specific risk adjustments for the period and explanation of changes | Pillar 3 – page 44 (table 35: AIRB expected loss and impairment provision) |
| 452(h) | Commentary of drivers of losses in preceding period | Pillar 3 – page 45 (AIRB model performance) |
| 452(i) | Estimates against actual losses for sufficient period, and historical analysis to help assess the performance of the rating system over a sufficient period | Pillar 3 – page 45 (AIRB model performance) |
| 452(j) | Where applicable, PD and LGD by each country where the institution operates | Not applicable |
| **Use of credit risk mitigation techniques** | | |
| 453(a) | Use of on and off balance sheet netting | Pillar 3 – pages 26-27 (Collateral for secured retail and wholesale exposures)<br>ARA – page 155 (Derivative financial instruments) |
| 453(b) | How collateral valuation is managed | Pillar 3 – pages 26-27 (Collateral for secured retail and wholesale exposures) |
| 453(c) | Description of types of collateral used | Pillar 3 – pages 26-27 (Collateral for secured retail and wholesale exposures) |
| 453(d) | Types of guarantor and credit derivative counterparty and their creditworthiness | Not applicable |
| 453(e) | Disclosure of market or credit risk concentrations within risk mitigation exposures | ARA – pages 134-136 (Credit risk – mitigation) |
| 453(f) | For exposures under either the standardised or Foundation IRB approach, disclose the exposure value covered by eligible collateral | Not applicable |
| 453(g) | Exposures covered by guarantees or credit derivatives | Not applicable |
| **Use of the Advanced Measurement Approaches to Operational Risk** | | |
| 454 | Description of the use of insurance or other risk transfer mechanisms to mitigate operational risk | Not applicable, the Group does not use Advanced Measurement Approaches to operational risk. |
| **Use of Internal Market Risk Models** | | |
| 455 | Disclosures relating to the use of Internal Market Risk Models. | Not applicable, the Group does not use Internal Market Risk Models. |

# Glossary

| Term | Definition |
|---|---|
| **Advanced Internal Rating Based (AIRB) approach** | A CRD IV approach for measuring exposure to retail credit risks. The method of calculating credit risk capital requirements uses internal PD, LGD and EAD models. AIRB approaches may only be used with PRA permission. |
| **Additional Tier 1 capital (AT1)** | AT1 capital instruments are non-cumulative perpetual securities that contain a specific provision to write down the security or convert it to equity, should the CET1 ratio fall below a specified trigger limit. |
| **Basel III** | Global regulatory standard on Bank Capital Adequacy, Stress Testing and Market and Liquidity proposed by the Basel Committee on Banking Supervision in 2010. See also **CRD IV**. |
| **Business risk** | Any risk to a firm arising from changes in its business, including the risk that the firm may not be able to execute its business plan and strategy. It also includes risk arising from a firm's remuneration policy. |
| **Capital at Risk (CaR)** | Approach set out for the quantification of interest rate risk expressed as the impact to the present value of the Group's capital under interest rate sensitivity analysis. |
| **Charge off** | Charge off occurs on outstanding credit card balances which are deemed irrecoverable. This involves the removal of the balance and associated provision from the balance sheet with any remaining outstanding balance recognised as a loss. |
| **Company** | Virgin Money Holdings (UK) plc. In Appendix 8, Virgin Money plc. |
| **Conduct risk** | The risk that the Group's operating model, culture or actions result in unfair outcomes for customers. |
| **Common Equity Tier 1 capital (CET1)** | The highest form of regulatory capital under Basel III that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments. |
| **CET 1 ratio** | CET 1 capital expressed as a percentage of total risk-weighted assets. |
| **CRD IV** | In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in. |
| **Credit concentration risk** | The risk of losses arising, due to concentrations of exposures from imperfect diversification. This imperfect diversification can arise from the small size of a portfolio, a large number of exposures to specific obligors (single name concentration), or from imperfect diversification with respect to economic sectors or geographical regions. |
| **Credit underestimation risk** | A firm's capital requirements for credit risk are determined in accordance with Pillar 1 of the Capital Requirements Regulation (CRR). However, the PRA believes that there are asset classes for which the standardised approach (SA) underestimates the risk (e.g. zero risk-weighted sovereigns or standardised risk weights for unsecured retail lending). A credit risk assessment as part of the Pillar 2 review of capital adequacy is therefore required. |
| **Credit valuation adjustment (CVA)** | These are adjustments to the fair values of derivative assets to reflect the credit worthiness of the counterparty. |
| **Earnings at Risk (EaR)** | Approach set out for the quantification of interest rate risk expressed as the impact to forecast net interest income under interest rate sensitivity analysis. |
| **Expected loss** | Regulatory expected loss represents the anticipated loss, in the event of a default, on a credit risk exposure modelled under the AIRB approach. Expected loss is determined by multiplying the associated PD, LGD and EAD. |
| **Exposure at default (EAD)** | An estimate of the amount expected to be owed by a customer at the time of a customer's default. |

| | |
|---|---|
| **Forbearance** | Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties or for where the contractual terms have been cancelled for credit cards. Forbearance options are determined by assessing the customer's personal circumstances. |
| **Funding for Lending Scheme (FLS)** | The Bank of England launched the Funding for Lending scheme in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to households and businesses by lowering interest rates and increasing access to credit. |
| **Funding risk** | The inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan. |
| **Group** | Virgin Money Holdings (UK) plc |
| **Impaired assets** | Loans that are in arrears and where the carrying amount of the loan exceeds the expected recoverable amount. All mortgage expired terms, fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due. |
| **Interest rate risk** | The risk of a reduction in the present value of the current balance sheet or earnings as a result of an adverse movement in interest rates. |
| **Interest rate risk in the banking book (IRRBB)** | The risk of a reduction in the present value of the current balance sheet or earnings as a result of an adverse movement in interest rates arising as a consequence of carrying out and supporting core business activities. |
| **Internal capital adequacy assessment process (ICAAP)** | The part of the Pillar 2 assessment to be undertaken by an institution. The ICAAP allows institutions to assess the level of capital that adequately supports all relevant current and future risks in their business. In undertaking an ICAAP, an institution should be able to ensure that it has appropriate processes in place to ensure compliance with CRD IV. |
| **Leverage ratio** | Total Tier 1 capital expressed as a percentage of Total assets (adjusted in accordance with CRD IV). |
| **Liquidity risk** | The inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet the Group's contractual obligations to make payments as they fall due. |
| **Long run average probability of default** | An estimate of the likelihood of a borrower defaulting on their credit obligations over a forward looking 12 month period, with the estimates based on default experience across a full economic cycle rather than current economic conditions. |
| **Loss Given Default (LGD)** | A parameter used to estimate the difference between EAD and the net amount of the expected recovery expressed as a percentage of EAD. |
| **Operational risk** | The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes legal risk. |
| **Pillar 1** | The part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk. |
| **Pillar 2** | The part of CRD IV that ensures institutions hold adequate capital to support the relevant risks in their business. It also encourages institutions to develop and use enhanced risk management techniques in monitoring and managing their risks. |
| **Pillar 3** | The part of CRD IV that sets out the information institutions must disclose in relation to their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline. |
| **Probability of Default (PD)** | The probability of a customer defaulting over a defined outcome period. Default occurs where a borrower has missed 6 months of mortgage repayments or 3 months of credit card repayments, or the borrower is deemed to be unlikely to repay their loan. The outcome period varies for assessment of capital requirements and for assessment of provisions. |
| **Repurchase Agreements (Repos)** | A form of short-term funding where one party sells a financial asset to another party with an agreement to repurchase at a specific price and date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos). |

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| **Ring-fenced body** | The Financial Services (Banking Reform) Act 2013 introduces a ring-fence for UK retail banks from 2019, with the aim of separating core banking services critical to individuals and small and medium-sized enterprises from wholesale and investment banking services. |
| **Risk appetite** | The risk appetite sets limits on the amount and type of risk that the Group is willing to accept or tolerate in order to meet its strategic objectives. |
| **Risk-weighted assets (RWAs)** | A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules and are used to assess capital requirements and adequacy. |
| **Securitisation** | Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities through an SPV. |
| **Standardised approach** | In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings of obligators (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines. |
| **Tier 1 capital** | A measure of institutions financial strength defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to deductions including in respect of material holdings in financial companies. |
| **Tier 1 capital ratio** | Tier 1 capital as a percentage of risk-weighted assets. |
| **Tier 2 capital** | A further component of regulatory capital defined by the PRA for the Group. It comprises eligible collective assessed impairment allowances under CRD IV. |
| **Write off** | Mortgages may be written off where the outstanding balance or shortfall from sale of property is deemed irrecoverable. Assets written off will be deducted from the balance sheet. |

# Abbreviations

| Abbreviation | Meaning |
|---|---|
| **AIRB** | Advanced Internal Ratings Based |
| **ARA** | Annual Report and Accounts |
| **AT1** | Additional Tier 1 |
| **BBR** | Bank Base Rate |
| **CaR** | Capital at Risk |
| **CET1** | Common Equity Tier 1 |
| **CCR** | Counterparty credit risk |
| **CRR** | Capital Requirements Regulation |
| **CRD** | Capital Requirements Directive |
| **CSA** | Credit Support Annexes |
| **CVA** | Credit Valuation Adjustment |
| **EAD** | Exposure at default |
| **EaR** | Earnings at Risk |
| **EBA** | European Banking Authority |
| **ECAI** | External Credit Assessment Institution |
| **EL** | Expected loss |
| **FCA** | Financial Conduct Authority |
| **FLS** | Funding for Lending Scheme |
| **FPC** | Financial Policy Committee |
| **HPI** | House Pricing Index |
| **IFRS** | International Financial Reporting Standards |
| **IRRBB** | Interest rate risk in the banking book |
| **ISDA** | International Swaps and Derivatives Association |
| **LCR** | Liquidity Coverage Ratio |
| **LGD** | Loss given default |
| **LIBOR** | London Inter-Bank Offered Rate |
| **LRA** | Long run average |
| **LTIP** | Long-Term Incentive Plan |
| **LTV** | Loan to Value |
| **MDB** | Multilateral Development Bank |
| **MREL** | Minimum Requirements for Own Funds and Eligible Liabilities |
| **PD** | Probability of Default |
| **PRA** | Prudential Regulation Authority |
| **RMBS** | Residential Mortgage Backed Securities |
| **SME** | Small and Medium Sized Enterprise |
| **SPV** | Special Purpose Vehicle |
| **TFS** | Term Funding Scheme |

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