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800 Bourke Street
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Tuesday, 7 July 2015

ASX Announcement

Clydesdale Bank business update

On 7 May 2015, NAB announced its intention to pursue a demerger and IPO of Clydesdale Bank to enable a greater focus on building a stronger Australian and New Zealand business.

Material work on a potential demerger and IPO (by way of institutional offer) of Clydesdale is continuing. The transaction is a substantial and complex undertaking subject to a range of risks and issues, including shareholder vote, regulatory approvals and board approvals.

An exit from Clydesdale within this calendar year remains a priority for NAB. As a result, NAB is today providing the market with an update on the business, the UK market backdrop and introducing new Clydesdale Chief Executive Officer David Duffy.

Should the separation occur, Clydesdale will be one of the leading mid-sized retail and SME banks in the UK, with long established franchises in core regional and select national markets, a strongly capitalised balance sheet, and an experienced new leadership team in place to deliver on the business's clear strategic priorities of driving growth and returns.

A copy of the update on Clydesdale is attached including:

- Clydesdale Update Presentation, providing an overview of Clydesdale's operations
- An overview of the UK retail and SME banking market
- Clydesdale historical financial information including:
    - Clydesdale unaudited consolidated historical financial information for the six months ended 31 March 2015 (this is presented at the level of Clydesdale Bank's holding company)
    - Clydesdale audited annual report and consolidated financial statements for the three years ended 30 September 2012, 30 September 2013 and 30 September 2014 (this is presented at the level of Clydesdale Bank's holding company)

This update is being provided for informational purposes only. Shareholders will be provided with further information at the appropriate time, should a decision be made to pursue the demerger.

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Clydesdale Update

7 July 2015

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Proposed IPO and demerger of Clydesdale

- ✓ *For the purposes of this presentation the name "Clydesdale" has been used for the business activities of National Australia Group Europe Limited ("NAGE") and its subsidiaries ("NAGE Group"). The financial information presented in this presentation is that of NAGE*

- ✓ *Clydesdale's parent (National Australia Bank ("NAB")) announced on 7th May its intention to pursue a demerger and IPO Clydesdale via*
  - *Demerger of 70% – 80% to existing NAB shareholders*
  - *IPO of approximately 20% – 30% to institutional investors*

- ✓ *Transaction intended by the end of 2015, subject to market conditions*

- ✓ *Targeting primary listing on the London Stock Exchange and listing of CHESS depositary interest on the Australian Securities Exchange*

- ✓ *Material work on a potential demerger and IPO (by way of institutional offer) of Clydesdale is continuing. The transaction is a substantial and complex undertaking subject to a range of risks and issues, including shareholder vote, regulatory approvals and board approvals*

Today's presenters

David Duffy

Appointed as CEO in June 2015

Previously Chief Executive of Allied Irish Banks

- ***Almost three decades of international banking experience***
- ***Former CEO of Standard Bank International and Head of Global Wholesale Banking Network with ING Group***

Ian Smith

Appointed as CFO in November 2014

Previously a partner at Deloitte specialising in financial services for 13 years

- ***Deputy Group CFO of HBOS PLC in 2008 and Lloyds Banking Group PLC in 2009***


Sector
Overview
Clydesdale Bank
We care about here
Yorkshire Bank

UK banking market trends at a glance

Macroeconomic

- **Sustainable GDP growth forecast**, ahead of European peers – 2.1% 2015E
- **Measured increase in base rates expected** to start in early 2016
- **Inflation expected to remain below 2%** BoE target
- **Reduced unemployment and improved retail sentiment** proven by sales growth trends
- **Sustained momentum in the housing market** – transactions returning to normalised levels
- **Continued modest house price inflation** – more upside outside London & South East
- **Credit environment remains strong**

Regulatory

- UK market an early **adopter of full Basel III / CRD IV**, sector fully transitioned to new requirements
- Leverage requirements partially **mitigate any future adoption of RWA floors** for mortgages
- **High degree of regulatory oversight**
- **BoE has established an annual stress testing** process with strong regulatory credibility
- **Regular liquidity/operational assessments** established by regulator
- UK market **focused on conduct regulation**, customer fairness embedded in regulatory framework
- **Ring-fencing and resolution frameworks** should ensure stability and instil customer confidence

Competition

- **Numerous regulatory reviews to promote competition** and improve customer outcomes
- **Prudential Regulation Authority given secondary remit to facilitate effective competition**
- **Introduction of Current Account Switching Service in Sept-13**
- **Creation of the Competition and Markets Authority ('CMA') in Apr-14**
- **FCA granted statutory authority to improve competition in Apr-15**
- Against this backdrop, a number of **UK challenger banks have recently listed (5 since Jun-14), enhancing competition in the market**
- **Current focus of CMA on a level playing field for banks in the UK** in ongoing banking review

In the context of current uncertainties in Europe, the UK enjoys a positive macroeconomic backdrop and a mature regulatory regime, with increasing market focus on customer experience and competition

UK banking market trends at a glance (cont'd)

Retail

- ✓ Relatively concentrated market, however **new challengers increasing competition,** particularly in mortgages
- ✓ Underlying retail banking **profitability is recovering**
- ✓ **Mortgage lending remains a key driver of profits** and returns on equity
- ✓ **Intermediaries continue to lead origination** (c.65%, 1Q'15)
- ✓ Strong growth in deposits, with **shift from term deposits to PCAs in low rate** environment
- ✓ **Personal lending volumes are recovering**, reflecting improved consumer sentiment

SME

- ✓ **Relatively concentrated market**
- ✓ **Alternative lenders (e.g. P2P) competing with main-stream banks** who face a relative capital disadvantage
- ✓ Significant reduction in the demand for credit during the financial crisis; **evidence of a modest recovery since 2014** with demand now outstripping supply
- ✓ **Attractive margins in niche segments**, where large UK banks are not competing (e.g. development lending, cashflow lending)
- ✓ **Deposit-rich businesses** offering strong customer funding underpin

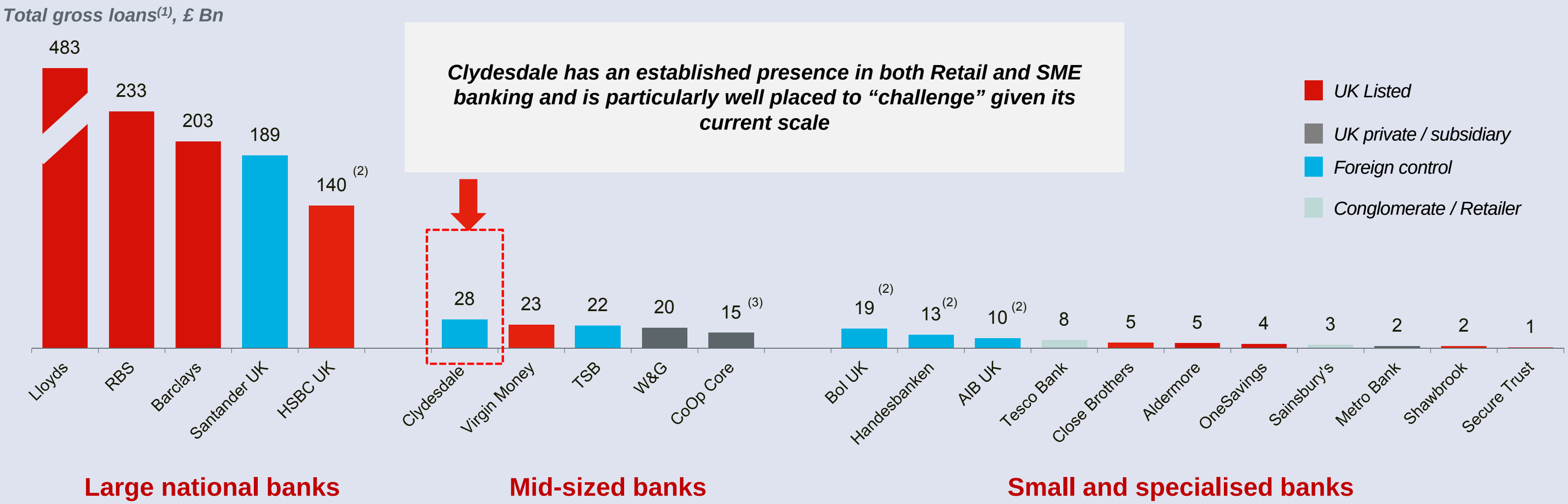
Digital

- ✓ Growing **importance of digital channels** for transactions / processing
- ✓ **55% of UK banking customers are omni-channel users** (customers who use both digital and physical channels)
- ✓ Branch role and functionality changing – **increasing need for "advisory" staff**
- ✓ Consistent focus across key players on **digital initiatives** to **increase cross-selling and improve cost-efficiency**

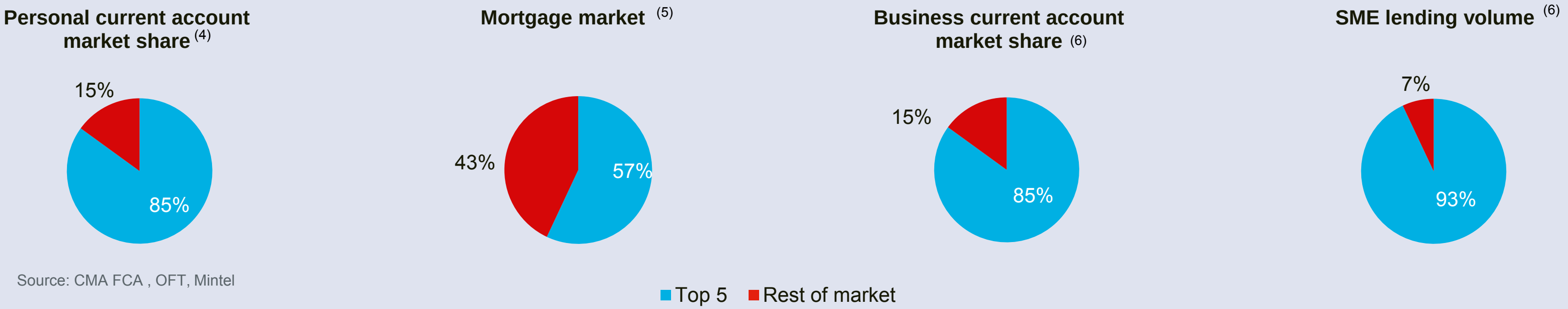
Evidence of a recovery across sectors alongside a shift to digitisation in line with the modern customers' needs

Favourable UK banking competitive landscape

Existing UK banking market participants



Relatively concentrated market – scope to take market share from "Top 5"



Source: CMA FCA , OFT, Mintel

1. Lloyds Banking Group represents total group; Barclays represents UK Personal and Corporate division (excl. Barclays Italy c.£ 14bn loans); RBS represents UK Personal and Business Banking; Santander represents retail and consumer finance division; HSBC represents UK retail and commercial; Nationwide represents Retail and Commercial division. Clydesdale, TSB, Virgin, OSB , Metro, Aldermore and Shawbrook represent the total group. W&G based on RBS FY2014 disclosure, Financials as at 31-Dec-2014 unless otherwise stated. Tesco Bank and Sainsbury's Bank results as at 28-Feb-2015, Close Brothers result as at 31-Jan-2015. Excludes building societies; 2. Results converted to GBP based on exchange rate as at 31-Dec-2014; 3. Excluding Optimum and Non Core Corporate; 4. OFT review of the PCA market (2014); 5. Mintel mortgages review (2013); 6. CMA FCA Banking Services to Small and Medium-Sized Enterprises July 2014, BCA share for England and Wales only

Largest mid-sized UK bank with meaningful market shares

Figures (2014) in £ Bn unless stated otherwise

Largest of the mid-sized UK banks

UK gross loans (£ Bn) and mortgage market share (%)[1]

	Clydesdale / Yorkshire Bank	Virgin money	TSB	Williams & Glyn[2,6]	The co-operative bank[3]	aldermore	One Savings Bank
Mortgage market share	2%	2%	2%	1%	1%	<1%	<1%
UK gross loans	28	23	22	20	15	5	4

Full service offering with strong SME presence

UK gross loans mix and SME lending market share (%)[4,5]

	Clydesdale / Yorkshire Bank	Virgin money	TSB	Williams & Glyn	The co-operative bank	aldermore	One Savings Bank
SME lending market share	4%	n/a	<1%	7%	<1%	n/a	n/a
Unsecured	5%	5%	11%	9%	7%		
SME / Corporate	29%		1%	61%	5%	47%	3%
Mortgages	66%	95%	88%	31%	88%	53%	97%

Multichannel distribution

	Clydesdale / Yorkshire Bank	Virgin money	TSB	Williams & Glyn	The co-operative bank	aldermore	One Savings Bank
	294	75	c.615[12]	314	222[13]	0[14]	9
Branches	✓	✓	(✓)[15]	(✓)[16]	✓	✓	✓
Intermediary	✓	✓	✓	(✓)[16]	✓	✓	✓
Telephony	✓	✗	✓	(✓)[16]	✓	✗	✗
Mobile[11]							

Strong current account foothold based in core regions

Customer deposit mix and PCA market share (%)[6]

	Clydesdale / Yorkshire Bank	Virgin money	TSB	Williams & Glyn	The co-operative bank	aldermore	One Savings Bank
PCA market share (%)	3%	n/a	4%	2%	3%	n/a	n/a
Variable	26%	57%	57%	42%[8]	42%	77%[9]	33%[10]
Fixed	24%	43%	12%	37%[8]	39%	23%	67%
Current Accounts	50%[7]		31%	21%[8]	19%		

The only UK mid-market bank which has material scale, full service capabilities and substantially standalone IT platform

Source: Company Information, Mintel, BBA, Bank of England

1. Clydesdale, TSB, Virgin, OSB , Metro, Aldermore and Shawbrook represent the total group; 2. W&G based on RBS FY2014 disclosure; 3. Excluding Optimum and Non Core Corporate; 4. Based on BBA postcode lending data; 5. Latest portfolio mix disclosure for W&G is as at H1 2012; 6. PCA market share based on Mintel data July 2014. For W&G, based on Santander report, August 2010; 7. Clydesdale PCAs includes non interest bearing demand deposits; 8. Represents RBS UK mix; 9. Amounts repayable within one year assumed as proxy for variable; 10. Includes flexible savings; 11. Defined as mobile banking app available on line with transaction functions; 12. Estimated branches adjusting for announced branch closures post Sabadell acquisition announcement; 13. Core branches; 14. Defined as branches only, not SME centres; 15. Short track record, offering available only since 19 January 2015; 16. All functions embedded in RBS platform with no fully standalone capabilities


Clydesdale Update
Clydesdale Bank
We care about here
Yorkshire Bank

Leading mid-sized UK Retail and SME bank

- ✓ ***Long established franchise in our core regional and selected national markets***
- ✓ ***Strong local community brands***
- ✓ ***Standalone, scalable and full service operating platform***
- ✓ ***Profitable with a resilient and strongly capitalised balance sheet***
- ✓ ***Clear strategy to drive growth and returns***
- ✓ ***Experienced leadership team***

Our business at a glance

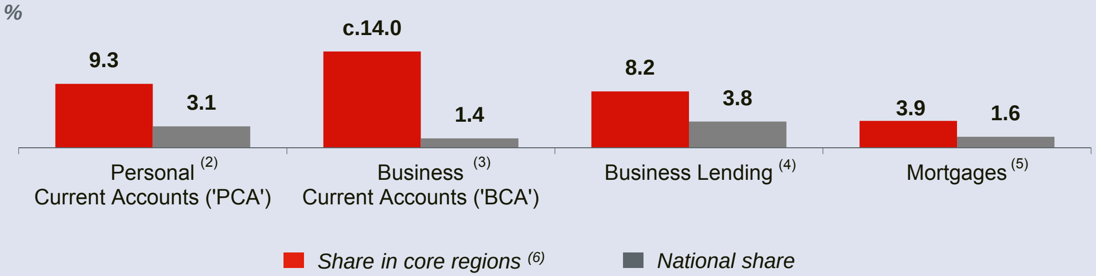
Significant scale *(1H2015)*

- *2.8m retail and business customers*
- *£ 28 Bn customer loans*
- *£ 25 Bn customer deposits*

Full service product range

Retail			SME		
PCAs	Savings Accounts & Term Deposits		Payment & Transaction Services	BCAs & Deposits	Term Lending
Mortgages	Personal Loans	Credit Cards & Overdrafts	Working Capital Solutions[(1)]	Overdrafts	Savings

Strong market shares in core regions



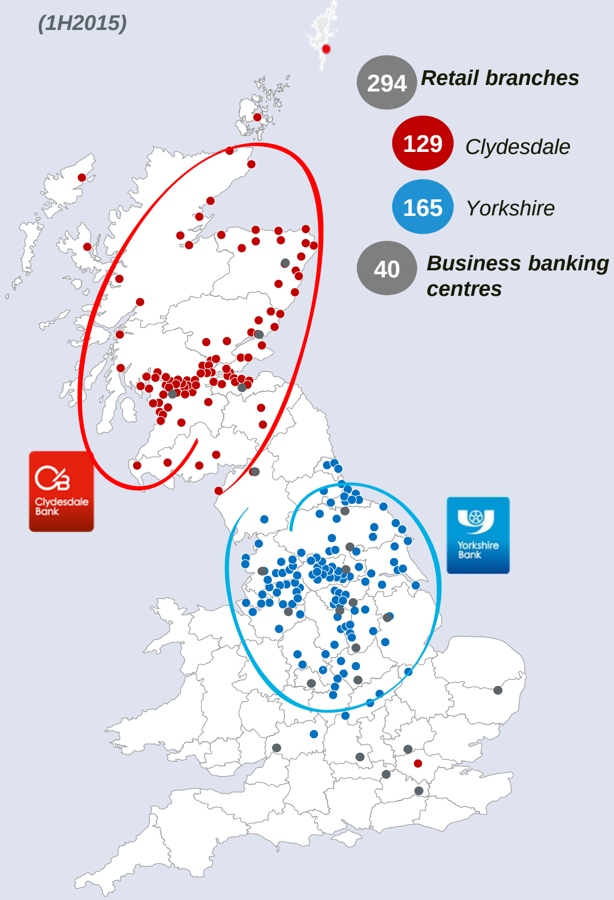
Source: BBA, CACI, CMA, BoE, CML

Broad channel distribution capability

Branch Network & Business PB Centres	Telephony / Voice	Internet Banking	Mobile Banking	Mortgage Intermediaries	ATMs	Post Office partnership

Established regional franchise

(1H2015)



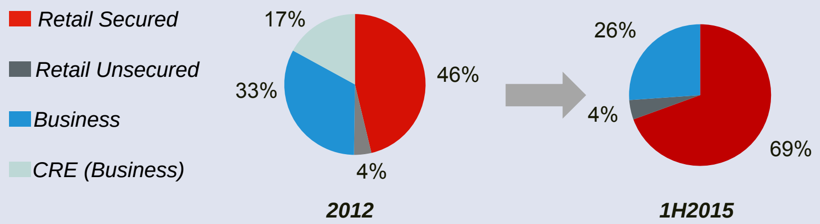
→ *Population of c.19m within a 10 minute drive of a Clydesdale or Yorkshire branch*[(7)]

1. Defined as asset finance, invoice finance, trade finance, treasury solutions, payment services and international services; 2. CACI (March 2015); 3. Regional market share based on Scotland only as calculated by CMA review (Banking services to small and medium sized enterprises, July 2014), national market share based on BOE 2015 calculation; 4. BBA 2Q14 SME lending stock; 5. Share of stock CML (1H2015), regional based on availability of data (72% of UK market); 6. Defined as Scotland, Yorkshire and the Humber and North-East and North-West England; 7.Based on Experian Branch Catchments (April 2015)

Significantly reshaped and strengthened

Strengthened balance sheet

✓ Loan book reshaped

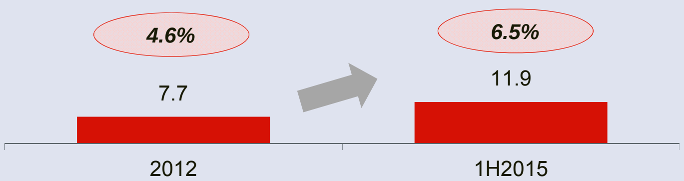


✓ Asset quality restored

	2012	1H2015
NPL Ratio (%)[1]	2.48%	1.60%
(Impairment charge/avg. customer loans[2], bps)	74bps	16bps[10]

✓ Capital strengthened

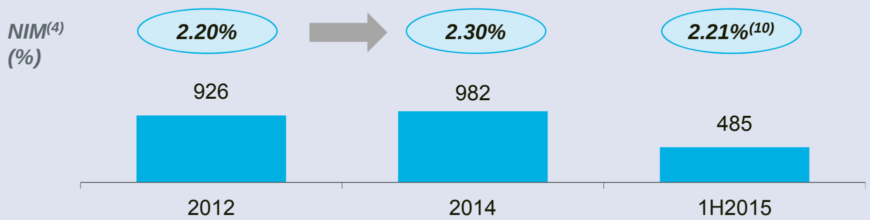
(CET1[3], %)



Franchise profitability building

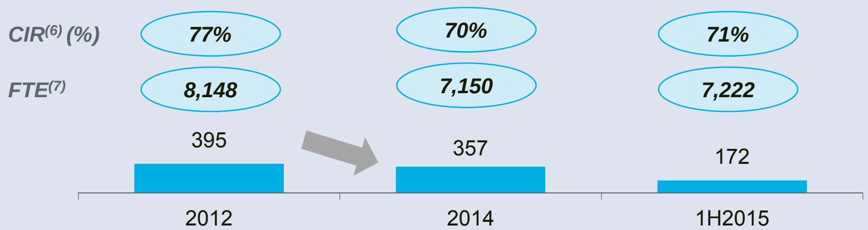
✓ Margins stable

(Total income[4], £ MM)



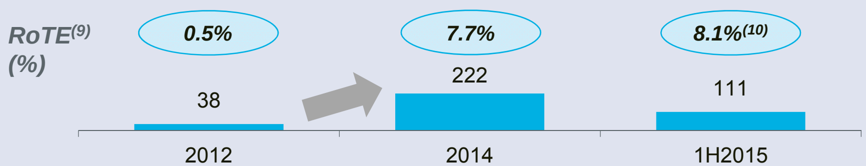
✓ Costs being addressed

(Personnel and premise expenses[5], £ MM)



✓ Restoring profitability

(Profit before tax[8], £ MM)



Conduct risk addressed

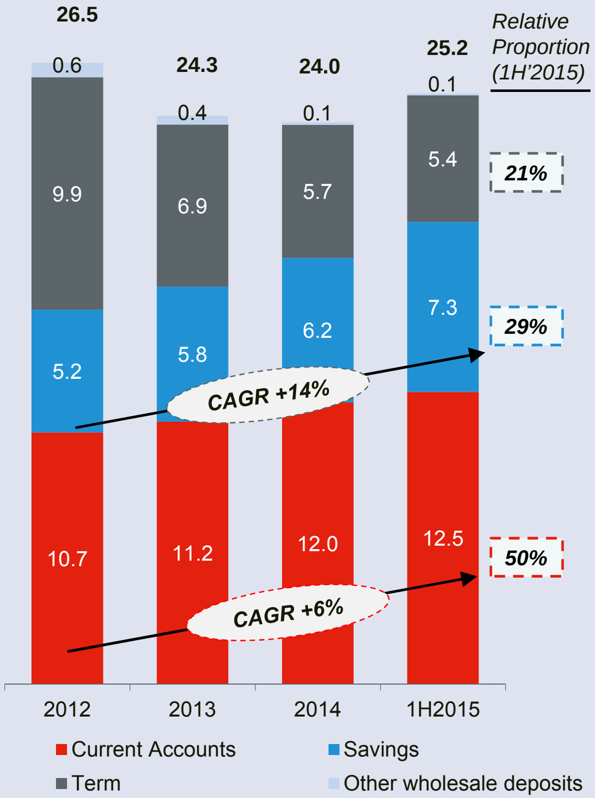
- ✓ £1.7 Bn mitigation package to be put in place
- ✓ £0.7 Bn unutilised conduct provisions as at 1H2015

1.Defined as customer loans that are more than 90 days overdue plus gross impaired assets as a percentage of total customer loans, excludes CRE in 2012; 2. Defined as impairment charge to monthly average customer loans, excludes CRE in 2012; 3. CET1 CRDIV full look through (FLT); 4. Management basis; 5. Management basis personnel expenses, operating lease rental and other occupancy charges; 6. Management basis cost-to-income ratio ("CIR") is defined as management basis total operating expenses as a percentage of management basis total operating income for a given period; 7. The FTEs previously reported in the NAB investor presentation on 7 May were on a spot basis. The FTEs quoted in this slide are on an average basis; 8. Underlying PBT, See Appendix page 27 for a reconciliation between underlying and reported statutory profit; 9. Management basis ROTE is defined as underlying profit after tax as a percentage of average tangible equity (total equity less intangible assets excluding minorities, AT1 and preference shares for a given period); 10. Annualised

Strong regional franchise drives relationship deposits

Proven track-record of growth in deposits

Gross customer deposit balances, £ Bn



Strong regional market shares and customer loyalty

RETAIL

- **9.3%** *PCAs share in core regions(1)*
- **80%** *PCA customers with us > 10 years*
- **81%** *PCA customers in core regions*
- **3.6%** *Savings share in core regions(1)*

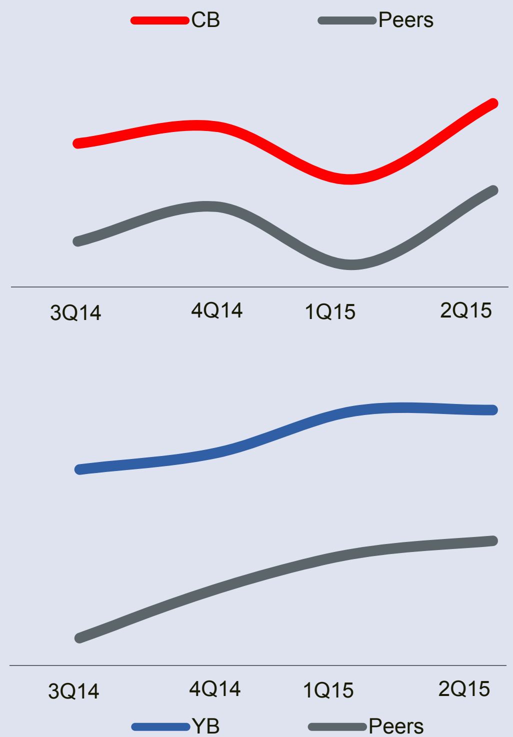
SME

- **#3** *BCA market share in Scotland in the last 10 years(2)*
- **c.14%** *BCA market share in Scotland(2)*
- **56%** *Customers with us for >10 years*

Source: CACI, CMA, BoE

Strong regional brands rated ahead of peers

Better reputation score than peers [3]



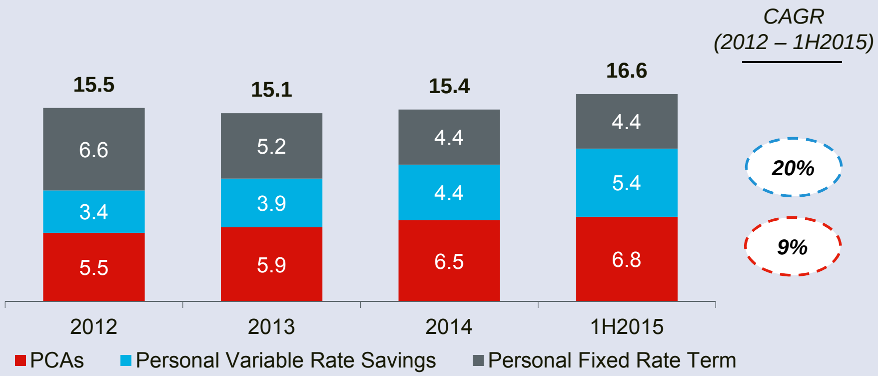
Source : YouGov

1. Core regions defined as Scotland, Yorkshire and the Humber and North-East and North-West England; CACI (March 2015); 2. Market share based on Scotland only as calculated by CMA review (Banking services to small and medium sized enterprises; 3. Brand Tracker survey. CB peers include Bank of Scotland, RBS, TSB and Santander. YB peers include Barclays, Co-op, Halifax, HSBC, Lloyds, Nationwide, Natwest, Santander and TSB;

Proven track record of growth in chosen segments

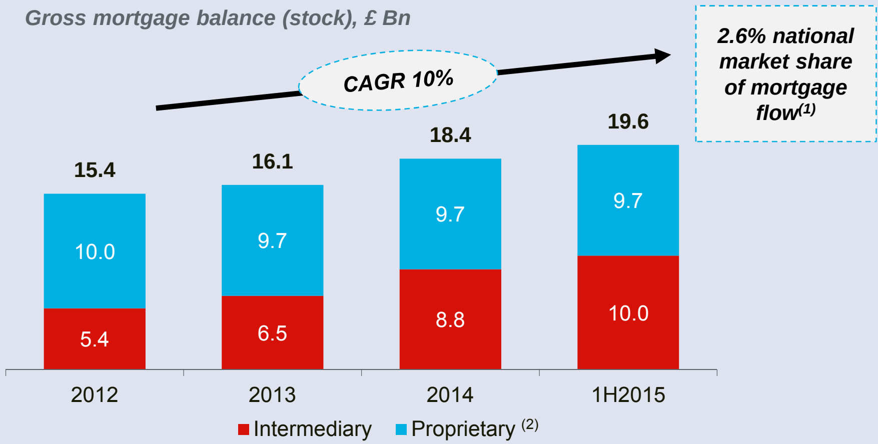
Growth in retail deposits

Gross retail customer deposit balances , £ Bn



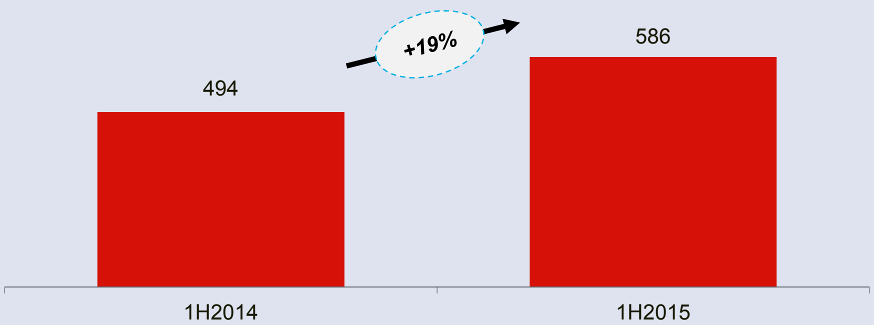
Sustained growth in mortgages

Gross mortgage balance (stock), £ Bn



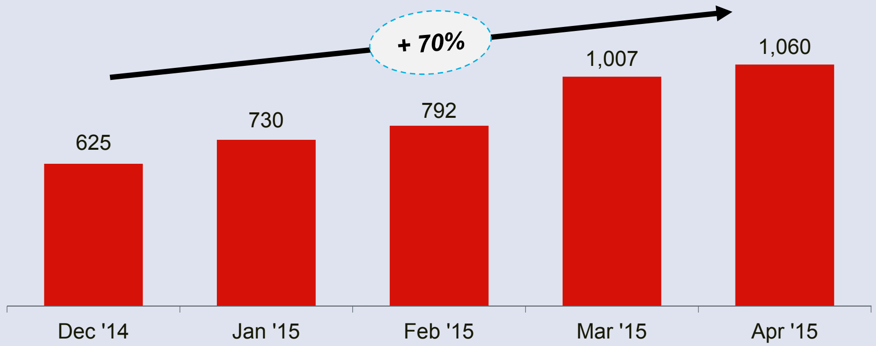
SME franchise lending reinvigorated

Gross new SME franchise facilities, £ MM[4]



Small business new customer growth[3]

Number of BCAs opened (accounts)



Continued growth in chosen segments, while running off lower yielding portfolios

1. Flow market share for 1H2015 as per CML; 2. Includes branch, direct and private bank; 3. Small business customers defined as micro customers, business direct and small business customers with turnover <£2.0m and lending <£0.25m; 4. Gross new SME Franchise facilities reflects drawn and limit based products

Our strategic positioning

Our business today

We are a strong regional bank with established Retail and SME franchises supported by trusted local community brands

Our strategic aims

1. ***Leverage our capabilities in existing core regional markets***
2. ***Continue our successful national growth strategy focusing on selected products and sectors where we have a strong history and established capabilities***
3. ***Deliver a consistently superior experience to our customers underpinned by our local community brands and a customer driven omni-channel strategy***
4. ***Deliver enhanced shareholder returns***

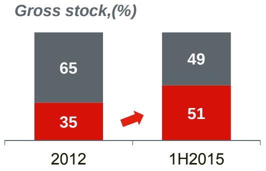
Retail franchise strategic priorities

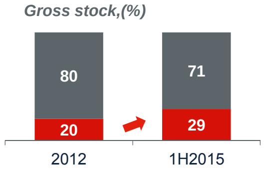
Today *(1H2015)*

Products

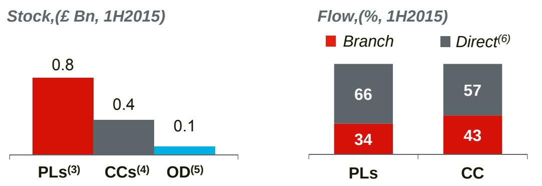
Mortgages

- ✓ *Stock 1H15* ***£19.6 Bn***
- ✓ *Gross new lending FY14:* ***£4.9 Bn***
- ✓ ***1.6%*** *stock share[1]*
- ✓ ***2.6%*** *gross flow share[2]*



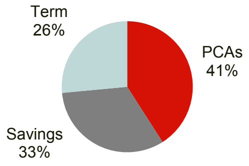


Unsecured



Personal deposits

- ✓ *Stock 1H15* ***£16.6 Bn***



Market share[7]

- **9.3%** *PCA regional*
- **3.1%** *PCA national*
- **3.6%** *Savings regional*
- **1.3%** *Savings national*

Strategic priorities

- ***Continue to grow mortgage book***
- ***Enhance cross-sell across existing and new customer base***
- ***Continue to grow PCA customer base***

Medium term

- ***Maintain growth in mortgages and increase national market share***
- ***Maintain prudent risk appetite***
- ***Run-off low yielding tracker portfolio[8]***

- ***Grow unsecured book within prudent risk appetite***

- ***Increase national market share of PCA flow***
- ***Grow customer deposits to maintain our overall loan to deposit ratio***

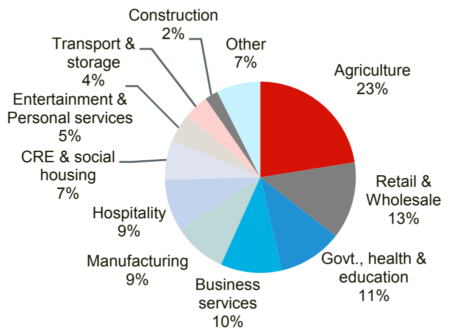
1. Share of stock per CML (1H2015); 2. Share of gross new lending per CML (1H2015); 3. Personal loans; 4. Credit cards; 5. Overdraft; 6. Includes telephony and digital; 7. CACI (March 2015); 8. Tracker portfolio size of £2.8 Bn as at 1H2015. No new tracker lending since 2012, book amortising and expected to reduce NIM drag over time

SME franchise strategic priorities

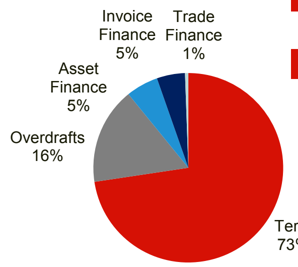
Today *(1H2015)*

Products

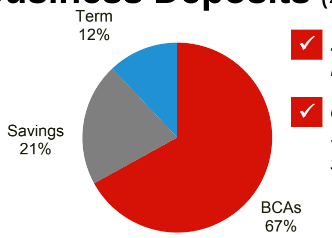
Business Loans *(£7.4 Bn)*



- ✓ ***3.8%** national stock share*[1]
- ✓ ***8.2%** regional stock share*[1]



Business Deposits *(£8.5 Bn)*



- ✓ ***1.4%** BCAs national share*[2]
- ✓ ***c.14%** BCAs Scotland share*[2]

Strategic priorities

- ***Deepen existing relationships***
- ***Run-off low yielding portfolio***[3]

- ***Expand in selected products and sectors***

- ***Grow BCA customer base***

Medium term

- ***Grow SME lending market share regionally and nationally***
- ***Grow diverse portfolio with balanced risk appetite***
- ***Continue to leverage strong capabilities in working capital products***

- ***Increase national market share of BCA flow***
- ***Grow SME deposits, with a focus on small business customers***[4]

1. Share of stock (BBA 2Q14); 2. Regional market share based on Scotland only as calculated by CMA review (Banking services to small and medium sized enterprises, July 2014), national market share based on BOE 2015 calculation; 3. £1.4 Bn as at 1H2015 in run off, expected to reduce NIM drag over time; 4. Defined as micro customers, business direct and small business customers with turnover <£2.0m and lending <£0.25m

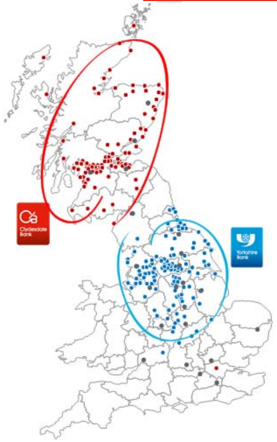
Omni-channel strategic priorities

Today

Customer service delivered through multiple channels

Branches at heart of customer service

Branches



Digital Nascent

Digital

Other well-established

Intermediary

Telephony

Proven, flexible and resilient operating platform

Strategic priorities

- ***Continue to strengthen our digital platform*** *to support consistent and seamless omni-channel experience*
- ***Optimise and align physical footprint*** *to omni-channel customer experience*
- ***Develop enhanced customer data management and analytics*** *to support delivery of superior customer experience*
- ***Digitise and simplify customer processes*** *to enhance customer experience and reduce costs*

Medium term

Consistent, superior customer experience delivered through seamless omni-channel

Optimised and aligned

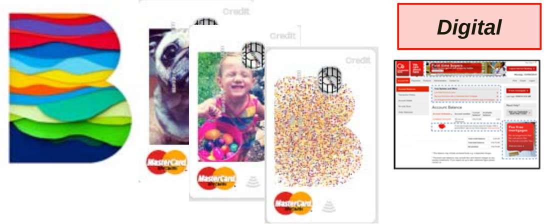
Branches

Intermediary

Multi-media contact centres

Digital at heart of customer experience

Digital



Operating platform simplified and efficiency increased

We seek to provide customers with banking where, when and how they want it

Leading mid-sized UK Retail and SME bank

- ✓ *Long established franchise in our core regional and selected national markets*
- ✓ *Strong local community brands*
- ✓ *Standalone, scalable and full service operating platform*
- ✓ *Profitable with a resilient and strongly capitalised balance sheet*
- ✓ *Clear strategy to drive growth and returns*
- ✓ *Experienced leadership team*


Clydesdale Bank
We care about here
Yorkshire Bank
Appendix A:
Financial Performance & Trading Update

Straightforward Retail and SME bank with improved profitability and returns

1 Management actions to reshape the business have driven turnaround in profitability

- ✓ *Loan portfolio reweighted to retail secured and core SME*
- ✓ *Liability mix reshaped to reduce funding costs and support NIM*
- ✓ *Product portfolio restructured to align to regulatory developments*
- ✓ *Asset quality materially improved*
- ✓ *Ongoing cost reduction initiatives reflecting business model changes*

2 Balance sheet and capital position strengthened to support planned asset growth

3 2015: a year of investment for growth; delivery of strategic objectives on track

- ✓ *Balance sheet growth is on track*
- ✓ *Near term NIM headwinds mitigated by continued reweighting to PCA funding*
- ✓ *Cost base expected to reflect step up in investment*
- ✓ *Asset quality trends nearing cyclical low*

1 Extensive management actions to reshape the business have driven turnaround in profitability

Income statement (management basis)(1)(2)

£MM	Year Ended 30 September 2012	2013	2014
Net interest income	806	768	785
Other operating income (“OOI“)	264	225	205
Gains / losses on financial inst. at FV (6)	(144)	(35)	(8)
Total income	**926**	**958**	**982**
Operating and admin. expenses	(715)	(683)	(686)
Operating profit before impairment losses	**211**	**275**	**296**
Impairment losses (credit exposures)	(173)	(144)	(74)
Underlying profit before tax	**38**	**131**	**222**
Key Metrics (Management Basis)			
NIM(3)	**2.20%**	**2.18%**	**2.30%**
Cost-to-income ratio (‘CIR‘)	**77%**	**71%**	**70%**
Impairment Charge / Average Customer Loans	**74bps**	**59bps**	**30bps**
RoTE (Underlying basis)(4)	**0.5%**	**4.4%**	**7.7%**
FTEs (average)(5)	**8,148**	**7,201**	**7,150**

- ✓ ***NIM improvement* due to optimised deposit mix**
- ✓ ***OOI decline driven by pro-active response* to regulatory backdrop and reshaping of book**
- ✓ ***Cost:Income Ratio improvement and absolute cost reduction* driven by operational restructuring; scope for further efficiencies**
- ✓ ***Improved asset quality,* reflecting sustained credit focus and improving economic cycle**
- ✓ ***Rebuilding profitability* – RoTE of 7.7% on an underlying basis in 2014**

1. Presented on a management basis which represents the historical results of Clydesdale excluding adjustments that Clydesdale's Directors believe are non-recurring, or otherwise not indicative of the underlying performance of the business. These include conduct redress expenses, restructuring costs, impacts of the disposed UK CRE portfolio, impairment losses on goodwill and other one off items. Conduct charges exclude charges relating to Interest Rate Hedging Products (IRHP). Underlying profit tax is a non-statutory profit measure; refer to page 27 for reconciliation to reported statutory profit; 2. Management basis also excludes the impacts of the "Insurance Intermediary Business" (the non-trading holding company National Wealth Management Europe Holdings Ltd, and its trading subsidiary National Australia Insurance Services Ltd (NAIS), which are expected to be included in the perimeter of Clydesdale). Total income and net profit after tax for the Insurance Intermediary Business was as follows: FY14: £23m, FY13: £31m, FY12: £41m; and FY14: £12m, FY13: £17m, FY12: £22m respectively; 3. The difference in 2012 margin to that previously reported is due to rounding; 4. Management basis RoTE is defined as underlying profit after tax as a percentage of average tangible equity (total equity less intangible assets excluding minorities, AT1 and preference shares for a given period); 5. The FTEs previously reported in the NAB investor presentation on 7 May were on a spot basis. The FTEs quoted in this slide are on an average basis; 6. Gains and losses on financial instruments at FV comprises: fair value gains and losses on derivatives held for economic hedging activities, ongoing hedge ineffectiveness and movement of fair value loans that are no longer sold

2 Straightforward and conservatively managed balance sheet underpins planned asset growth

£MM	Year Ended 30 September FY12	FY13	FY14	1H15	*CAGR (12–1H15)*
Balance Sheet					
Retail & Private Banking Loans	*16,679*	*17,422*	*19,726*	*20,897*	*9%*
Business Banking Loans[1]	*16,548*	*9,002*	*7,970*	*7,395*	*(28%)*
Net Lending Book	**33,227**	**26,424**	**27,696**	**28,292**	***(6%)***
Liquid Assets	8,968	7,695	7,154	8,281	*(3%)*
Other Assets[2]	2,187	2,629	2,542	2,352	*3%*
Total Assets	**44,382**	**36,748**	**37,392**	**38,925**	***(5%)***
Customer Deposits[3]	26,528	24,266	23,989	25,209	*(2%)*
Wholesale Funding	3,190	3,135	3,518	4,050	*10%*
NAB Funding	7,716	3,036	2,677	1,792	*(44%)*
Other Liabilities[4]	4,329	3,862	4,670	4,700	*3%*
Total Liabilities	**41,763**	**34,299**	**34,854**	**35,751**	***(6%)***
Equity and Reserves[5]	2,619	2,449	2,538	3,174	*8%*
Liabilities and Equity	**44,382**	**36,748**	**37,392**	**38,925**	***(5%)***
Ratios					
LDR (%)	*104%* [7]	*109%*	*115%*	*112%*	
CET1 CRDIV FLT[6]	*7.7%*	*9.6%*	*9.4%*	*11.9%*	
Leverage Ratio	*4.6%*	*5.1%*	*5.2%*	*6.5%*	

- ***✓ Above system mortgage growth***
- ***✓ Refocused business lending***

- ***✓ Excess liquidity reduced in 2012 post CRE transfer***

- ***✓ Robust customer deposit funding***
- ***✓ Reduced utilisation of NAB funding***

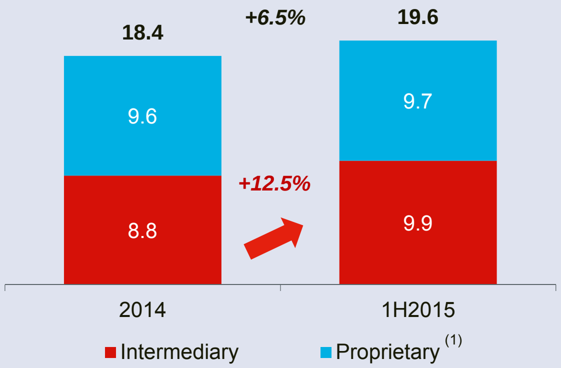
- ***✓ Strong capital position***

1. Includes £5,652 MM of CRE assets which were transferred to NAB in October 2012; 2. Other assets include derivative assets, amounts due from NAB and capitalised software costs of £237m at 1H15 (FY14: £213m; FY13: £215m; FY12: £198m) ; 3. The difference to previously reported balance as at 31 March 2015 reflects a £12 MM reallocation to Other Liabilities; 4. Other liabilities include derivative liabilities, amounts due to NAB and notes in circulation; 5. Includes non-controlling interest, preference shares and AT1 of £450m at 1H15 (FY14: £300m, FY13 £300m, FY14 £300m); 6. Full look through (fully phased); 7. Calculated on underlying management basis which excludes CRE assets of £5,652 MM

3 1H2015 balance sheet trends in line with strategy

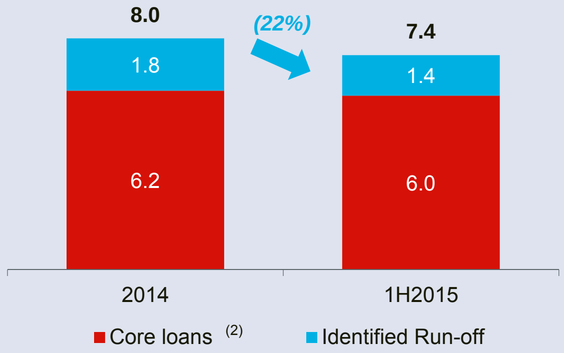
Continued mortgage growth driven through intermediary

Retail secured balance, £ Bn



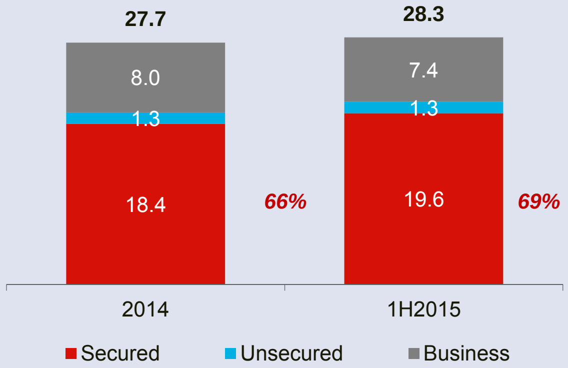
Business banking non-core run-off ahead of plan

Business balance, £ Bn



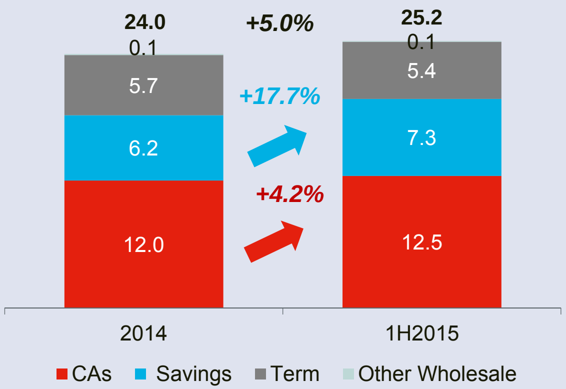
Reweighting to retail secured continues

Customer loans balance, £ Bn



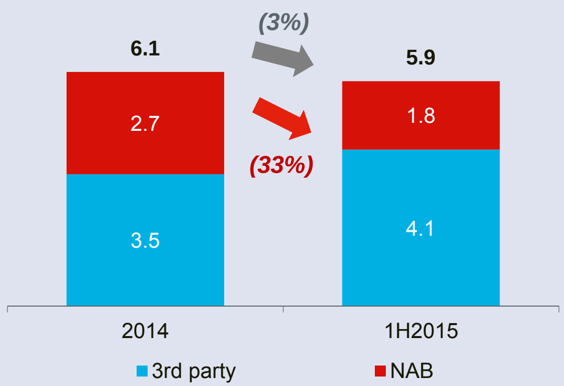
Strong deposit growth

Stock of customer deposits, £ Bn



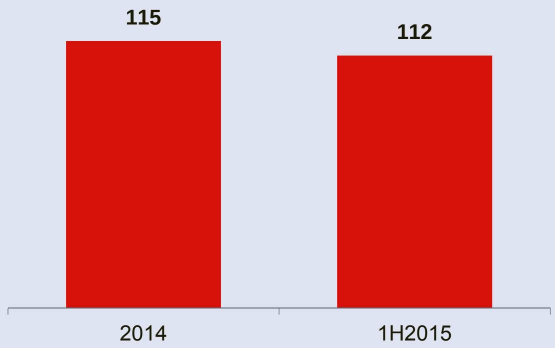
Lower wholesale funding

Wholesale funding (3rd party and NAB), £ Bn



Stable LDR

Loan-to-deposit (LDR), (%)



1. Defined as branch and private banking; 2. Defined as core business stock loans, excluding non core run off book;

3 Increased investment and income headwinds

Income statement (management basis)[1][2]

£ MM	Year Ended 30 September 1H2014	2H2014	1H2015	% change[3]
Net interest income	385	400	390	*1.3%*
Other operating income	102	103	89	*(12.7%)*
Gains and losses on financial instruments at FV	(6)	(2)	6	*n.a*
Total income	**481**	**501**	**485**	*0.8%*
Operating and administrative expenses	(328)	(358)	(346)	*5.5%*
Operating profit before impairment losses	**153**	**143**	**139**	*(9.2%)*
Impairment losses (credit exposures)	(50)	(24)	(28)	*(44.0%)*
Underlying profit before tax	**103**	**119**	**111**	*7.8%*
Key Metrics (Management Basis)				
NIM	**2.29%**	**2.32%**	**2.21%**	***(8bps)***
Cost-to-income ratio ('CIR')	**68%**	**71%**	**71%**	***3ppts***
Impairment/Average Customer Loans	**42bps**	**16bps**	**16bps**	***(26bps)***
RoTE (Underlying basis)[4]	**7.7%**	**7.8%**	**8.1%**	*0.3ppts*
FTEs (average)[5]	7,037	7,263	7,222	*3%*

Key trends in 1H2015

Investment at higher level reflects:

- *Increased marketing spend*
- *Spend on digital platform and propositions*

Income headwinds include:

- *Pressure on mortgage book yield offset by higher mortgage volume and lower funding costs*
- *OOI lower due to changes to current account charging structures and non-recurrence of prior period sale and leaseback gains*

Low credit losses

- *Continued strong credit performance, cost of risk now close to or at cyclical low*

1. Presented on a management basis which represents the historical results of Clydesdale excluding adjustments that Clydesdale's Directors believe are non-recurring, or otherwise not indicative of the underlying performance of the business. These include conduct redress expenses, restructuring costs, impacts of the disposed UK CRE portfolio, impairment losses on goodwill and other one off items. Conduct charges exclude charges relating to Interest Rate Hedging Products (IRHP). Underlying profit tax is a non-statutory profit measure; refer to page 27 for reconciliation to reported statutory profit; 2. Management basis also excludes the impacts of the "Insurance Intermediary Business" (the non-trading holding company National Wealth Management Europe Holdings Ltd, and its trading subsidiary National Australia Insurance Services Ltd (NAIS), which are expected to be included in the perimeter of Clydesdale). Total income and net profit after tax for the Insurance Intermediary Business for the half year ended 31 March 2015 was £13m (FY14: £23m, FY13: £31m, FY12: £41m) and £6m (FY14: £12m, FY13: £17m, FY12: £22m) respectively; 3. 1H2015 vs. 1H2014; 4. Annualised management basis RoTE is defined as underlying profit after tax as a percentage of average tangible equity (total equity less intangible assets excluding minorities , AT1 and preference shares for a given period); 5. The FTEs at 31 March 2015 of 6,929 (FY14: 7,033; FY13: 6,904; FY12: 7,925) reported in the NAB investor presentation on 7 May were on a spot basis and excludes conduct related FTE. The FTEs quoted in this slide are on an average basis

Bridge to reported earnings – explaining the exceptionals

Earnings reconciliation

	Year Ended 30 September			
£ MM	FY12	FY13	FY14	1H15
Underlying PBT on ordinary activities	**38**	**131**	**222**	**111**
Pension scheme reform	130	–	–	–
PPI redress expense	(120)	(130)	(420)	–
PPI complaint handling fine	–	–	–	(21)
Other conduct	(23)	(50)	(13)	
Impairment of other intangible assets	(36)	–	(23)	–
Impairment losses on goodwill	(141)	–	–	–
Disposed legacy CRE portfolio result	(502)	–	–	–
Restructuring	(149)	–	–	(12)
Gain on capital restructuring	–	–	–	59
Pension increase exchange gain				18
(Loss) / profit on ordinary activities before tax	**(803)**	**(49)**	**(234)**	**155**
Tax credit / (charge)	156	5	44	(18)
(Loss) / profit for the period	**(647)**	**(44)**	**(190)**	**137**

Key trends

- ***Pension scheme reform*** – one-off contribution by NAB in FY12 upon its exit as a participating employer. In 1H15, plan arrangements were amended, resulting in a credit within personnel expenses
- ***Payment protection insurance (PPI) redress expense*** – recognition of, and revisions to, redress cost estimates
- ***Other conduct charges*** – relate to a number of industry and Clydesdale specific issues
- ***Impairment of intangible assets*** – relate to software
- ***Impairment losses on goodwill*** – FY12 charge of £141 MM relating to NAGE investment in Clydesdale Bank plc, reflecting the restructuring of the business in 2012
- ***Disposed legacy CRE portfolio result*** – The legacy CRE portfolio was reclassified as held for sale at FY12 and was transferred to NAB at book value
- ***Restructuring*** – Charges in FY12 and H115 comprised provisions for redundancies, lease break and associated property vacancy and other costs
- ***Gain on capital restructuring*** – relating to replacement/ redemption of non-CRD IV compliant instruments held by NAB

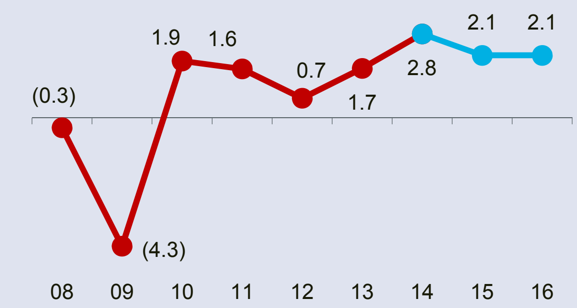
Appendix B: Industry Overview

(3rd Party Data)

Positive UK macroeconomic outlook

UK GDP growth expected to continue...

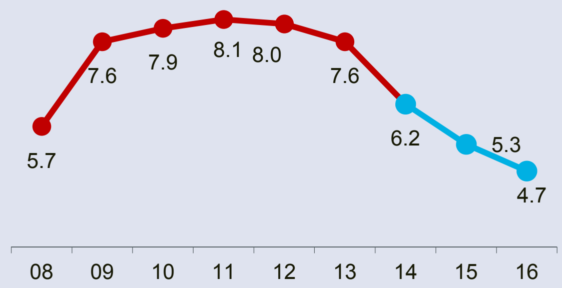
UK GDP growth rate, %



Source: 3rd party forecast - Office for National Statistics / EIU (May 2015)

...supported by a decline in unemployment...

UK unemployment rate, %



Source: 3rd party forecast - EIU (May 2015)

...and a sharp rise in consumer confidence ...

UK Consumer Confidence Index, %

Source: GFX

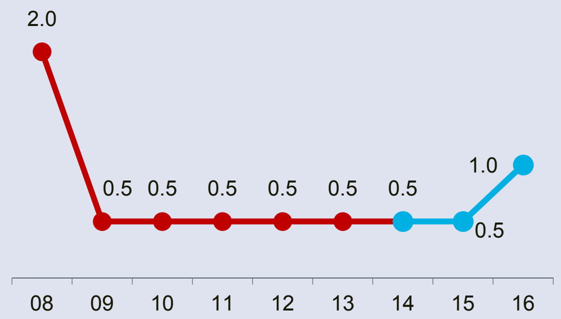
...driving recovery in retail sales growth...

UK retail sales growth, %

Source: 3rd party forecast - EIU (May 2015)

...and profitability supported by a gradual rise in base rates

UK base rates, %



Source: 3rd party forecast - EIU (May 2015)

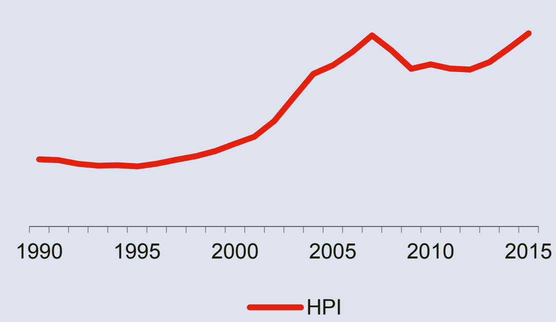
- ✓ ***Sustainable GDP growth rates ahead of European peers***
- ✓ ***Increased consumer confidence leading to a normalised transactional environment***
- ✓ ***Measured increase in base rates expected from early 2016***

Historical ***Forecast***

UK mortgage market well positioned for growth

Buoyant housing market with increasing house prices…

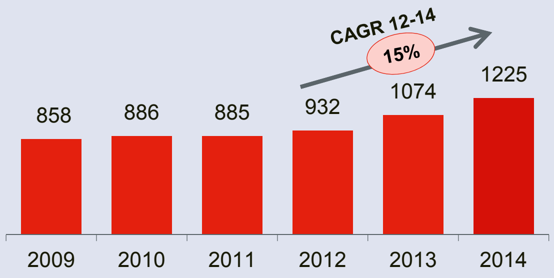
UK House Price Index ('HPI')



Source: Halifax

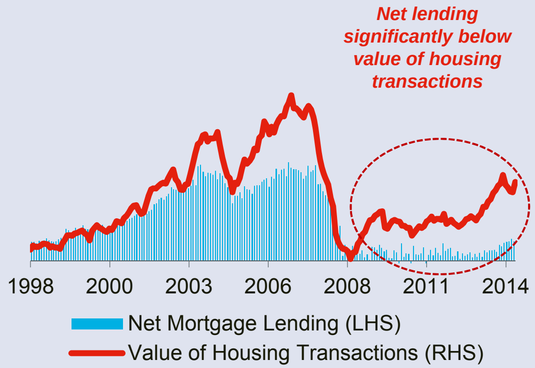
...and strong transaction volumes...

UK Property transactions, Seasonally adjusted, 000s



Source: CML

…with net lending significantly below housing transaction values, pointing to low leverage



Source: CML, Bank of England

Strong growth in residential and buy-to-let mortgages…

New mortgage lending by type, £ Bn

Source: CML

…with volumes expected to increase…

Total new mortgage lendiing, £ Bn

Source: CML (historical and forecast)

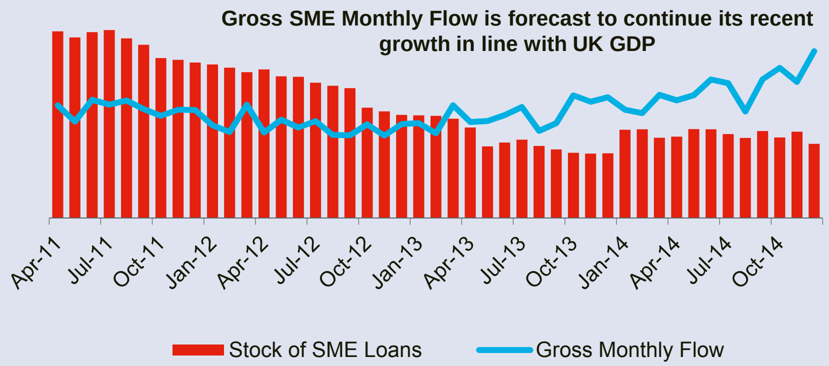
Historical ***Forecast***

- ***HPI dynamics expected to continue to drive mortgage growth***
- ***Remortgage volumes also increasing as borrowers generate equity in their homes***

Improving conditions in SME & Commercial market

Momentum building with flows increasing

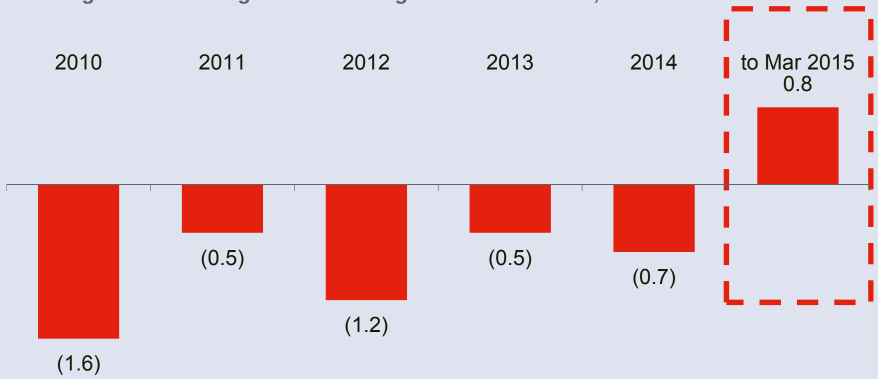
SME stock (LHS) and gross flows (RHS)



Source: Bank of England

Net lending inflection point reached in Q1 2015

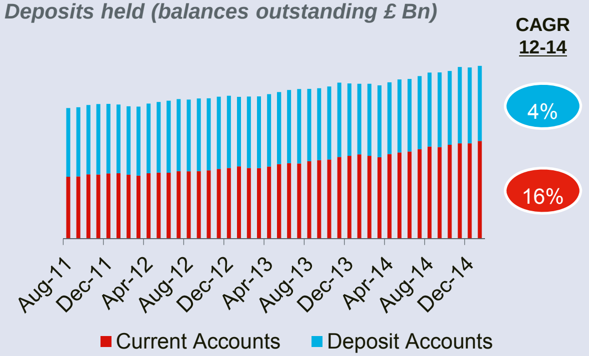
Average annual change in net lending to UK businesses, £ Bn



Source: Bank of England

SMEs further strengthening balance sheets, providing capacity for investment

Deposits held (balances outstanding £ Bn)



Source: BBA

"We expect business investment to continue to grow relatively strongly in 2015"

"Business investment growth has been revised up between 2016 and 2018"

Office for Budget Responsibility[1]

"Most industry sectors and regions saw more lending facilities approved in Q1 2015 than in Q1 2014"

British Bankers' Association[2]

- ✓ ***Business investment increased by 6.8%[1] in 2014 with growth expected to continue***
- ✓ ***Market turning for SME lending with loan volumes up 22%[2] in Q12015***

Source: 1. Economic and fiscal outlook, March 2015; 2. Bank support for SMEs – 1st Quarter 2015

INDUSTRY OVERVIEW

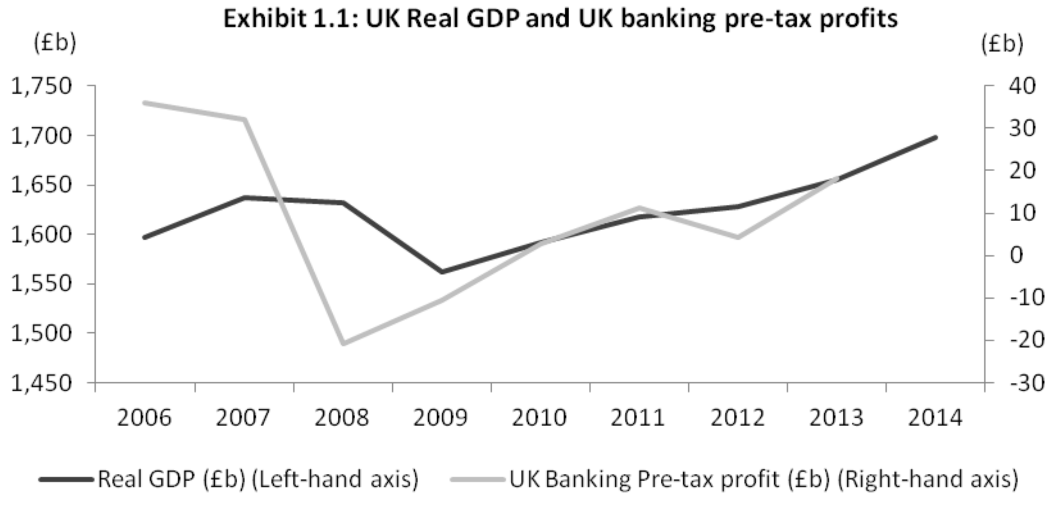
*The following information relating to the banking industry in the United Kingdom has been provided for background purposes only. The information has been extracted and derived from a variety of sources released by public and private organisations. The information has been accurately reproduced and, as far as National Australia Group Europe Limited ("**NAGE**") is aware, and is able to ascertain from information published by such sources, no facts have been omitted which would render the reproduced information inaccurate or misleading.*

1. UK Economic Context and Overview of the Banking Industry

1.1 *UK economic context*

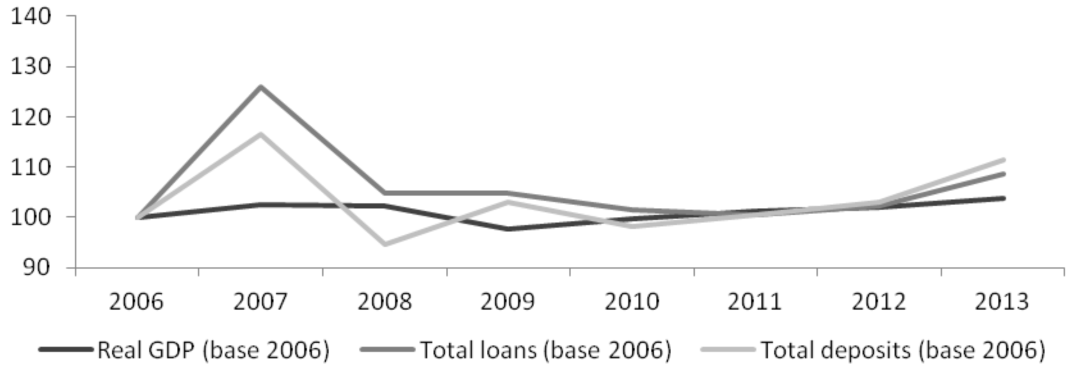
The financial services industry, encompassing banks, investment funds, insurance companies, credit unions and a range of other organisations, is an important part of the UK economy. As at January 2014, the industry employed approximately 1.1 million people in the UK, with UK banks directly employing over 400,000 people. In 2013, the industry represented 7.9 per cent. of UK GDP, compared to 4.9 per cent. in France, and 4.0 per cent. in Germany. The financial services sector accounted for 12.0 per cent. of total UK tax receipts in 2012 and 2013.

UK banking performance is correlated with the health of the UK economy. In 2008, the first year of the financial crisis, the UK banking sector collective pre-tax profits decreased from a sector-wide £32 billion in 2007 to a loss of £21 billion. Real GDP in the UK decreased by 4.3 per cent. between 2008 and 2009 from £1.63 trillion to £1.56 trillion, as shown in Exhibit 1.1 below. However, there has been a considerable period of recovery between 2009 and 2014 with real GDP growing by a compound annual growth rate ("**CAGR**") of 1.7 per cent. and the UK banking sector achieving collective pre-tax profits of £18 billion in 2013. UK GDP growth, which has been increasing ahead of European peers, further grew by 2.8 per cent. in 2014, and real GDP is forecast to grow 2.1 per cent. in 2015 (*Source: Office for National Statistics*). This trend is reflected in the trends in total loans in the UK banking sector, which have increased by a CAGR of 1.1 per cent. since 2009, and total deposits in the UK banking sector, which have increased by a CAGR of 2.4 per cent. since 2009, in line with GDP growth.



Source: Office for National Statistics, The Economist Intelligence Unit, Bank of England.

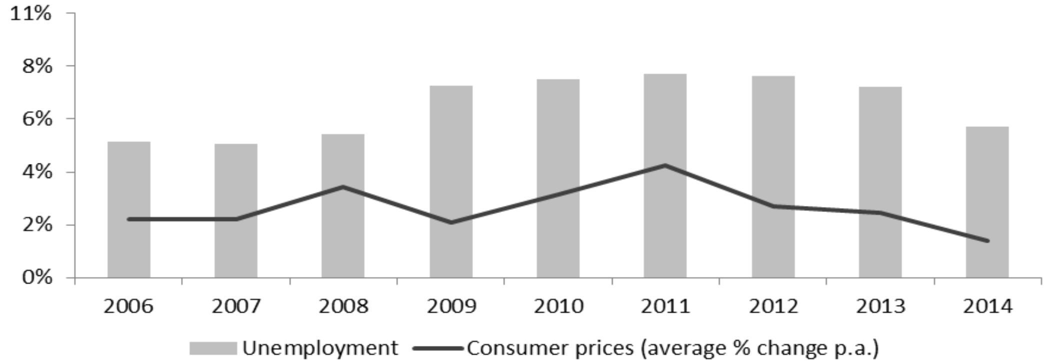
Exhibit 1.2: Real GDP compared to total loans and total deposits index (base 2006)



Source: Eurostat, The Economist Intelligence Unit

Other UK macro-economic indicators have also shown improvements. Unemployment decreased from 2.7 million in November 2011, representing 8.5 per cent. of the working age population in the UK to 1.9 million by December 2014, representing 5.7 per cent. of the working age population in the UK. The total number of people in employment increased from 29.3 million to 30.9 million over the same period, from November 2011 to December 2014. Between 2012 and 2014, inflation remained within the Monetary Policy Committee's target of 2 per cent. ±1 per cent. Having since fallen below this range, the Bank of England forecasts that inflation will return to the target range by 2016 and will stabilise at 2 per cent. by 2017.

Exhibit 1.3: UK unemployment rate and consumer price inflation

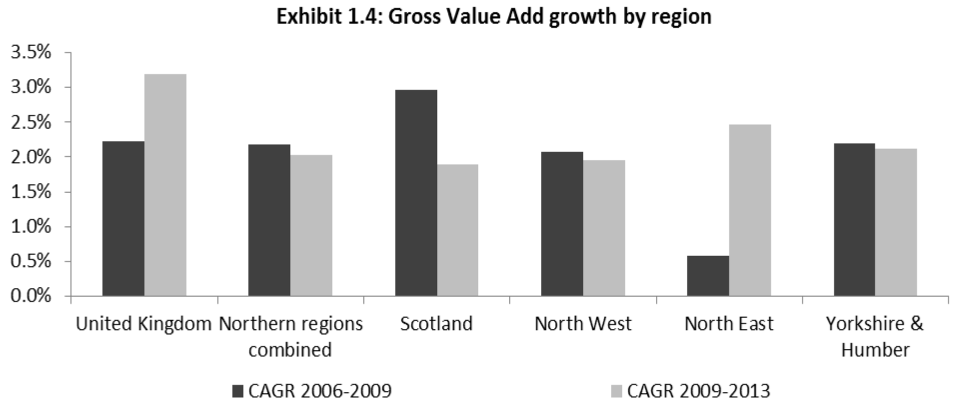


Source: The Economist Intelligent Unit, Office for National Statistics.

1.1.1 *Regional economic context*

The UK government reports on economic data from twelve regions, including NAGE's core regions: Scotland; North East England; North West England; and, Yorkshire and the Humber. The data reveals diverse demographics and macro-economic performances.

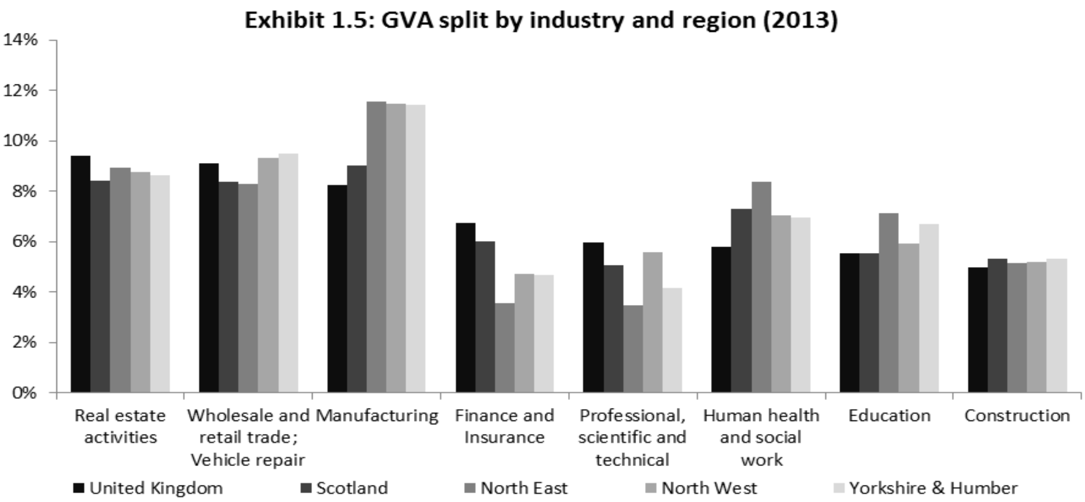
By 2013, in general the UK had recovered from the financial crisis to reach a higher nominal level of output (measured as gross value added ("**GVA**")), compared to 2006. Between 2006 and 2009, GVA in the North West and Yorkshire and the Humber grew in line with the UK average of 2 per cent. CAGR and 3 per cent. CAGR in Scotland. In Scotland, the North West and Yorkshire and the Humber GVA continued to grow between approximately 1 per cent. and 2 per cent. CAGR between 2009 and 2013, although at a slower rate than the UK average of 3 per cent. CAGR, as shown in Exhibit 1.4 below. In the North East, GVA grew at 0.6 per cent. between 2006 and 2009, but accelerated between 2009 and 2013, growing at 2.5 per cent. The Northern regions combined remained around 27 per cent. of the UK total GVA throughout this period.



Source: Office for National Statistics.

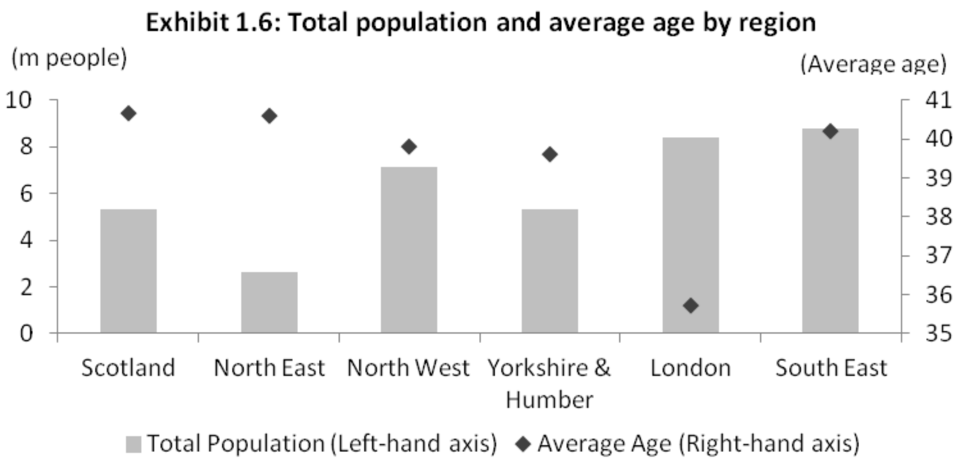
Note: Northern regions combined is the combination of Scotland, North West, North East and Yorkshire & Humber.

Exhibit 1.5 shows the GVA per industry in the UK and in each of the four core regions and for the UK as a whole. The output per industry, for the eight largest industries representing 56 per cent. of total GVA, in each region is broadly similar to the UK average. Manufacturing GVA in three of the core regions is an exception, producing outputs of approximately 11 per cent., compared to the UK average of 8 per cent. (*Source: Office for National Statistics*)



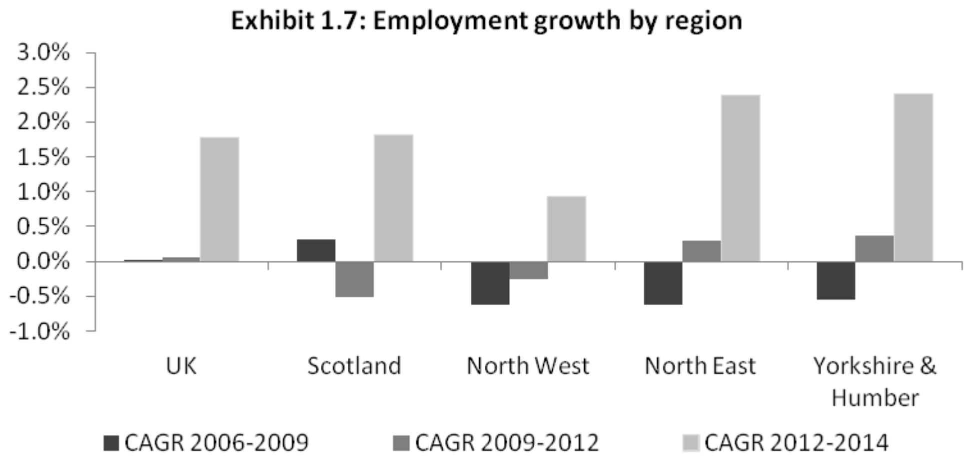
Source: Office for National Statistics
Note: 'Other' (which is not shown) comprises: 'Agriculture, forestry and fishing'; ' Mining and quarrying'; 'Electricity, gas, steam and air-conditioning supply'; 'Transportation and storage'; 'Accommodation and food service activities'; 'Administrative and support service activities'; 'Public administration and defence'; 'Arts, entertainment and recreation'; 'Other service activities'; 'Activities of households'; 'Information and communication'; 'Public admin and defence'. Chart displays available data as at 31 December 2013

The demographics of the population differs between London and the rest of the UK. Whilst the average age of the UK population, including in NAGE's core regions, is 40, London's population is notably younger, averaging 36 years of age, as shown in Exhibit 1.6 below. (*Source: Office for National Statistics*)



Source: Office for National Statistics; chart displays data as at mid-2013

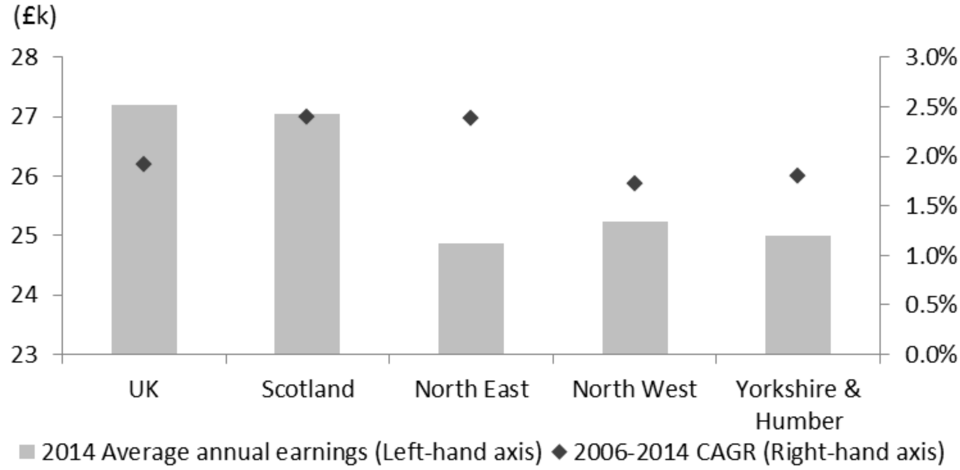
Employment also differs significantly between regions, as shown in Exhibit 1.7. Employment increased by a CAGR of 2.4 per cent. between 2012 and 2014 in Yorkshire and the Humber and the North East. Only employment in London increased at a faster rate, by a CAGR of 3.8 per cent. Employment growth in Scotland was more in line with the UK average increasing by a CAGR of 1.8 per cent. However, in the North West, employment fell between 2006 and 2012 and only grew by a CAGR of 0.9 per cent. between 2012 and 2014. (*Source: Office for National Statistics*)



Source: Office for National Statistics.

Exhibit 1.8 shows that average earnings also differ between regions. Average earnings in Scotland are approximately £27,000, reflecting the UK national average, while average earnings in NAGE's other core regions are slightly lower at approximately £25,000. Although London is an outlier with average earnings of £35,000, earnings growth rates in the core regions have almost equalled or surpassed earnings growth rates in London since 2006. London earnings grew by a CAGR of 1.8 per cent. between 2006 and 2014, whilst average earnings in the North West grew by a CAGR of 1.7 per cent. and Yorkshire and the Humber grew by a CAGR of 1.8 per cent., Scotland and the North East both grew by a CAGR of 2.4 per cent. over the same period. (*Source: Office for National Statistics*)

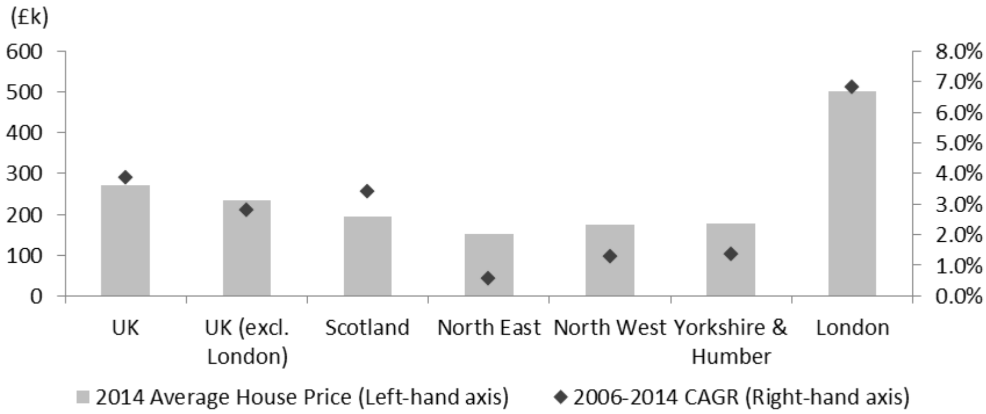
Exhibit 1.8: Average annual earnings and growth by region



Source: Office for National Statistics.

UK residential property prices have continued to differ significantly by region, as shown in Exhibit 1.9. Between 2006 and 2014, average UK property prices increased by a CAGR of 3.9 per cent. Over the same period, London average property prices increased by a CAGR of 6.8 per cent., resulting in average house prices reaching £502,000. Property prices outside of London increased by a CAGR of 2.8 per cent., reaching an average of £234,000. In NAGE's core regions, the increase in property prices varied from 0.5 per cent. CAGR in the North East England to 3.4 per cent. CAGR in Scotland, resulting in average house prices ranging from £153,000 in North East England to £193,000 in Scotland. (*Source: Office for National Statistics*)

Exhibit 1.9: Average house price and growth by region



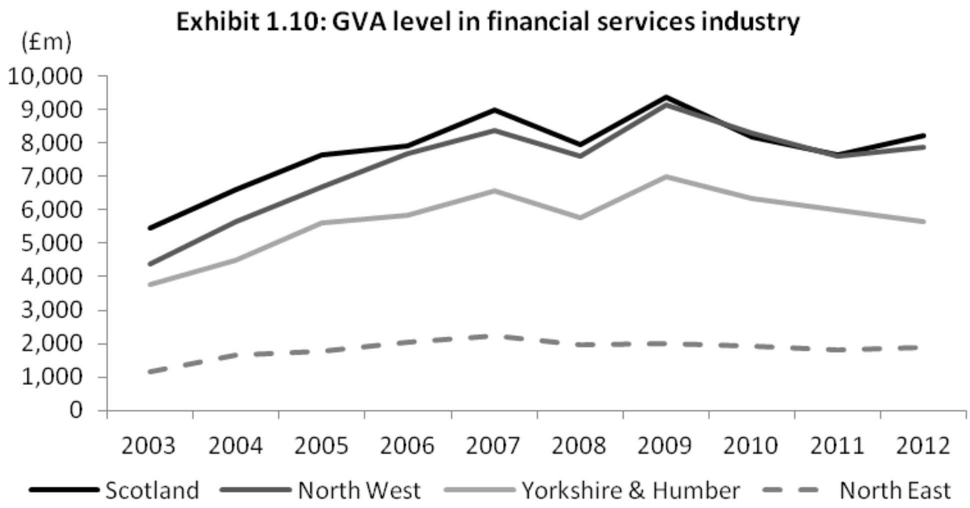
Source: Office for National Statistics.

The UK government is seeking to stimulate growth in a broad area around Manchester, spanning into NAGE's core regions, including Yorkshire and the Humber and the North West. As at June 2014, the combined metropolitan areas of Greater Manchester, Liverpool, Leeds and Sheffield were home to approximately 9 million people, a £154 billion economy and almost 3 million jobs.

1.1.2 *Regional financial sector importance*

The financial services industry is significant across NAGE's core regions, representing 4 per cent. of GVA in North East England to 6 per cent. of GVA in Scotland. The industry employs over half a million people in NAGE's core regions and provides a pool of experienced personnel for banks that operate in those regions. (*Source: TheCityUK*)

GVA growth in the financial services industry has been consistent across NAGE's core regions, and grew by 60 per cent. as a whole between 2003 and 2012. In 2012, total GVA of the financial services industry in the four regions was £24 billion, contributing 20 per cent. of the total UK financial services GVA. (*Source: Office for National Statistics*)



Source: Office for National Statistics.

1.1.3 *Regional Small and Medium size business importance*

Whilst the British Banking Association ("**BBA**") defines micro, small and medium-sized enterprises ("**SMEs**") as commercial businesses with an annual bank account debit turnover of up to £1 million, and the Department for Business Innovation and Skills ("**BIS**") considers SMEs as businesses which employ up to 250 employees, this section uses the Bank of England's definition as businesses with an annual turnover of up to £25 million.

SMEs represent a large part of the UK economy, including 99 per cent. of all businesses; 60 per cent. of all employees; and 47 per cent. of turnover. See "*Introduction to SME Banking*" below for further information. Private sector turnover from SMEs in NAGE's core regions is higher than the UK average, particularly in the North East where SMEs represent 58 per cent. of turnover compared to the UK average of 47 per cent. (*Source: Department for Business Innovation and Skills – Business population estimates for the UK and regions 2014: detailed tables*).

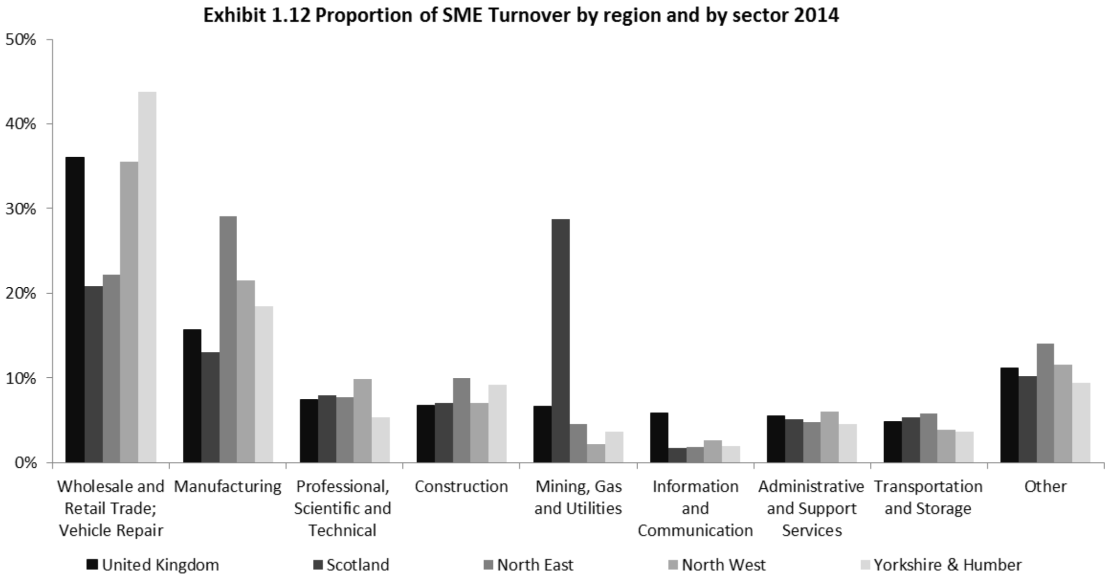
Exhibit 1.11: Proportion of all business turnover from SMEs 2014

Source: UK Department for Business, Innovation and Skills; chart displays available data as at 24 November 2014

Since 2004, the number of SMEs has increased from 3.9 million to 5.2 million, despite difficult economic conditions and declining levels of lending from banks following the financial crisis. (*Source: UK Department for Business, Innovation and Skills – Business Population Estimates: 2014 statistical release*) There are positive indications of further growth as 16 per cent. of SMEs plan to increase staff in 2015 and 43 per cent. expect revenue growth. (*Source*: *FSB Voice of Small Business Survey 2013-14*).

A 2013 European Commission study found the UK to be among the most competitive environments for SMEs in the European Union, with a positive outlook for future growth. The UK scored particularly high in business environment, public procurement, and conditions for international business. (Source: *European Commission for Enterprise and Industry*) Recently, the UK government has introduced a range of measures to stimulate SME success. (*Source: House of Commons*) These include advice to boost exports, changes in public sector procurement to include more SMEs, improved broadband access and business rate relief. See "*Introduction to SME Banking*" below for further information.

SMEs are represented across all sectors of the economy. NAGE's core regions broadly reflect the wider UK economy. There are some regional differences in Scotland, where turnover from SMEs in mining and gas utilities is significantly higher than the UK average as a result of the North Sea oil and gas industry, and in the historically industrial North East and North West where manufacturing remains strong. (*Source: UK Department for Business, Innovation and Skills – Business Population Estimates*)



Source: UK Department for Business, Innovation and Skills.
Note: 'Other' comprises: 'Arts, Entertainment and Recreation'; 'Accommodation and Food Service Activities'; 'Human Health and Social Work Activities'; 'Real Estate Activities'; 'Agriculture, Forestry and Fishing'; 'Other Service Activities' and 'Education'. Chart displays available data as at 24 November 2014

1.2 ***Structure of the UK banking industry***

Banks and other lenders play a vital role in the UK economy. This is reflected in the type of customers they serve, ranging from the general public and small businesses to sophisticated corporations and investors. Banks' services are essential in facilitating day-to-day financial transactions as customers interact with their banks as the centre of non-cash transactions, such as direct debit payments and salary deposits. Their services are also essential in providing capital for short to long-term purposes, they organise foreign exchange and provide sophisticated financial products that help consumers and businesses plan for the future.

The main players in the UK banking market can be grouped into six broad categories:

- *Large national banks*: These banks have national coverage and a full retail bank offering including current accounts, mortgages, savings, credit cards, and other personal banking services. Due to consolidation over the last ten to fifteen years, there are currently only five large national banks in the UK banking sector (the "**Big Five**"); Barclays plc ("**Barclays**"), HSBC Bank plc ("**HSBC**"), Lloyds Banking Group, which includes the Lloyds Bank, Halifax and Bank of Scotland brands ("**Lloyds**"), Royal Bank of Scotland Group plc, which includes the RBS, NatWest and Ulster Bank brands ("**RBS**") and Santander UK plc ("**Santander**"). (*Source: Bank of England: Evolution of the UK banking system*)

- *Challenger banks*: The Independent Commission on Banking defines challenger banks as banks that are large enough to be a threat to incumbents and have a strong incentive to compete with them to increase market share. (*Source: Independent Commission on Banking*) Challenger banks can be grouped into three sub-categories: (i) mid-sized banks that are branch-led, full service banks with an established customer base with the ability to compete with the Big Five; (ii) small and specialised banks with total assets of under £20 billion that focus on differentiating themselves through either customer service and/or specific product offerings; and (iii) retailer banks where retailers typically leverage their large customer base to cross-sell financial products, including savings accounts, loans, mortgages, credit cards, and in some cases, personal current accounts ("**PCAs**").

- *Building societies:* These are usually smaller lending institutions which are owned by their members. These mainly offer mortgages and savings products, although many now provide a broader range of retail banking products, such as current accounts and credit cards.

- *Credit unions:* These are usually smaller lending institutions which are owned by their members. They typically serve those customers who are unable to access standard retail bank products through the established high street banks.

- *Monoline product providers:* These providers focus on the provision of specific products, such as credit cards, rather than a full range of retail banking services.

- *Other lenders*: These include payday lenders, online specialists, peer-to-peer lending facilitators, and specialist mortgage lenders.

The Big Five have 85 per cent. market share of the retail PCA market and 57 per cent. market share of the mortgage market. (*Source: Office for National Statistics*) In England and Wales, the Big Five accounted for 93 per cent. of business current accounts in 2013, while in Scotland three banks, RBS, Clydesdale Bank and Bank of Scotland, held 88 per cent. of SME business current accounts ("**BCAs**").

Many foreign banks are also active in the UK, typically serving multi-national companies which operate in the UK, but with activities across the globe.

1.2.1 *Increasing competition in UK Banking*

The UK government has emphasised the need to introduce more competition into the SME and retail banking market, in response to poor customer satisfaction. In a study conducted by YouGov as at April 2013, retail banking customers rated large banks, namely the Big Five, negatively for customer satisfaction. On the other hand, smaller and mid-sized banks enjoyed a much higher customer satisfaction score. Similarly, a study conducted into the SME banking market as at July 2014 revealed that only 13 per cent. of SMEs believe that their bank acts in their best interest (*source: A CMA and FCA market study – Banking services to small and medium sized enterprises*). The studies identify high levels of market concentration amongst the Big Five as one of the key drivers for dissatisfaction.

Many smaller and mid-sized banks have become popular with customers by focusing on strong customer service with minimal brand damage from the financial crisis. This has been complemented by greater interest in the banking sector from the business and investor community. In 2010, Metro Bank, a new bank, was awarded a full service banking licence. This was the first time a new full banking licence had been granted to a new High Street bank in over 100 years. (*Source: Metro Bank*) A number of banks are expected to launch IPOs by 2016 in addition to the IPOs of TSB, Virgin Money, OneSavings, Shawbrook and Aldermore, which have already taken place in the past 12 months.

(a) *The landscape of banks outside the Big Five*

Banks outside of the Big Five typically compete by providing a specialised offering to customers, either in terms of product range, service level, regional focus, pricing or a combination. These are outlined further below:

- *Product range focus:* banks that provide a subset of products to their customers. For example, banks such as Sainsbury's bank offer a set of savings, personal loan, credit card, travel money and general insurance products to customers. (*Source: Sainsbury's Bank*)

- *Service focus*: banks that seek to differentiate on the quality of their customer service. For example, Metro Bank emerged on the promise of customer-focused retail business, offering convenience and simplicity in the form of 7-day opening hours. (*Source: Metrobank*)

- *Regional focus*: banks with a long-standing UK banking history that largely focus on a subset of UK regions. NAGE is an example of a bank with a long-standing market position, focusing on the markets in Scotland and Northern England. Additionally, newly emerging banks and traditionally localised banks are expanding across different regions. For example, TSB has used a pre-existing network of former Lloyds TSB branches, while Bank of Scotland which has a regional concentration, now sit within Lloyds. (*Source: Bank of England*)

- *Pricing focus*: some smaller and mid-sized banks are also offering lower rates for customers compared to incumbents. This is particularly notable for fixed-term savings products, where some banks such as Charter Savings, are offering a superior interest rate as they seek to build up their deposit book.

(b) *Competing with the Big Five*

Although the brand reputation of the major banks has weakened, the Big Five continue to have a significant national presence and established customer base, allowing them to enjoy high volume, scale efficiencies and benefits from customer inertia. The market share for PCAs and BCAs has remained largely stable over the last five years, inhibiting the ability of smaller participants to compete effectively. (*Source: Office of Fair Trading - Letter to Chancellor, September 2013*)

Due to the continued dominance of the Big Five, smaller and mid-sized banks are encouraged to meet some or all of the requirements set out in a letter to the Chancellor from the Office of Fair Trading in September 2013 in order to become an effective competitor. The requirements include: a branch network for PCA and SME banking services; a wide breadth of products; a strong base of PCAs; an established brand and reputation; ability to generate and reinvest profits; ability to innovate and differentiate the offering and a strong management team. (*Source: Office of Fair Trading - Letter to Chancellor, September 2013*)

1.2.2 *Key trends in distribution*

(a) *Digitisation of the banking model*

The UK banking industry is experiencing a significant shift towards digitisation. Banking has become increasingly multi-channel, as digital channels such as online and mobile banking are increasingly complementing traditional customer channels such as branches and call centres.

Retail banking customers tend to use digital functionality for speed and convenience, while using human interaction at key decision points such as obtaining a mortgage or opening a current account. Digital functionality is typically used to conduct routine transactions and to purchase simple products such as savings accounts and credit cards. (*Source: Mintel – Deposit and Savings Accounts UK*) Internet banking remains the main driver of digital channel usage, with an average of 7 million log-ins per day, compared to 2.6 million mobile log-ins per day in the UK in 2014. (*Source: BBA – The Way We Bank Now*). Additionally, 81 per cent. of SME customers interact with their banks online, with 39 per cent. using online banking services on a daily basis in 2014. (*Source: BBA – Promoting Competition*).

Mobile payments systems were introduced by a group of banks in the UK in 2014. They launched a mobile payments service, where payments can be sent and received using a mobile number, called "Paym", which allows users to link their bank accounts to their mobile phones. Sixteen UK banks participate – including the Big Five, Clydesdale Bank and Yorkshire Bank – and as at February 2014 nearly 2 million UK customers signed up for the service. (*Source: Paym*)

In general, the rate of growth in customers using digital channels has been significantly faster than the rate of decline in the number regularly using branches. (*Source: BCG – Distribution 2020: The Next Big Journey for Retail Banks*)

Digitisation has enabled banks to reduce cost and improve efficiency. Banks are increasingly leveraging tools such as e-forms and digital workflow systems to automate servicing and fulfilment processes (*Source: McKinsey & Co – The Rise of the Digital Bank*). Digital data and analytics systems have increasingly been used to tailor and personalise product offerings to different customer segments and expand banks' share of wallet. (*Source: BCG – Winning Share of Wallet in Wholesale Banking, February 2014*)

Price comparison websites, also known as aggregator websites, have emerged as another channel through which consumers research and purchase retail banking products. In 2014, 20 per cent. of UK internet users used a price comparison website to compare savings account products, with 7 per cent. of those using the price comparison website to apply for a savings account. (*Source: Mintel – Web Aggregators in Financial Services UK, June 2014*)

(b) *Importance of branch network and visible footprint*

A strong branch network remains an important part of the banking model in both the retail and SME markets. 72 per cent. of retail customers use branches to access financial services, and over 67 million transactions are carried out each week in UK bank branches. Branches are particularly important in the sale of core customer products (*Source: BBA*), such as current accounts and mortgages. 41 per cent. of current account customers use their branch at least once per month (*Source: Mintel Packaged and Current Accounts UK, July 2014*), and 42 per cent. of customers prefer to arrange a mortgage face-to-face (*Mintel Mortgages UK, March 2014*). In the SME market, 47 per cent. of SME customers have an employee visit a branch at least once a month. (*Source: Mintel Packaged and Current Accounts UK, July 2014*)

The bricks-and-mortar presence of a branch network is an advantage that banks use in order to compete against purely digital payment providers. However, most major UK banks have started to repurpose their branches from being transaction centres into product showrooms and technologically enabled locations that facilitate customer engagement. Branch employees are being trained to not only assist customers with everyday transactions, but also to offer face-to-face advisory services.

(c) *Regional variations in NAGE's distribution channels*

Consumers' preferred channels for purchasing retail banking products varies by both product and region. On a national level, consumers prefer to apply online for products with a simpler application process, such as savings accounts and credit cards, while products with longer application processes, such as mortgages, are more frequently arranged in a branch. Consumers in NAGE's core regions are an exception to the national trend and tend to prefer branches to online channels to a greater extent than the average UK customer. (*Source: Mintel – Deposit and Savings Accounts, April 2014*)

According to a survey conducted in January 2014, the proportion of customers applying for savings accounts in a branch in NAGE's core regions was significantly higher than the UK average. In Yorkshire and the Humber, 56 per cent. of those surveyed applied for savings accounts in a branch compared to the UK average of 48 per cent. (*Source: Mintel Deposit and Savings Accounts UK*) Online channels were also less favoured in NAGE's core regions, with as few as 49 per cent. of residents in the North West using online channels to open a savings account compared to the UK average of 55 per cent. Similarly, 45 per cent. of UK customers surveyed in May 2014 prefer online channels to branches when applying for a credit card, compared to 41 percent of customers in Yorkshire and the Humber, and whilst 26 per cent. of UK customers opened a credit card account in a branch, 31 per cent. of customers in Yorkshire and the Humber preferred to apply in person. In a national survey conducted in November 2013, 35 per cent. of respondents preferred to arrange a personal loan face-to-face with a bank or loan provider, compared to 30 per cent. who preferred to arrange the loan directly online. However, in NAGE's core regions, 39 per cent. of those surveyed preferred to apply face-to-face, while 24 percent reported that they would apply for a bank loan online.

1.3 ***Banking sector financial statements***

1.3.1 *Revenue*

Revenue consists of net interest income and other operating income. Net interest income is primarily derived from loans, deposits, and other sources of funding. It is generated through the differential between the rate charged to borrowers and the cost of funds. Other operating income is primarily earned from customer fees and commissions.

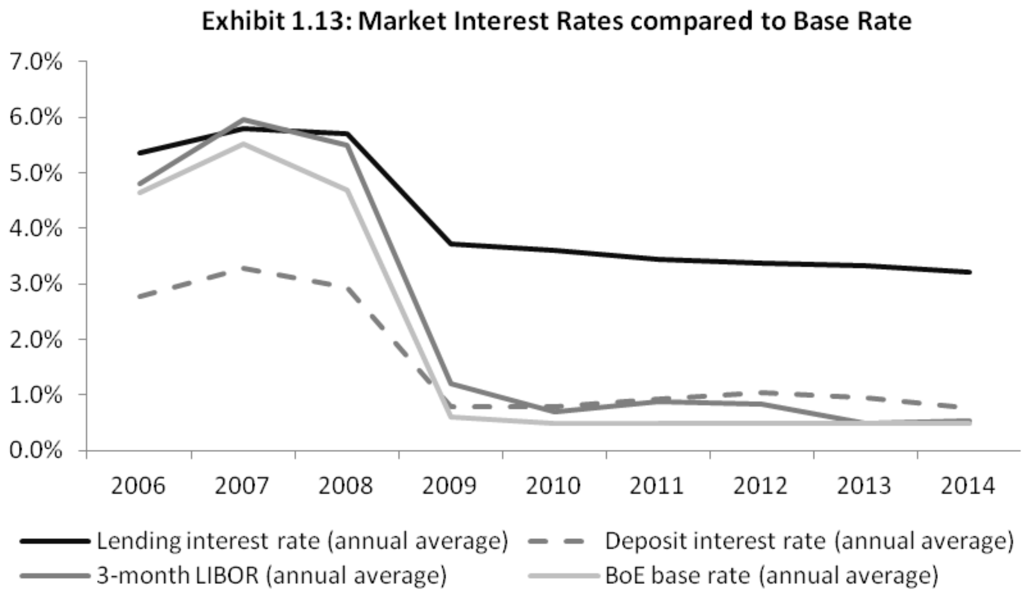
For retail-centric businesses, net interest income is the main driver of revenue, focusing on core lending and deposit products. Business banks offer more fee-based products, such as transaction banking or trade finance.

1.3.2 *Cost of funds*

Banks have four main sources of funding: (i) customer deposits; (ii) borrowing from the Bank of England; (iii) borrowing from other banks; and (iv) borrowing from other institutions (e.g. pension funds or insurance firms).

The cost of funding to a bank is a combination of the four sources. The cost differs across banks due to differences in weighting of each source by the banks and is not disclosed at the product level.

The base rate, set by the Bank of England, is one of the key determinants of all other market rates. Other market interest rates which track the Bank of England's base rate include both the monthly lending and deposit sterling weighted average interest rates of UK resident monetary financial institutions (excluding the Bank of England).



Source: Bank of England, British Bankers Association.

1.3.3 *Base rate used for this section*

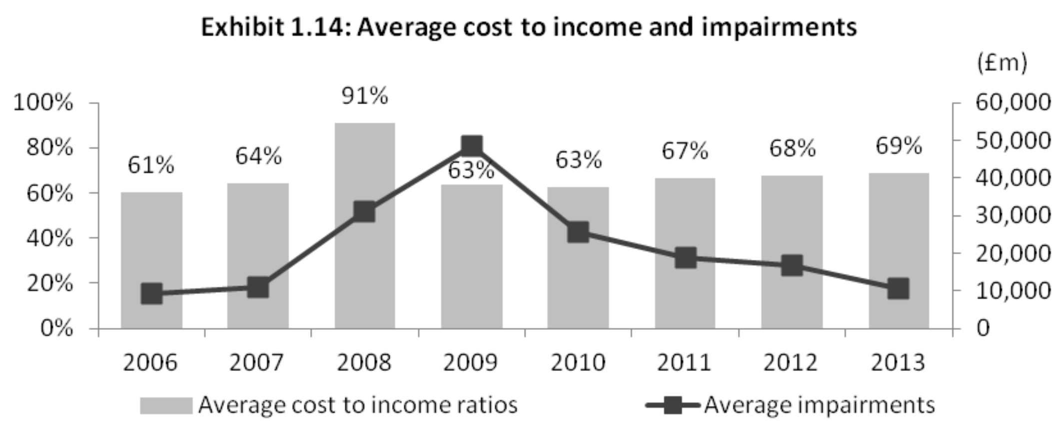
This section uses the base rate as a constant point of comparison for different product interest rates. Any individual bank's cost of funds will vary, depending on their internal allocation methodology, and cannot be readily stated on a product-by-product basis.

1.3.4 *Cost*

After calculating net interest income and other operating income, a bank incurs two costs: operating costs and impairments.

(i) The main components of operating costs are IT, property and salaries. The cost to income ratio measures the efficiency of a bank's operating model. Following a sharp increase in 2008, cost income ratios of major banks have remained relatively stable in the UK market, reflecting continued cost improvement to counteract downward pressure on revenue. (*Source: Bank of England*)

(ii) Impairments represent a provision against current and potential losses on the stated value of assets on a bank's balance sheet. Impairments rose steeply for UK financial institutions during the financial crisis. Between 2009 and 2014, the value of impairments has decreased to a pre-crisis level of £11 billion.



Source: Bank of England

1.3.5 *Profitability*

A bank's profit after tax is based on the sum of revenues earned (net interest income and other operating income) less operating costs, impairments, one-off charges, taxes and other provisions for future losses.

1.3.6 *Capital structure*

A bank's assets can be unsecured, for example, credit cards or secured, such as, mortgages. Banks apply two different risk weighting methods in calculating their total risk-weighted assets:

- *The Standardised Approach*, as followed by NAGE, uses standardised risk weightings in accordance with the European Union's Capital Requirements Directive. These are more explicit rules which aim to remove subjectivity from the risk weighting.

- *The Internal Ratings Based Approach* ("**IRB**") permits banks to use their own empirical models to best assess the appropriate risk weightings. Banks are permitted to use this approach in the UK, subject to approval from the PRA. The two IRB approaches to risk weighting, foundation and advanced, usually generate lower risk-weighted assets ("**RWAs**").

In the UK, the minimum capital required for each bank is established through discussion with the PRA, which sets each bank an individual capital guidance ("**ICG**"). The ICG is typically a multiple of the underlying required Tier 1 ratio. In the UK, all banks are required to meet a minimum 6 per cent. Tier 1 capital ratio, which is calculated as Tier 1 capital / RWAs. The major UK banks are required to meet a minimum of 7 per cent. (*Source: Bank of England*)

2. Retail Banking

2.1 *Summary of the retail banking market in the UK*

2.1.1 *The role of retail banks*

Retail banks offer a range of banking products which include PCAs, savings accounts, mortgages, personal loans, credit cards, and insurance and investment products. Banks offer these products through a number of bank-owned distribution channels such as branches, telephone and digital channels as well as through third party distribution channels such as mortgage intermediaries, known as "brokers".

Retail banks in the UK serve three main customer segments: (i) mass affluent customers typically customers who have investible assets between £50,000 and £1,000,000 ("**Mass Affluent Customers**") – above which they generally become private banking customers; (ii) retail banking customers in the UK who are mass market customers, with investible assets below £50,000; and (iii) customers with few to no assets, such as students and youth customers.

Traditionally, retail banks in the UK have operated a "full-service" model offering a broad suite of products to a diverse customer base. The major full-service banks have a large base of current account holders, a branch network of sufficient scale, as well as complementary channels. The combination of a large customer base, extensive channel reach and a broad product suite allows these banks to address the varying needs of their customers. For example, 58 per cent. of PCA holders also hold a savings account with their PCA provider. (*Source: Mintel – Consumers and Retail Banking*).

2.1.2 *Regional view on retail banking*

At a regional level, demand for retail banking products varies according to local economic and competitive conditions.

Strong employment growth in NAGE's core regions have contributed to increased demand for credit. The proportion of residents taking out personal loans in these regions increased by 13 per cent. between 2011 and 2013. Between 2006 and 2014, those four regions experienced year-on-year house price growth of 0.5 per cent. to 3.4 per cent., and in December 2013, approximately 20 per cent. of residents in these regions planned to take out a mortgage or re-mortgage their homes. (*Source: Mintel – Mortgages UK*)

Although the percentage of the total UK population which was classified as Mass Affluent Customers grew by only 0.11 per cent. per annum between 2004 and 2009, the growth rate experienced in the core regions was significantly higher from a 0.35 per cent. CAGR in Yorkshire to a 2.04 per cent. CAGR in Scotland.

Retail banking markets in Scotland and Yorkshire include a number of smaller participants whose presence in those regions is larger than their presence in the national market. In Scotland, the top four brands with the highest branch network concentrations are Bank of Scotland, RBS, TSB, and Clydesdale Bank. In Yorkshire, the top four brands by branch concentration are Yorkshire Bank, HSBC, NatWest, and Lloyds. For example, as at 31 December 2013, while Barclays had the largest network of branches in the UK, it had less than 30 branches in Scotland, while Bank of Scotland, RBS, TSB, and Clydesdale Bank each had more than 100 in Scotland. (*Source: SNL*)

2.1.3 *Distribution channels*

Consumers more frequently purchase simpler products online than in branches. For example, 42 per cent. of consumers surveyed in December 2013 prefer mortgage application processes, which are longer and more detailed, to be entirely face-to-face compared to 29 per cent. who prefer the process to be entirely online, whereas a higher percentage of customers surveyed applied for products with simpler application processes, such as savings accounts, online. (*Source: Mintel – Mortgages UK*) See "*Key trends in distribution – Regional variations in distribution channels*" above for further information.

Retail banking customers are also increasingly turning to online channels to service their accounts. 80 per cent. of PCA customers in the UK surveyed in May 2014 used online banking at least once per month to access their accounts, compared to 41 per cent. who used branch counter services. However, branches continue to be an important channel as 91 per cent. of PCA customers report using branch services at least once per year, compared to 86 per cent. who use online banking. (*Source: Mintel – Packaged and Current Accounts UK*). Furthermore, a survey conducted in June 2014 reported that 57 per cent. of banking customers agreed that branches were necessary for discussing banking issues. (*Source: BBA – Promoting Competition in the UK Banking Industry*)

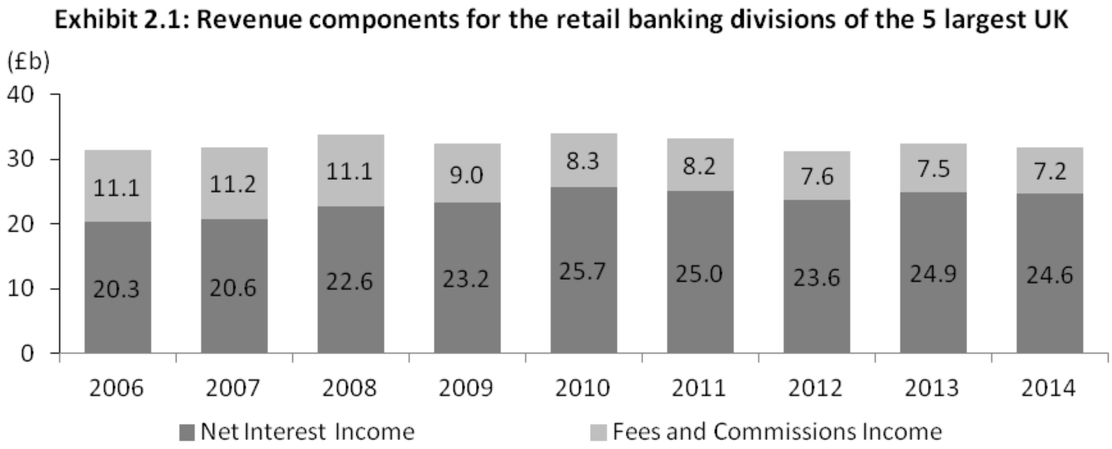
2.1.4 *Customer sentiment*

The financial crisis significantly impacted customer attitudes towards the banking sector and the way in which consumers interact with banks. Attitudes towards the banking sector vary between large and small banks. A 2013 YouGov survey of over 4,000 people found that 73 per cent. considered the banking sector to have a bad reputation, scoring lower than any of the other 25 industries included in the survey. This negative view is largely associated with the Big Five, which scored lowest in the survey. A July 2014 market report by the UK Competition and Markets Authority found an inverse relationship between the size of a retail bank's customer base and its customer satisfaction scores, with the five highest-scoring brands in customer satisfaction being amongst the UK's smaller institutions, including Clydesdale Bank and Yorkshire Bank.

Retail banks have experienced declining levels of customer retention. Between 2012 and 2014, the proportion of UK banking customers who had been with their bank for more than 10 years decreased from 72 per cent. to 59 per cent. Customer service quality is an important factor in customers' decisions to switch account providers. A May 2014 survey found that 20 per cent. of UK adults who changed current account providers in the past five years changed providers due to a better reputation for customer service from the new provider. (*Source: Mintel – Packaged and Current Accounts UK*). A similar proportion of 21 per cent. cited poor customer service from their previous provider as the factor that persuaded them to switch providers.

2.2 *Retail Banking performance*

The profitability of a retail bank is determined by the relative levels of its income and expenses. The two primary streams of income for a retail bank are net interest income and other operating income. Fees and commissions income are the primary source of other operating income and is reflected in Exhibit 2.1 below. The primary costs are operating costs and impairments. Banks often look at impairment costs as a factor in determining profitability. Exhibit 2.1 below shows these revenue streams for the Big Five between 2006 and 2014.



Source: Annual reports

2.2.1 *Net interest income*

Net interest income for the Big Five rose steadily between 2006 and 2010, from £20.3 billion to £25.7 billion, before stabilising at around £25 billion. In 2014, net interest income accounted for 77 per cent. of total banking income for the Big Five.

2.2.2 *Fees and commissions income*

Retail banks charge customers fees for a variety of services, such as overdraft facilities, credit cards, and international transfers of funds. They also receive commissions from distributing products such as insurance. Taken together, these make up income from fees and commissions.

Exhibit 2.1 illustrates how both regulatory scrutiny and other market conditions have impacted fee and commission income in the retail divisions of the Big Five between 2007 and 2014, leading to a decline from £11.2 billion to £7.2 billion over this period.

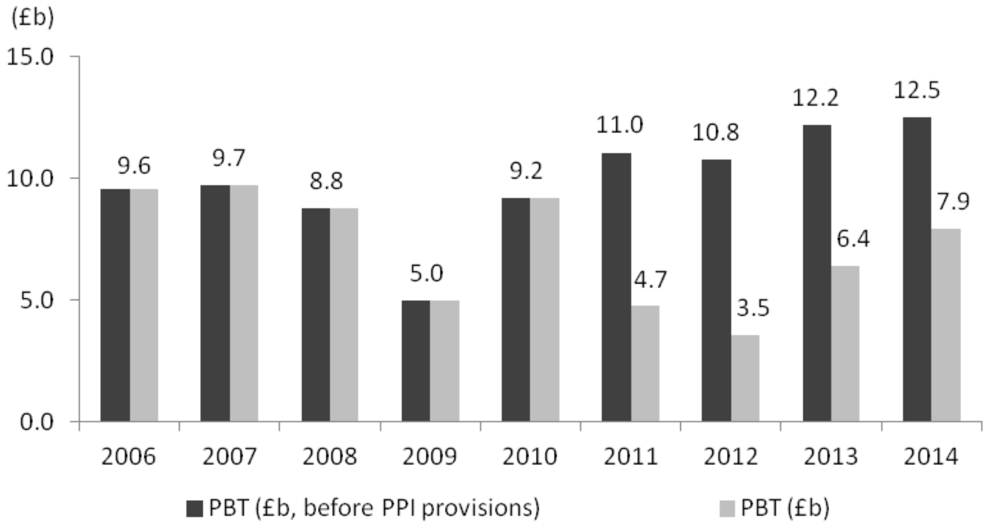
2.2.3 *Impairments*

The Big Five experienced rising impairments during the financial crisis. Impairments tend to be higher on unsecured assets than on secured assets since the bank is able to realise security of the asset in order to repay part of, or the entire, loan. Impairments have since returned to pre-crisis levels as unemployment has fallen and interest rates have remained low

2.2.4 *Profitability*

Exhibit 2.2 shows the underlying and reported profits of the Big Five. Underlying profitability fell sharply in 2009 as a consequence of the financial crisis, but has since rebounded, growing at a rate of 20.2 per cent. per annum between 2009 and 2014. However, fines and repayments for the mis-selling of payment protection insurance ("**PPI**") and interest rate hedging products ("**IRHP**") have impacted banks' profits, reducing 2014 headline profits of £12.5 billion to £7.9 billion. Between 2011 and 2014, PPI mis-selling and other conduct-related issues led to the Big Five making total provisions of £23.9 billion, equivalent to 51 per cent. of pre-tax profits. As a result, reported profits decreased at a CAGR of 3.6 per cent. between 2010 and 2014.

Exhibit 2.2: Calculated Profit Before Tax for the retail banking divisions of the 5 largest UK retail banks



Source: Annual reports

2.3 ***Key products: personal current accounts***

2.3.1 *Introduction*

A PCA is central to most retail customers' personal finances, and typically defines their primary relationship with a bank.

The PCA market can be divided into: (i) primary PCA, where the customer uses the PCA for everyday transactions, usually where there is a direct deposit of salary and the use of direct debits for regular bills; and (ii) secondary PCA, where the customer opens a second PCA with another provider. It is estimated that 32 per cent. of PCA holders in the UK have PCAs with more than one provider; this figure is 25 per cent. in the North East and Scotland, 30 per cent. in the North West and 32 per cent. in Yorkshire. (*Source: Mintel – Packaged and Current Accounts UK*)

Retail banks compete to be the primary PCA provider, since primary PCA customers are likely to hold further products, such as mortgages, credit cards and loans, and are generally more loyal customers. (*Source: CMA – Personal Current Accounts*) Due to competition, many UK banks have explicit strategies to generate 'main banking relationships', i.e. using the primary PCA as an anchor to secure multi-product holdings and multi-channel usage. (*Source: BCG - Retail Banking: Winning Strategies and Business Models Revisited*)

PCAs also provide a valuable source of stable, long-term funding. The cost for banks is typically lower than savings deposits or wholesale funding. (*Source: Office of Fair Trading – Review of Personal Current Account Market*)

2.3.2 *Competitive landscape*

PCA market concentration is expected to decrease as a consequence of three developments. The first is the divestment by Lloyds of 631 branches and their accounts into TSB Bank. TSB Bank was established as a separate business from Lloyds in September 2013, with more than 4.6 million former Lloyds customers and over £20 billion in both loans and customer deposits. TSB Bank became a stand-alone bank through an initial public offering in June 2014. A similar but smaller divestment is underway for RBS, where 314 branches have been divested to a consortium of investors in anticipation of a full high street re-branding towards SME and mid-corporate customers. The second development is the rise of new challenger banks, some of which have sought to capture market share from top PCA providers.

The third development was the UK Payments Council introduction of the Current Account Switching Service ("**CASS**") in September 2013. The intention was to increase competition amongst retail banks and support the entry of new banks into the PCA market. The scheme provides a guarantee that an account can be switched from one provider to another within seven working days. Currently, thirty-six banks and building societies participate, accounting for most of the UK PCA market, including Clydesdale Bank and Yorkshire Bank. In October 2014, the Financial Conduct Authority ("**FCA**") and Payment Systems Regulator announced that they intend to explore the introduction of full bank account portability in order to facilitate the CASS. UK Payments Council data indicates over an annual period ending 31 March 2015 there were 1,136,251 switches and since the new service launched in September 2013 it has successfully processed 1,758,301 switches.

As at May 2014, the top seven PCA providers and their estimated market shares of primary PCAs, defined as a customer's main current account, were Santander (15 per cent.), Barclays (14 per cent.), Lloyds (12 per cent.), Halifax (11 per cent.), NatWest (11 per cent.), HSBC (9 per cent.), and Nationwide (8 per cent.). Clydesdale Bank and Yorkshire Bank were each estimated to hold 1 per cent. of the UK primary PCA market. (*Source: Mintel Packaged and Current Accounts*)

2.3.3 *Key metrics*

There are approximately 80 million PCAs in the UK, of which 65 million are active. (*Source: CMA Personal Current Accounts Market Study*) As at 31 January 2015, there were £6.7 billion of outstanding PCA overdraft balances, a decrease of 9.5 per cent. since January 2014. (*Source: BBA – High Street Banking Statistics*)

2.3.4 *How banks make money from PCAs*

PCAs are a low cost source of funds for banks. Net interest income, overdraft balances, and fee and commission income from associated banking services make up the principal sources of income generated by PCAs.

Added value accounts, or 'Packaged Accounts', bundle additional products with the PCA for a fixed monthly fee. These products often include mobile phone insurance and auto breakdown coverage. (*Source: Office of Fair Trading – Review of the PCA Market*)

2.4 ***Key products: cash savings products***

2.4.1 *Introduction*

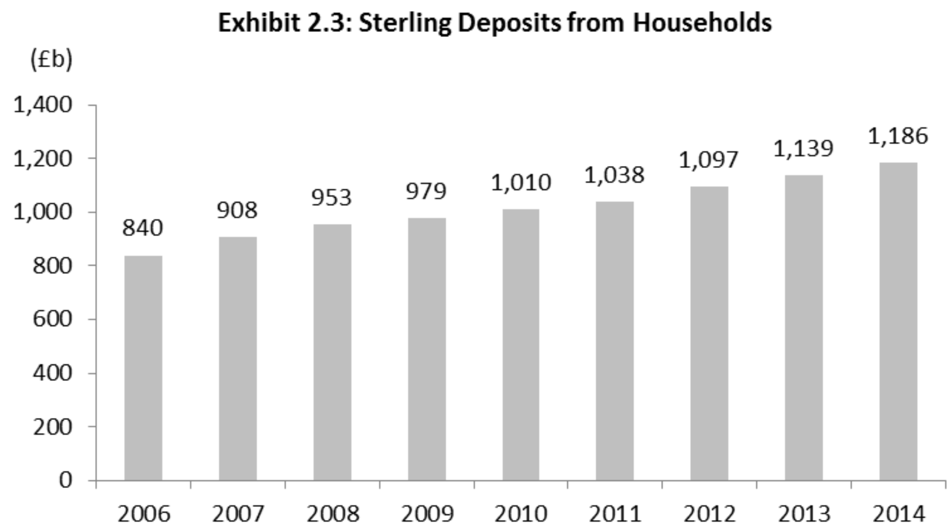
Cash savings products allow customers to deposit cash funds and to receive interest on those funds at rates which are typically higher than funds held in a PCA. There are two main types of cash saving products: fixed rate term deposits and variable rate savings accounts.

2.4.2 *Competitive landscape*

As at October 2014, 109 banks, building societies, and credit unions offered cash savings products in the UK, with the six largest providers holding approximately 68 per cent. of all cash savings balances. Estimates of market concentration show that while the cash savings products market has remained relatively concentrated for a number of years, the divesture of TSB Bank from Lloyds and the entrance of new providers such as Tesco Bank decreased market concentration in 2014. (*Source: Financial Conduct Authority - Cash savings market study report: Part I: Final findings Part II: Proposed remedies*)

2.4.3 *Key metrics*

As shown in Exhibit 2.3, total UK household cash savings products deposits stood at £1,186 billion as at 31 December 2014. During 2014, household cash savings products deposit balances increased at a rate of 4.4 per cent.

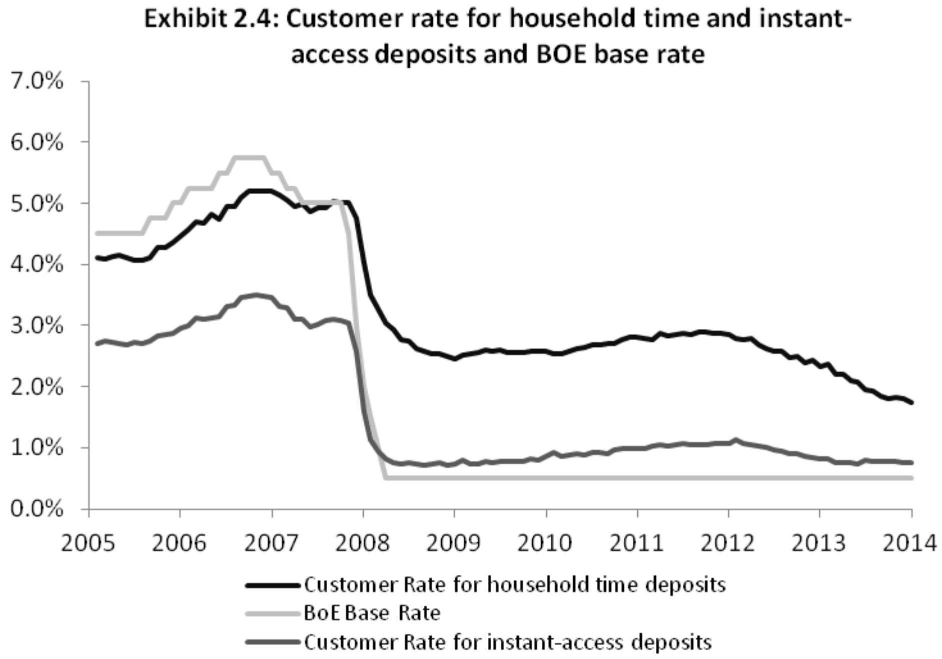


Source: Bank of England

Despite the fall in interest rates between 2008 and 2009, cash savings deposits increased steadily. It is estimated that in 2013, around £160 billion of instant-access savings deposits earned an interest rate equal to, or lower than, the Bank of England base rate of 0.5 per cent. Approximately £145 billion of these balances were held in accounts with more than £5,000.

2.4.4 *Cash savings products*

Exhibit 2.4 displays trends in the customer rates for time deposits (also known as 'term' deposits) and instant-access savings deposits, as well as the official rate set by the Bank of England. The gap between the interest rates paid on time deposits compared to instant-access deposits reflects the premium banks attach to time deposits, which are held for longer periods.



Source: Calculated from Bank of England

Between 2008 and 2009, the decline in the Bank of England base rate was sharper than the decline in interest rates offered for customers' deposits. This has resulted in savings deposits becoming a relatively more expensive source of funding compared to the official rate than before the financial crisis.

2.5 ***Key products: mortgages***

2.5.1 *Introduction*

The most common form of financing used by individuals in the UK to purchase residential property is a loan secured by using the property as collateral. There are three principal types of mortgage products:

- Variable rate mortgages have interest rates that broadly follow the Bank of England base rate but are determined by the lender and can change at any time;
- Fixed-rate mortgages offer a constant rate that typically lasts for a two to five-year period before reverting to a variable interest rate; and
- Tracker mortgages track the Bank of England base rate at a set margin.

As at 31 December 2014, 59 per cent. of total outstanding mortgage balances were subject to a variable rate while 41 per cent. were subject to a fixed rate. 33 per cent. of mortgage balances were subject to fixed rates in December 2013 and 28 per cent. as at 31 December 2012 (*Source: Financial Conduct Authority - Statistics on Mortgage Lending*), an increase suggesting mortgage customers are increasingly capitalising on low interest rates by purchasing or refinancing to fixed rate mortgages.

In addition to differentiating mortgages based on the interest rate, mortgage products can be further categorised by the type of repayment made by the customer:

- Capital repayment mortgages require the full value of the loan and the interest to be repaid by the end of the term;
- Interest-only mortgages require the borrower to repay only the interest on the loan; at the end of the term, the borrower still owes the full value of the original

loan. These mortgage products are therefore often dependent on rising house prices or other forms of repayment plans to pay back the capital repayment at the end of the term or a separate repayment vehicle; and

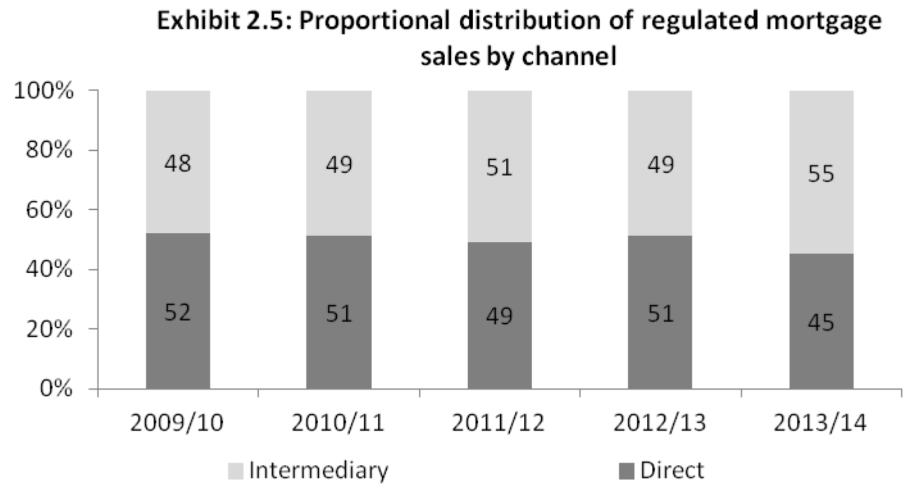
- Part capital repayment/part interest-only mortgages have only part of the mortgage payment being made towards the capital, with the remainder of the borrower's regular payment made towards the interest.

In 2013, the FCA required mortgage lenders to contact all borrowers with interest-only mortgages due to mature before the end of 2020 due to concerns about the borrowers' ability to repay the original loan at the end of the term. As a result, the Council of Mortgage Lenders reports that the number of interest-only mortgages fell 12 per cent. between 2012 and 2013 as borrowers converted to capital repayment mortgages.

2.5.2 *Competitive landscape*

The UK mortgage market has become increasingly competitive since 2009. The six largest lenders accounted for 72 per cent. of gross mortgage advances in 2013 compared to 86 per cent. in 2009. (*Source: Council of Mortgage Lenders*) The decrease in market share of the top six lenders, which includes the Big Five and Nationwide Building Society, is due to the increasing shares of smaller lenders which have entered the top ten. The ten largest lenders and their respective shares of gross advances are Lloyds (20.2 per cent.), Nationwide (15.3 per cent.), Santander (10.4 per cent.), Barclays (9.6 per cent.), HSBC (8.2 per cent.), RBS (8.1 per cent.), Yorkshire Building Society (3.9 per cent.), Coventry Building Society (3.3 per cent.), Virgin Money (3.2 per cent.), and Clydesdale Bank (1.8 per cent.). (*Source: Council of Mortgage Lenders*) The competitiveness of the UK mortgage market is reinforced by an estimate by the British Bankers' Association that 23 per cent. of current account customers had a mortgage from a lender other than the provider of their PCA. (*Source: BBA – Promoting Competition in Mortgage Lending*)

Intermediaries play a significant and growing role in the UK mortgage market. As shown in Exhibit 2.5, intermediaries accounted for 55 per cent. of mortgage sales in 2013/14, rising from 48 per cent. in 2009/10. As a result, intermediaries enable smaller banks to compete for mortgage business on a national scale.



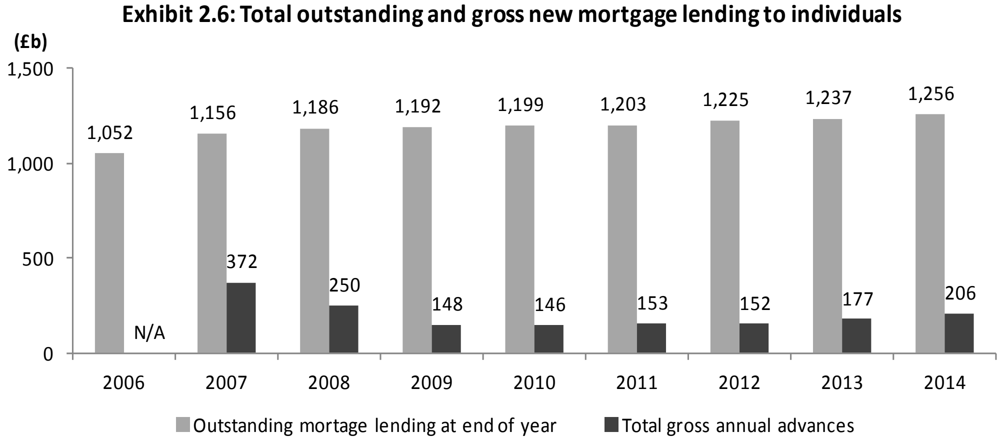
Source: Mintel (November 2014); Note: Data covers the period 1 April-31 March in each year

The increased proportion of intermediaries as a key channel in 2013-2014 can be explained by two factors. First, an increase in mortgage lending throughout 2013 and 2014, combined with an increasingly diverse range of mortgage products offered by lenders, has fuelled demand for the advisory services offered by brokers. Second, the 2014 Mortgage Market Review ("**MMR**") has prohibited non-advised mortgage sales. As a result, lenders without sufficient in-house advisory capabilities have turned to intermediaries to provide such services. (*Source: Mintel – Mortgages Intermediary Focus*)

2.5.3 *Key metrics*

The total value of outstanding mortgage balances in the UK was £1.3 trillion as at 31 December 2014, as shown in Exhibit 2.6. This figure has remained relatively stable over recent years, with a CAGR of 1.5 per cent. for the three years to 31 December 2014. Data from the Financial Services Authority ("**FSA**") and FCA also show that levels of net new mortgage lending, which measures gross new lending minus repayments, remained below £22 billion per annum between 2009 and 2013.

Exhibit 2.6: Total outstanding and gross new mortgage lending to individuals

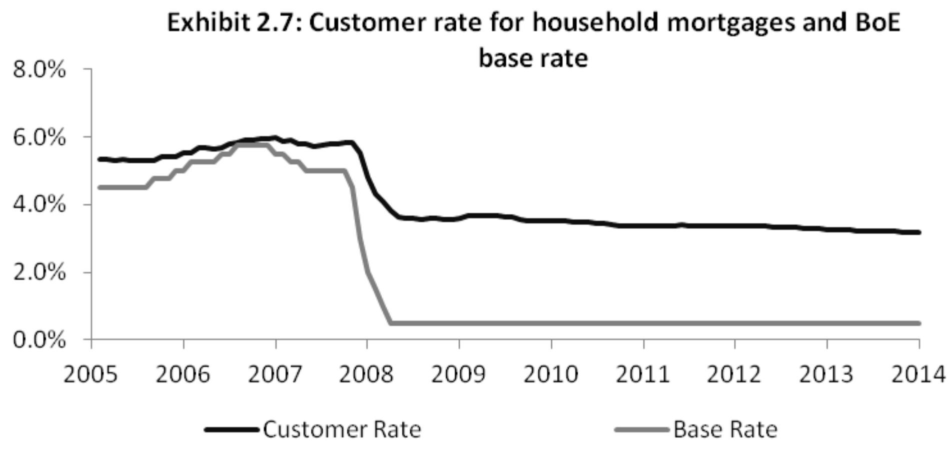


Source: Bank of England, Financial Conduct Authority mortgage lending statistics

The slowdown in growth of total mortgage stock in the UK following the financial crisis can be explained by two factors. First, levels of gross new lending remained relatively stable between 2009 and 2012, as shown in Exhibit 2.6. Second, the Bank of England reports that a fall in the official bank rate from 5 per cent. to 0.5 per cent. between October 2008 and March 2009, with the rate since remaining at 0.5 per cent., may have caused households to repay more of their mortgage principal. (*Source: Bank of England*) This increase in repayments would effectively counter-balance some of the gross new mortgage loans extended since 2009. (*Source: Prudential Regulation Authority and the Financial Conduct Authority - Mortgage Lenders and Administrators Statistics*)

2.5.4 *How banks make money from mortgages*

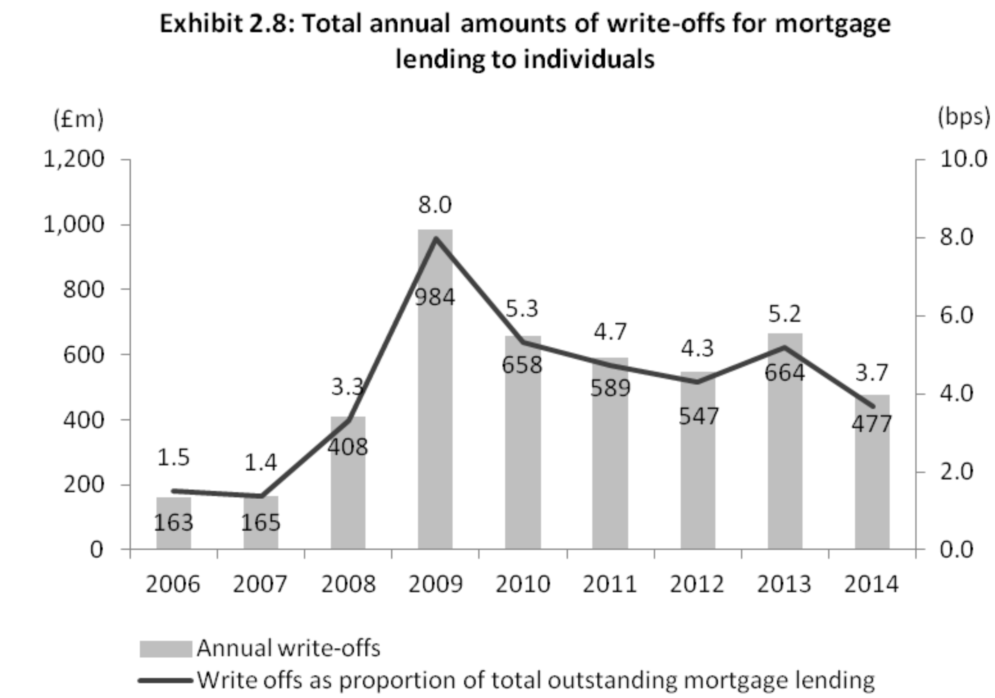
The key source of income for mortgage providers is the interest rate spread on mortgage loan balances. As shown in Exhibit 2.7, this spread has widened significantly since 2008 as the interest rate charged to customers has decreased at a significantly slower rate than the base rate, which is directly correlated to the funding cost for banks, suggesting an improvement in the overall profitability of mortgage lending. However this spread has been under pressure more recently as banks seek to grow their mortgage portfolios.



Source: Calculated from Bank of England data

During the financial crisis, a proportion of revenue from this increased spread has been used in addressing the significant impairment charges incurred on loans during this period. The total UK financial institutions' mortgage impairments are shown in Exhibit 2.8.

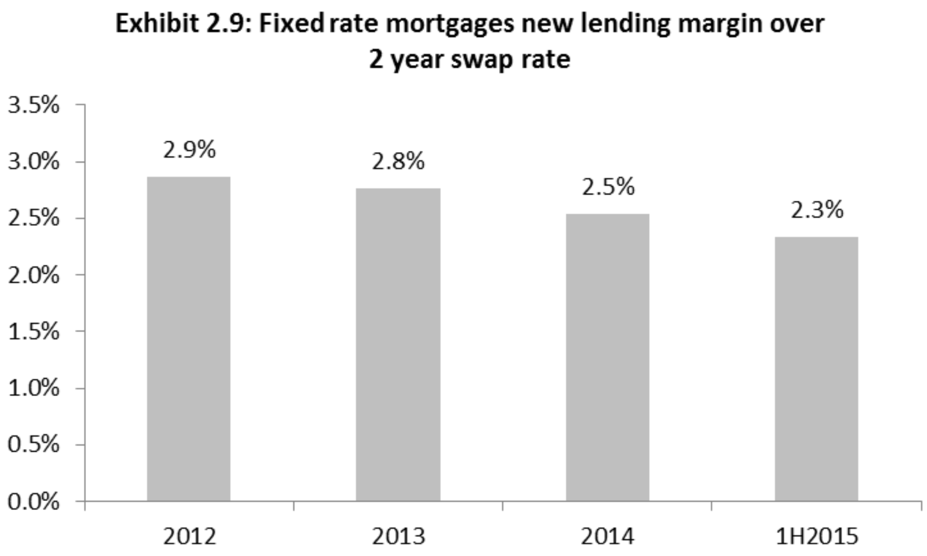
There has been an overall improvement in both the annual amount of mortgage loans written-off and outstanding mortgage lending between 2009 and 2014, reflecting improved macroeconomic conditions and a more risk-adverse approach to mortgage lending.



Source: Calculated from Bank of England data

2.5.5 *Fixed rate mortgages*

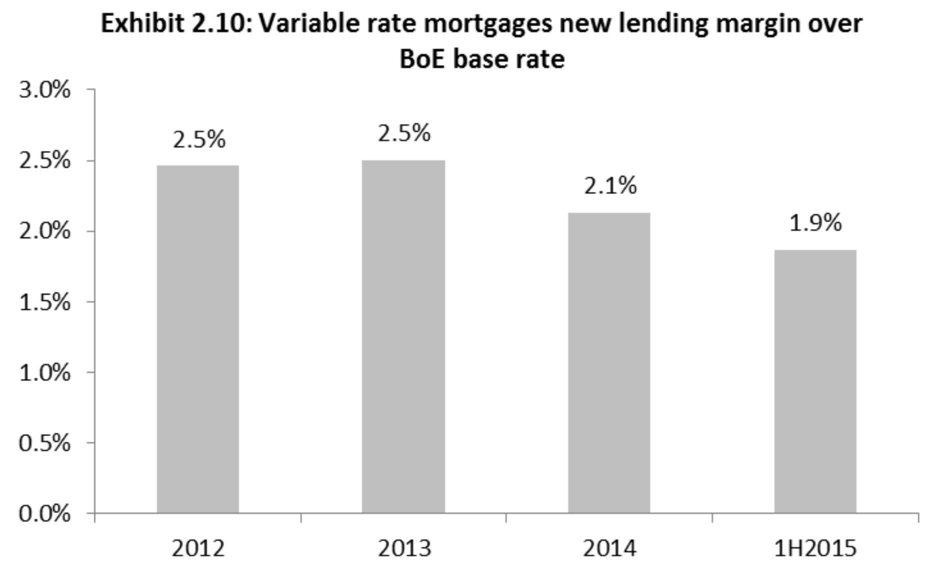
The market average margin on fixed rate mortgages in the UK has gradually declined over the period from FY12 to 1H15, as shown in Exhibit 2.9 below.



Source: Calculated from Bank of England mortgage statistics (FY12-1H15)

2.5.6 *Variable rate mortgages*

The market average margins on variable rate mortgages in the UK have also gradually declined between the period from FY13 to 1H15, as shown in Exhibit 2.10 below.



Source: Calculated from Bank of England mortgage statistics (FY12-1H15)

2.6 ***Key products: personal loans***

2.6.1 *Introduction*

Personal loans allow customers to borrow a sum of money for a specified period of time without providing any collateral. The interest rate varies with loan value and term, as well as customer credit quality. As at January 2015, the average interest rate charged by UK banks for a £5,000 personal loan was 9.0 per cent. and 4.8 per cent. for a £10,000 personal loan *(Source: Bank of England)*.

2.6.2 *Competitive landscape*

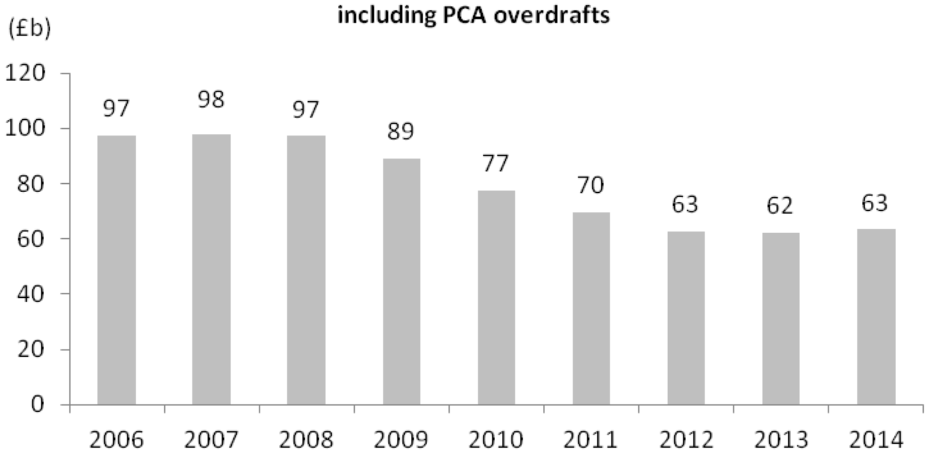
The UK personal loan market is relatively fragmented. The leading providers of personal loans, consisting of the Big Five, Clydesdale Bank, Yorkshire Bank, and Nationwide, account for approximately 60 per cent. of the personal loan market, with smaller lenders and specialist lenders accounting for the remainder. (*Source: BBA – Unsecured Personal Loans*)

42 per cent. of personal loan holders purchase the product from their PCA provider, therefore the PCA is an important gateway product.

2.6.3 *Key metrics*

The personal loan market can be measured in terms of total outstanding loan balances, as shown in Exhibit 2.11. Outstanding loan balances, including PCA overdrafts, dropped 35 per cent. from the average outstanding peak of £98 billion in 2007 to £63 billion in 2014.

Exhibit 2.11: Average outstanding personal lending to individuals including PCA overdrafts



Source: Calculated from Bank of England data

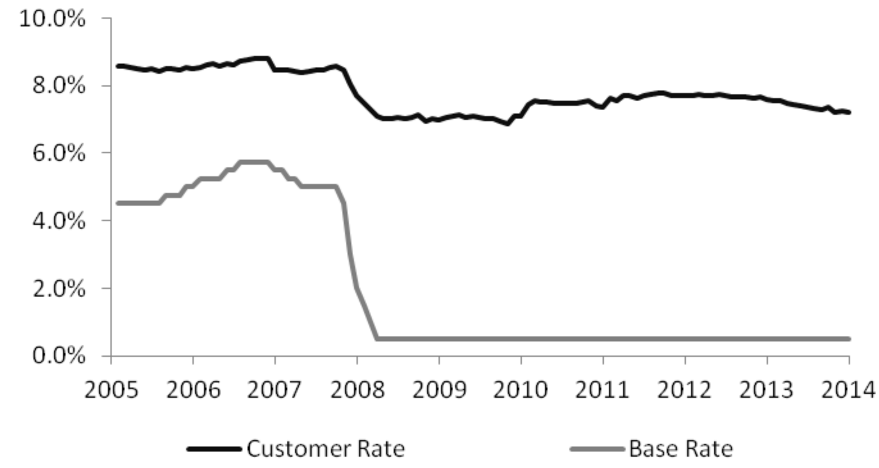
The decline in outstanding personal loan balances in 2008-2013 can be explained by changes in both consumer and lender preferences. As consumers sought to shift from consumption to savings amidst an uncertain macroeconomic environment, their appetite for personal loans decreased. At the same time, banks tightened their lending criteria as they sought to reduce their credit losses and to reduce the size of their balance sheets.

2.6.4 *How banks make money from personal loans*

Unsecured personal loans are associated with higher risk as there is no corresponding collateral and therefore they have higher interest rates than mortgages. As shown in Exhibit 2.12, customer rates (interest rates charged to customers) for unsecured loans fell from 8.57 per cent. in September 2008 to 7.22 per cent. in December 2014. Given the drop in the Bank of England base rate (which is directly correlated to the funding cost for banks) from 5 per cent. to 0.5 per cent. over the same period, banks have, at times, experienced an increased interest spread on personal loans between 2008 and 2014.

Although now a less common source of income, personal loans also generate a small amount of fee income, predominantly from penalties for late payments and, to a lesser extent, fees for early repayment.

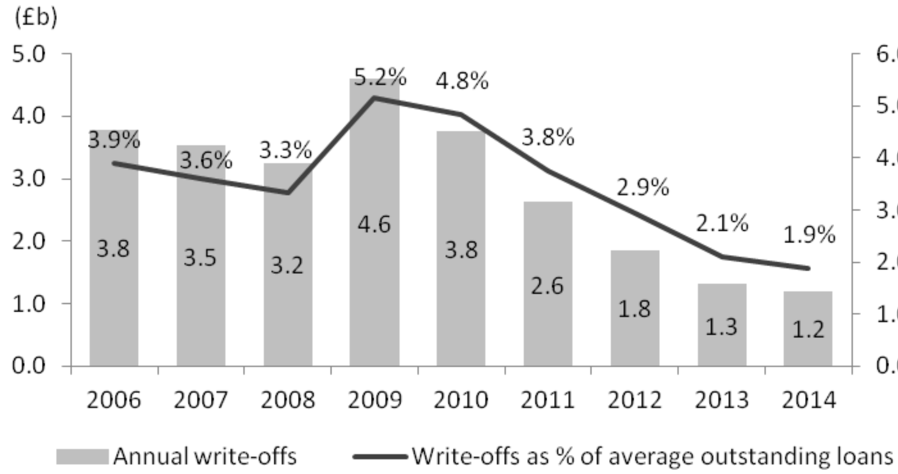
Exhibit 2.12: Customer Rate for personal loans and BoE base rate



Source: Calculated from Bank of England data

Between 2008 and 2009, there was an increase in impairments on unsecured personal loans. The total amount of UK financial institutions' impairments is illustrated in Exhibit 2.13. Between 2009 and 2014, there has been a steady decline in both the annual amount of write-offs and their proportion of total outstanding personal loans. This reflects both improved macroeconomic conditions and the tightening of lending criteria by personal loan issuers.

Exhibit 2.13: Total annual amounts of write-offs for personal lending to individuals



Source: Calculated from Bank of England data

2.7 *Key products: credit cards*

2.7.1 *Introduction*

Credit cards provide customers with a means of executing transactions along with an unsecured revolving credit facility. The main stakeholders in the credit card business are the card issuer (i.e. the issuing bank), card scheme (i.e. clearers of card payments), acquirer (e.g. arrangers of card transaction settlement), and merchant (i.e. retailer).

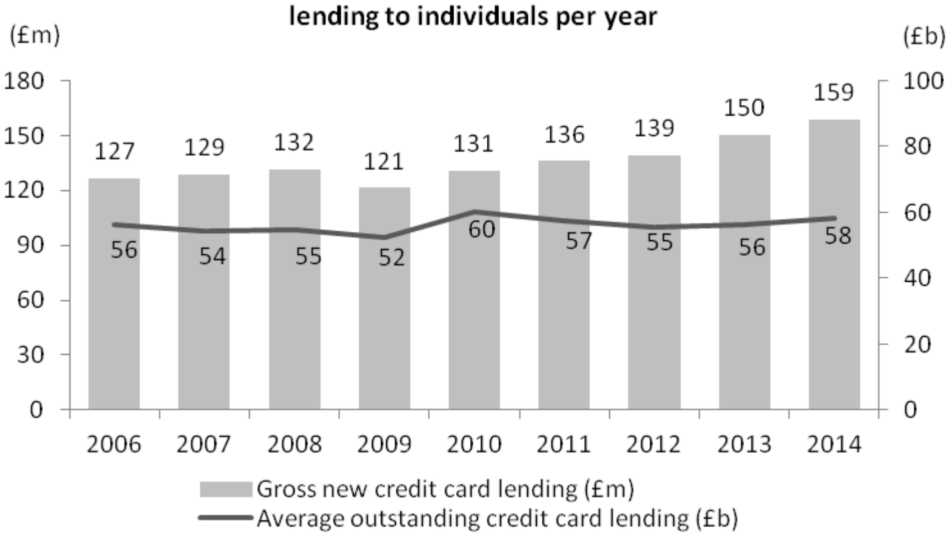
2.7.2 *Competitive landscape*

The wide range of participants in the UK credit card market include high street banks, building societies, and monoline card issuers. Estimates from May 2014 show that five providers account for 53 per cent. of the UK credit card market: Barclays (15.7 per cent.), Lloyds (15.6 per cent.), HSBC (10.0 per cent.), RBS (6.3 per cent.), and MBNA/Virgin Money (5.5 per cent.). The remainder of the market is fragmented between monoline providers such as Capital One, card issuers such as American Express, and retailer banks such as Tesco Bank, M&S Bank, and Sainsbury's Bank. Market share also varies widely by region: 16 per cent. of card holders in Greater London have an American Express card compared to 8 per cent. of the whole of the UK, while in Yorkshire and the Humber, Yorkshire Bank has 4 per cent. share compared to 1 per cent. across the UK. (*Source: Mintel – Credit Cards*)

2.7.3 *Key metrics*

There are 59 million credit cards in issue in the UK, relating to 51 million accounts, of which 67 per cent. have outstanding balances. (*Source: BBA – Statistics High Street Banking*) In December 2014, average outstanding balances stood at £58 billion, as shown in Exhibit 2.14.

Exhibit 2.14: Average outstanding and gross new credit card lending to individuals per year



Source: Calculated from Bank of England data

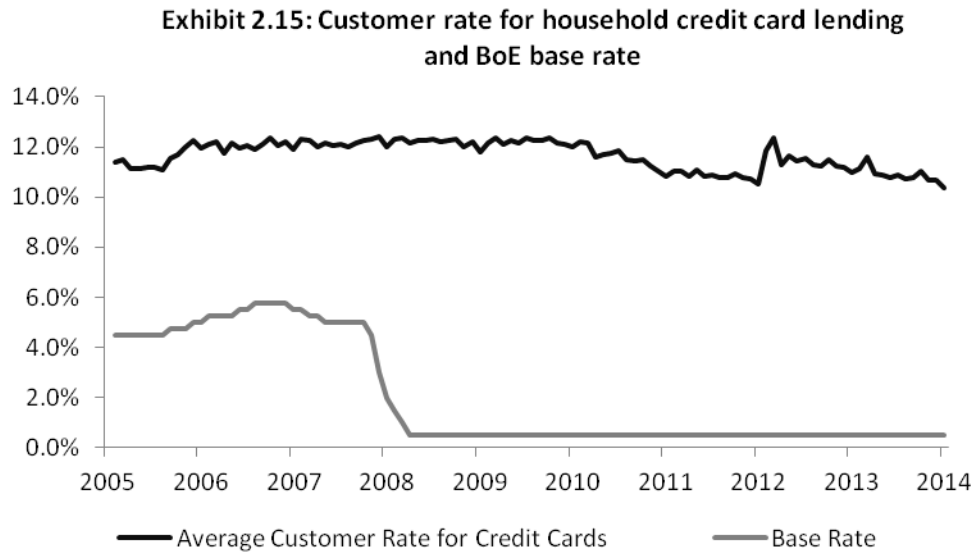
Consumers in the UK have greater appetite to take on credit as the economy recovers. Exhibit 2.14 shows the annual amount of gross new lending extended to credit card holders (in millions of GBP). While outstanding credit card lending reflects the amount of revolving balances on existing lines of credit, gross new lending reflects the expansion or contraction of lines of credit, driven by the number of credit cards issued and their respective credit limits.

Both outstanding and gross new credit card lending declined between 2008 and 2009 as banks sought to reduce their loan-to-deposit ratios and restrict capital commitments. However, new lending increased by a CAGR of 5 per cent. between 2010 and 2014 as providers re-entered the market to benefit from attractive margins and the improving economic environment.

2.7.4 *How banks make money from credit cards*

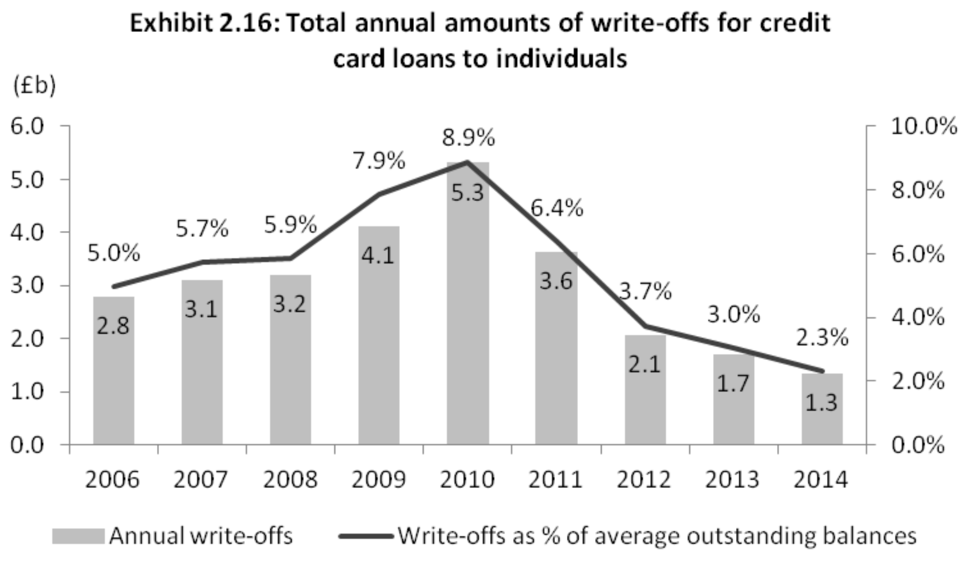
The primary source of income for credit cards is the spread between interest rates charged to customers and the funding cost for banks (which has fallen in correlation to the Bank of England base rate). In addition, issuers generate fees and commissions through interchange fees, late payment penalties, and card fees charged to consumers periodically.

Interest rate spreads on credit cards have increased as the average interest rate charged to customers on credit card balances fell from 11.9 per cent. in December 2007 to 10.4 per cent. in December 2014, at a slower rate of decline compared to the Bank of England base rate.



Source: Calculated from Bank of England data

During the financial crisis, banks incurred significant impairments on credit card loans. Impairments, as a percentage of total balances outstanding stood at nearly 9 per cent. of all credit card lending made in 2010. However, since 2010 there has been a steady decline in both the annual amount of write-offs and total outstanding credit card loans, reflecting improved macroeconomic conditions, as shown in Exhibit 2.16 below.



Source: Calculated from Bank of England data

3. Introduction To SME Banking

SMEs are a large and vital part of the UK economy, constituting an important target segment for many UK banks. The traditional relationship between SMEs and their banks have been affected by the financial crisis as banks have become more risk adverse and businesses look for alternative forms of credit. Bank lending to SMEs continues to fall and new forms of lending, will compete to regain the ground left behind by conventional bank financing. In addition to the liquidity squeeze, there has been a fall in the demand for borrowing from SMEs due to a combination of risk-aversion and the belief that lending is unavailable. (*Source: BBA*)

3.1 *The role of banks for SMEs*

Banks and other lenders provide financial products and services to organisations and businesses of all varieties and sizes. Customer needs in this segment vary by the size and type of businesses.

To address these needs, NAGE segments customers according to size and turnover:

- Micro, including sole proprietorships: NAGE defines these as businesses with no loans outstanding, with turnover less than £120,000. Many sole proprietorships and small businesses use PCAs for business purposes and therefore function similarly to a retail customer.

- Small: NAGE defines these as businesses with loans of up to £0.25 million, with turnover greater than £120,000 and up to £2 million.

- Commercial: NAGE defines these as businesses with loans of £0.25 million to £10 million, with turnover greater than £2 million.

There are many reasons why SMEs borrow. In 2014, 54 per cent. of loans were to ensure adequate working capital, 27 per cent. to buy equipment and 25 per cent. to inject working capital. (*Source: FSB – Voice of Small Business Report*) Products used by SMEs are principally current accounts, overdrafts, loans and credit cards.

Generally, banks generate a larger proportion of their revenue from fees in the commercial banking sector than in the retail sector.

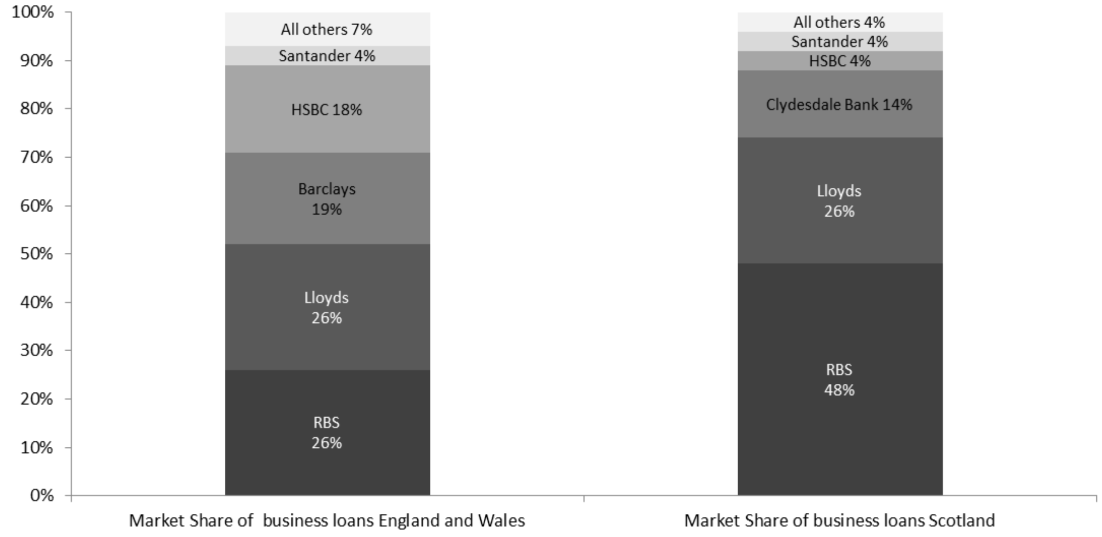
3.2 *Main market participants*

The market for SMEs generates annual revenue of over £2 billion for banks and other lenders in the UK. It is relatively concentrated, with the Big Five accounting for 93 per cent. of volume of business lending to SMEs in England and Wales in 2014. BCA market share is similarly concentrated, with the four largest banks accounting for 85 per cent. of main banking relationships. This concentration has been broadly stable for the last 14 years.

In Scotland, three banks (RBS, Lloyds and Clydesdale Bank) have accounted for 88 per cent. of lending to SMEs and accounted for 80 per cent. of SME BCAs in 2013. The market shares in England and Wales and Scotland have remained stable since 1999. (*Source: Competition and Markets Authority and Financial Conduct Authority – Banking Services to small and medium-sized enterprises*)

Although the UK market is generally stable, there have been successful entrants, such as Handelsbanken, which emphasises its branch network and local, face-to-face relationships. It now has 175 branches and £8.8 billion of business loans, the majority of which are to SMEs.

Exhibit 3.1: SME business loans market share 2013



Source: CMA FCA Banking Services to Small and Medium-Sized Enterprises July 2014

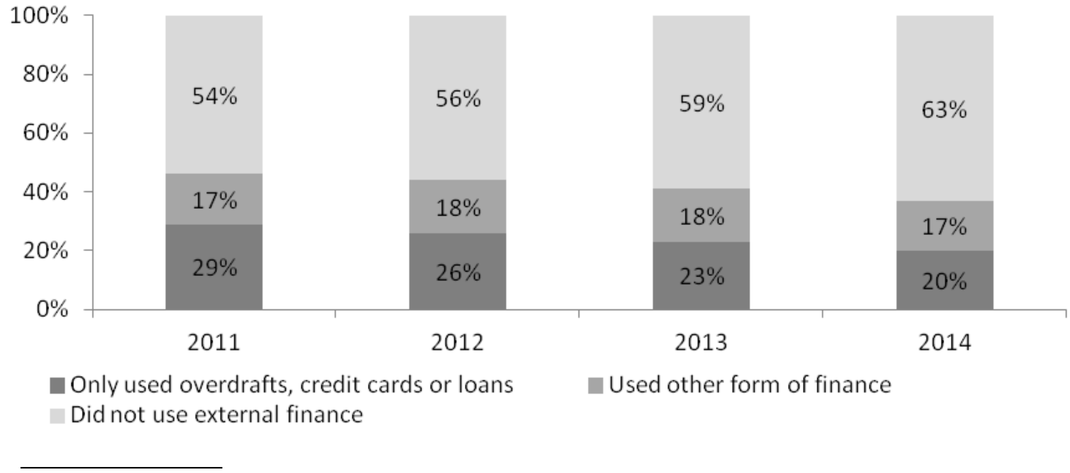
3.3 ***Access to finance***

The use of traditional banking products available to SMEs has declined. Overall, the use of *any* form of finance, referred to as "external finance", has declined in recent years across sectors, from 46 per cent. in 2011 to 37 per cent. in 2014. The decline in overdrafts, credit cards and loans is particularly significant. (*Source: BDRC Continental SME Finance Monitor Q4 2014*)

Economic pessimism during the years following the financial crisis was reflected in fewer investment opportunities for businesses, which held more of their cash in deposits. Despite signs of economic recovery, some SMEs wanting to borrow are discouraged by the difficulty of applying for loans, or a perception that they will not be approved. In Q4 2014, 79 per cent. of SME loans were approved, but only 33 per cent. of applicants assumed they would be successful. (*Source: BBA*)

Due to the perception of loans being harder to obtain, fewer SMEs turn to external sources of finance. The use of traditional banking products such as overdrafts, term loans and credit cards has declined from 39 per cent. to 29 per cent. between 2011 and 2014.

Exhibit 3.2: How SMEs use finance 2011-2014



Source: BDRC Continental SME Finance Monitor Q4 2014

3.4 ***Use of bank financing***

SMEs also use non-banking sources of finance. Informal sources include loans from friends and family or personal savings. Formal sources include vendor financing, amongst others and recent innovations such as peer-to-peer lending, driven by digital technology. Although these newer channels remain small, they are, however, growing. (*Source: BBA - Promoting competition Report*)

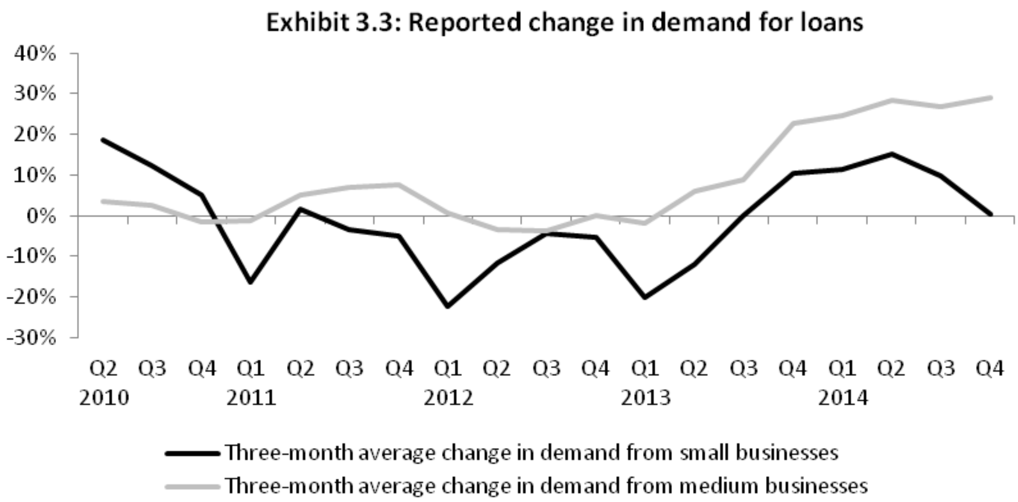
43 per cent. of SMEs in the UK are considered "permanent non-borrowers", having neither borrowed for 5 years nor looking to borrow currently. (*Source: BRDC SME Finance Monitor Q4 2014)* In a YouGov survey conducted in 2014, the most common reason cited from the options given for choosing not to borrow was the economic climate. Another potential contributing factor is a deficit of trust. A survey by the Federation of Small Businesses found that only 16 per cent. considered banks to "care about small businesses". Excessive charges were the largest source of concern for SMEs in relation to their bank.

3.5 ***Trends in banking for SMEs***

Although demand for finance has increased since 2013, lending has fallen continuously since 2011. This decline is in spite of the 2012 Funding for Lending Scheme, in which the Bank of England attempted to boost lending to households and companies by providing funding to banks and building societies at a lower cost.

3.5.1 *SME demand*

After a period of decline, demand for lending from medium sized enterprises has grown since Q2 2013. Demand from small businesses also grew until Q2 2014, since then it has declined. Unlike medium-sized businesses, small businesses have reported that their demand has mostly been met since 2011. (*Source: YouGov – SME Banking Report*)

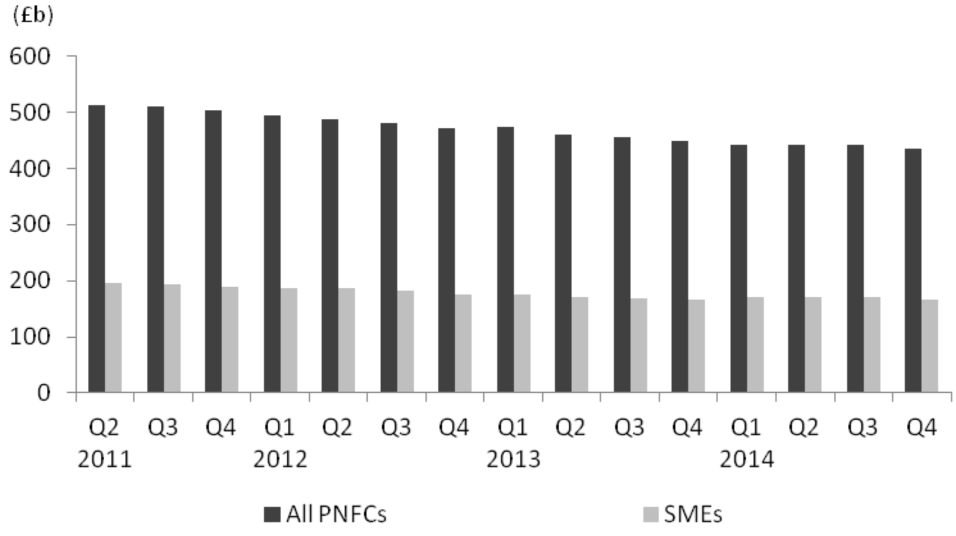


Source: Bank of England

3.5.2 *Lending to SMEs*

Lending to all private non-financial companies ("**PNFCs**") in the UK has declined since Q2 2011 by a total of 15 per cent. Lending to SMEs has also experienced a downward trend, as shown in Exhibit 3.4.

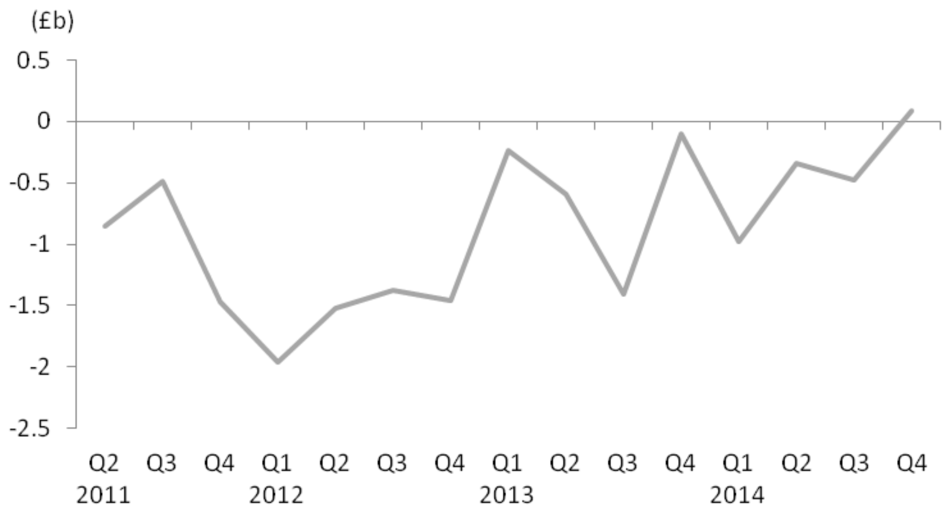
Exhibit 3.4: Total Outstanding Loans to UK PNFCs



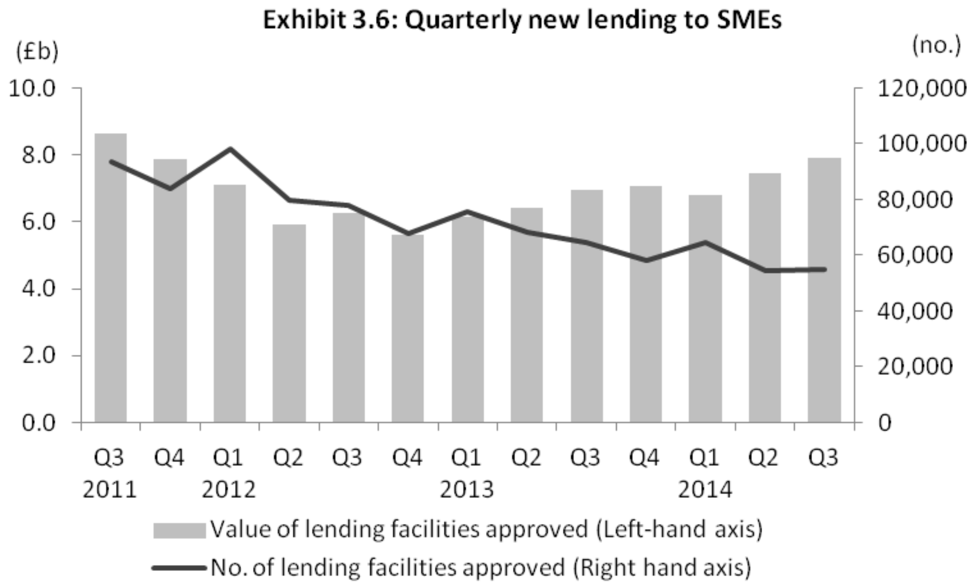
Source: Bank of England.

There are tentative signs of market recovery. First, the decline in loans outstanding slowed in the final three quarters of 2014, as shown in Exhibit 3.5. Secondly, although the approval rate for new borrowing facilities is still declining, total new lending to SMEs is now increasing, as shown in Exhibit 3.6, suggesting that the average new loan size is rising.

Exhibit 3.5: Quarterly changes in loans outstanding to SMEs

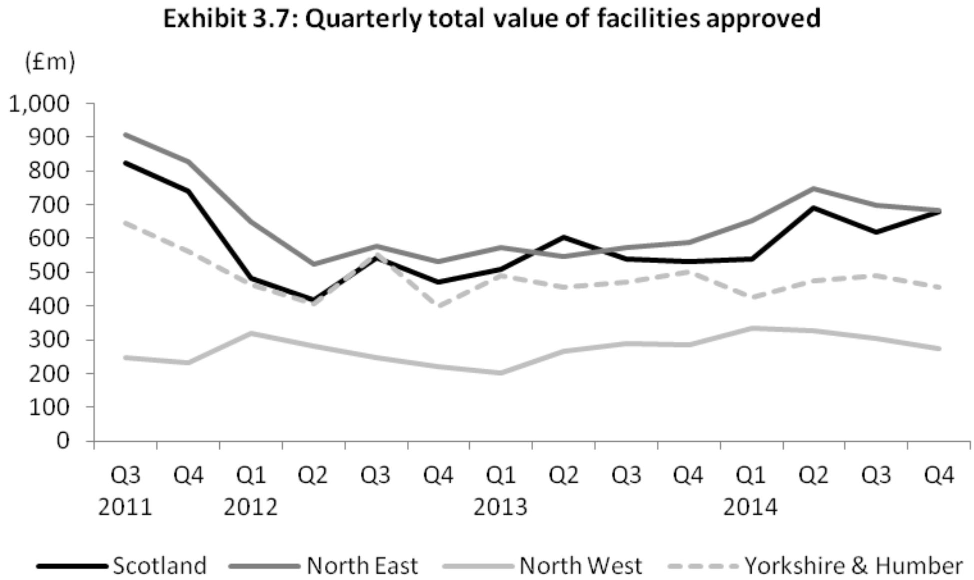


Source: Bank of England



Source: Bank of England

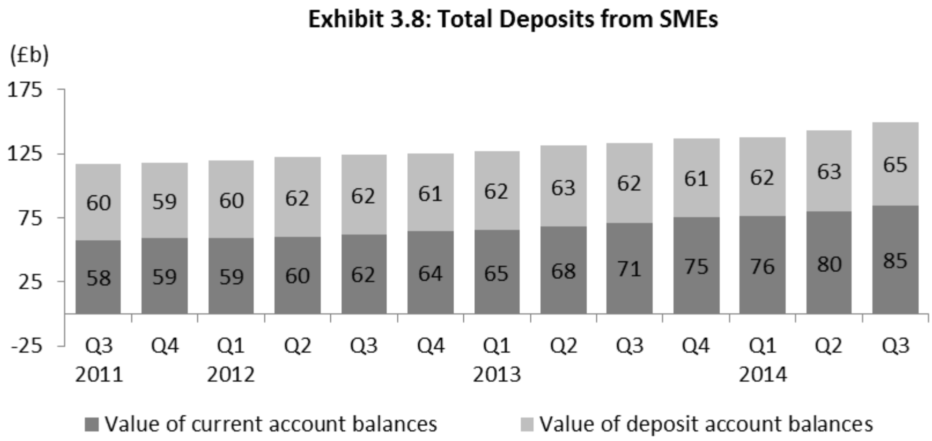
As shown in Exhibit 3.7, the core regions reflect tentative improvement in the value of new lending to SMEs. All regions except the North West experienced a considerable fall in lending in 2011. More positive trends in Scotland and the North East have emerged since 2011, with a less buoyant new lending market in Yorkshire and the North West.



Source: British Banking Association

3.5.3 *Deposits from SMEs*

During the challenging economic period between 2011 and 2014, deposits from both small and medium-sized businesses grew.



Source: British Banking Association

3.6 ***Distribution channels***

The main distribution channels used by SMEs are branches, online channels and by telephone. (*Source: YouGov*) Relationship managers, who have an understanding of each business, provide a single point of contact for larger SMEs. (*Source: YouGov – SME Banking*) SME customers use multiple channels, preferring digital options for simple interactions and using personal interaction for more complex banking needs. (*Source: YouGov*)

Personal contact and branch banking are important to SMEs. The largest SMEs place significant value on personal service and face-to-face contact from banks. 54 per cent. of SME customers visit a branch at least once a month and SMEs' most preferred means of communication with a bank is over the telephone with a branch employee. 31 per cent. of SME customers in Northern England and 30 per cent. of customers in Scotland conduct business at a branch at least once a week. On average, SME customers in both regions consider branches will continue to be important to a greater extent than customers in other regions in the UK. (*Source: YouGov – SME Banking Data*)

A strong digital presence is important for SME customers and they make frequent use of online banking. 81 per cent. of SME customers interact with their banks online, with 39 per cent. on a daily basis. SMEs overwhelmingly consider digital banking to be the channel most likely to grow in importance in the next year. (*Source: YouGov – SME Banking Data*)

3.7 ***Customer behaviour***

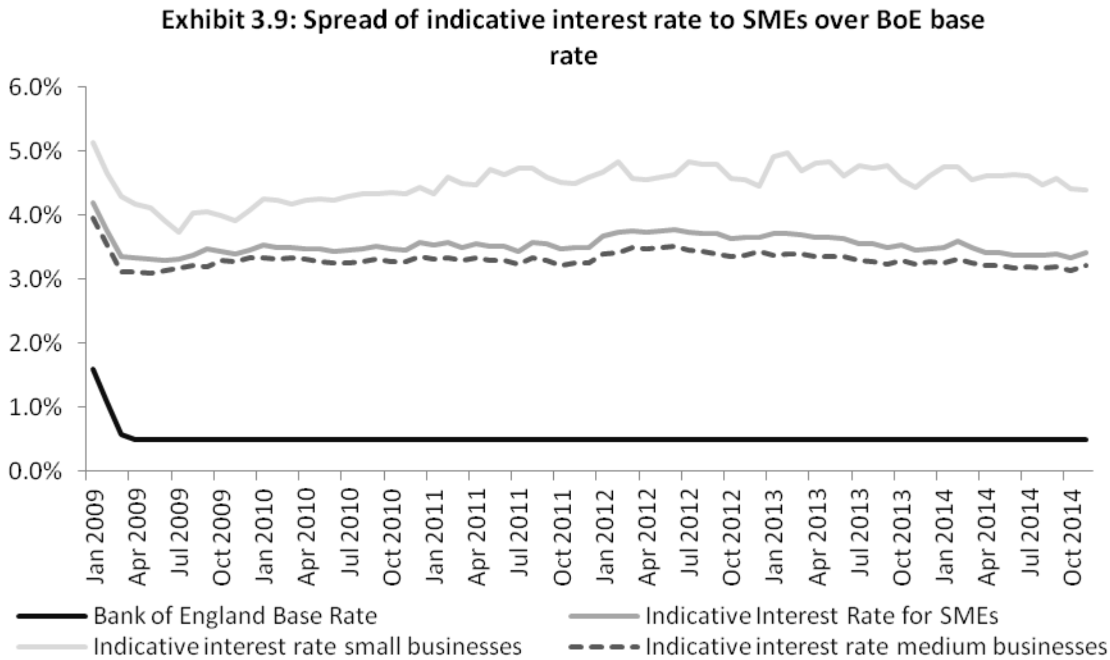
85 per cent. of SMEs prefer to receive their business current account banking services from a single provider. (*Source: YouGov – SME Banking Data*)

Satisfied customers are generally loyal to their banks, remaining with them for many years. The government and the banking regulator, however, may introduce greater competition to the SME banking market. When changing providers, SMEs are most concerned about price and the availability of free banking. SMEs also consider a good relationship and the ability to speak to an employee as the most important factors. (*Source: YouGov – SME Banking Data*)

There is considerable correlation between PCAs and BCAs. 31 per cent. of SMEs use a PCA as their main bank account and SMEs commonly open a BCA account with the bank they hold a PCA, benefitting banks with strong retail and SME propositions. (*Source: YouGov – SME Banking Data*)

3.8 ***Spreads on lending***

The spread between average interest rates for SME lending and the Bank of England base rate (which has a direct correlation to a bank's funding cost) has been steady since mid-2009 at an average of 3 per cent. Medium-sized enterprises have a lower spread at 2.8 per cent. while smaller enterprises are higher, at an average of 4 per cent.



Source: Bank of England

Spreads for SMEs are higher than for retail mortgages reflecting the more complex risk factors and higher cost to serve. A 2013 Bank of England study found that secured household loans in the retail sector have a rate of forbearance of approximately 5 to 8 per cent. of their total value, whereas SMEs had a rate of 14 per cent.

Research suggests that banks and other lenders perceive SMEs to be higher risk than they actually represent. A 2013 UK government study found that rejection rates for low and medium risk firms increased at a faster rate after 2009 than for high risk firms. (*Source: BIS Evaluating Changes in Bank Lending to UK SMEs*)

3.9 ***Asset and invoice finance***

Asset and invoice finance are fast-growing banking products. Unlike the BCA market, challenger banks have a considerable market share of these products, particularly in asset finance.

3.9.1 *Asset finance*

Asset finance typically involves a business paying a regular charge for the use of an asset over an agreed period of time. The most common types of asset finance are: (i) leasing, where the customer rents new equipment without owning the asset; and (ii) hire purchase, which allows the customer to buy equipment on credit.

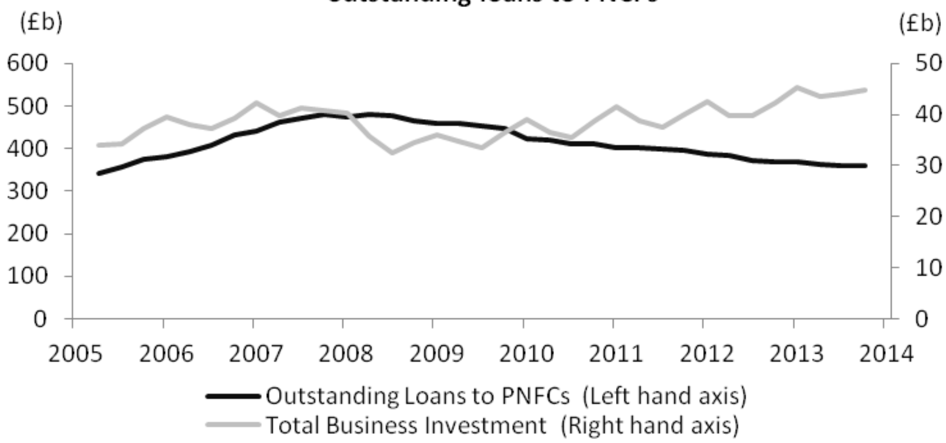
3.9.2 *Invoice finance*

Invoice finance involves businesses raising cash against as yet unpaid customer invoices. The most common types of invoice finance are: (i) factoring, where the provider interacts with a business' customers to receive payments owed, takes over the sales ledger and manages the credit control whilst receiving a percentage of the value in return; and (ii) discounting where the provider maintains the sales ledger and invoice processing but does not directly interact with the business' customers. Invoice finance typically earns a greater proportion of its income from fees than does asset finance.

3.9.3 *Background to growth of asset and invoice finance*

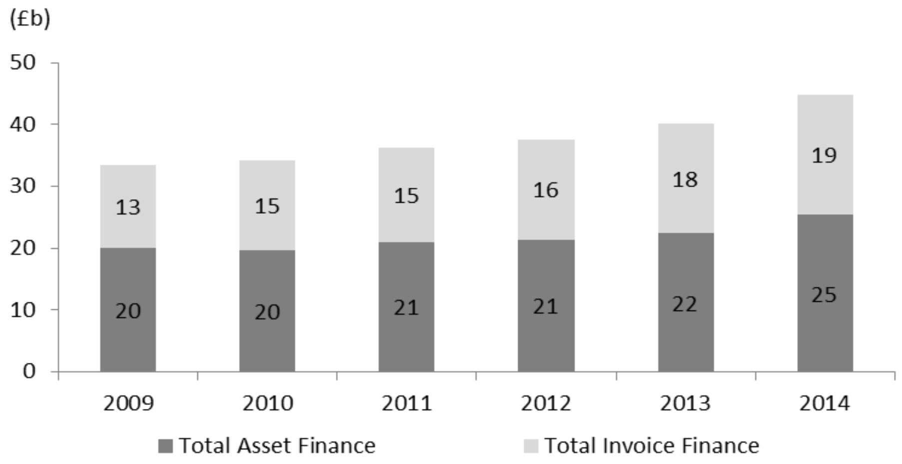
Since 2009, lending to PNFCs has consistently fallen each year, as shown in Exhibit 3.10. BIS forecasts a cumulative credit funding gap, the gap in businesses' access to funds, of £84 billion to £191 billion between 2013 and 2018 (*Source: Department for Business Innovation and Skills Boosting Finance Options for Businesses*). In addition, UK business investment has been unpredictable and moderately seasonal each year. Alternative sources of financing such as asset and invoice finance have expanded over 2009 to 2014 growing by a CAGR of 5 per cent. and 8 per cent. Respectively as shown in Exhibit 3.11.

Exhibit 3.10: Comparison of business investment and outstanding loans to PNCFs



Source: Office of National Statistics, Bank of England;

Exhibit 3.11: Loan balances for Asset and Invoice Finance



Source: FLA and ABFA

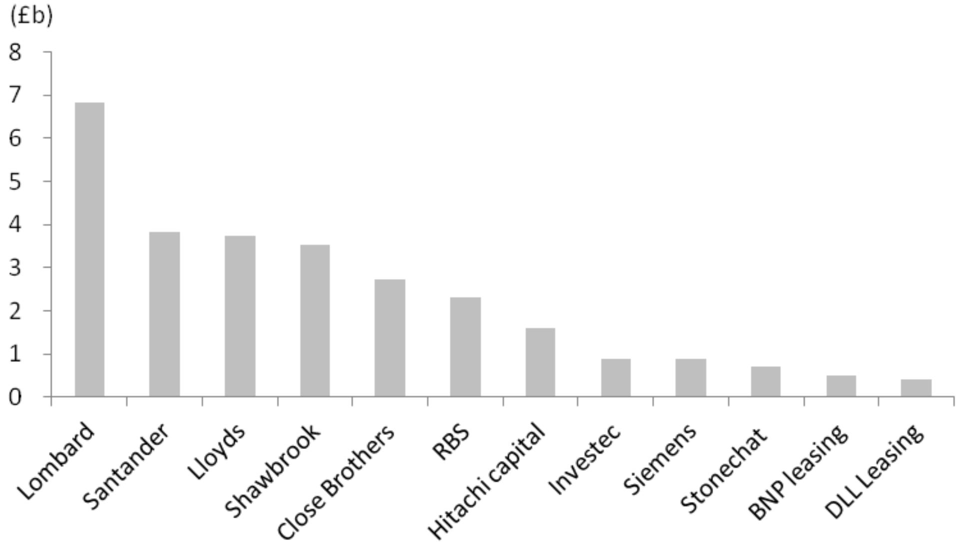
3.9.4 *Structure of the asset and invoice finance industry*

The asset and invoice finance industry comprises of three different types of participants:

- *Big Five high street banks*: these banks typically focus on larger business customers.
- *Original equipment manufacturers and vendors*: examples are General Electric and Siemens. They offer financing as part of their sales process and typically to large customers.
- *Challenger banks and niche specialists*: other banks such as Aldermore and Close Brothers, as well as specialists such as Bibby or Lombard. They focus on SME customers, and some on certain product types only.

For asset finance, there are 66 companies registered with the Finance and Leasing Association ("**FLA**"). The market overall is relatively fragmented. By value of loan book, smaller banks outside the Big Five, have a greater prominence than in traditional lending. Below is an example set of asset finance loan book values as provided in the companies' annual reports.

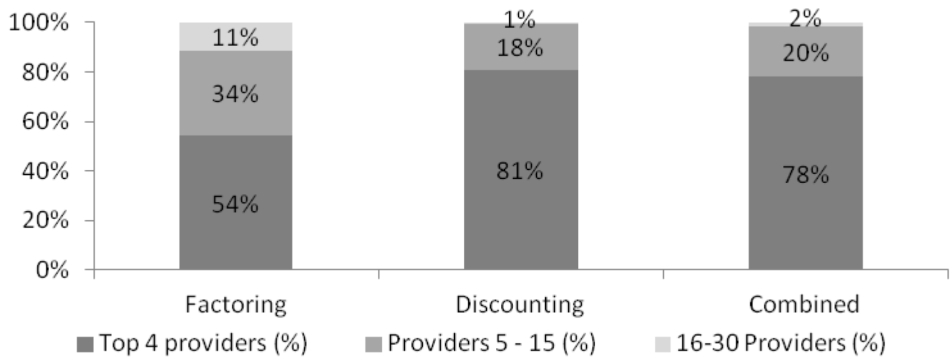
Exhibit 3.12: Sample of Asset Finance loan books 2013



Source: Company Annual Reports. Chart shows data as in 2013 Annual Reports.

In contrast to asset finance, the Big Five have a leading market share for invoice finance. Of the 30 invoice finance providers registered with the Asset-Based Finance Association ("**ABFA**"), the top four banks of the Big Five who provide invoice financing (RBS, Lloyds, Barclays and HSBC) occupy 54 per cent. market share for factoring and 81 per cent. for discounting. Combined, they have 78 per cent. market share. In the overall market, the next 10 providers (including Santander with 1.5 per cent. of the market) have 20 per cent. market share, and the remaining providers have only 2 per cent. share. Some providers such as Clydesdale Bank and Yorkshire Bank only operate in the discounting market, of which they have a combined market share of 3 per cent., whilst other such as Pulse Cashflow Finance or Ashley Commercial Finance only operate in factoring. Spreads on invoice finance loans typically range from approximately 2.25 per cent. to 3.75 per cent.

Exhibit 3.13: market share of Invoice Finance by loan value



Source: Business Money. Chart shows available data as at March/April 2014

3.9.5 *Asset finance market*

The market split of asset finance has evolved over the past 5 years, with business equipment becoming less significant, decreasing from 34 per cent. to 9 per cent., whilst plant and machinery from 7 per cent. to 22 per cent. and car finance, from 17 per cent. to 31 per cent., have both increased considerably. The category of commercial vehicles has retained a similar share, increasing from 21 per cent. to 24 per cent. (*Source: FLA Statistics 2009-2014*)

3.9.6 *Invoice finance market*

The number of invoice finance customers has remained relatively stable in recent years, witnessing a slight decline from 2006 to 2014.

By industry, the main market segments (manufacturing, distribution and services) have grown at a rate of 1 per cent. per annum since 2010.

When segmenting customers by turnover, there is a divergence in customer growth trends. Customers with turnover of less than £10 million have grown by 1 per cent. per annum since 2010, whereas customers with turnover of greater than £10 million grew at an annual rate of 9 per cent. This pattern of divergence in growth rates is also apparent in the balances since 2010. In total, average balances grew at 8 per cent. per annum from 2010 to 2014, as the existing customer base borrowed more heavily against their invoice assets. The larger contributors to the growth in the industry have been customers with high turnovers of greater than £10 million.

Definitions

"**ABFA**"	Asset-Based Finance Association
"**Barclays**"	Barclays plc
"**BBA**"	British Bankers Association
"**BCAs**"	business current accounts
"**BIS**"	the Department for Business Innovation and Skills
"**CAGR**"	compound annual growth rate
"**CASS**"	Current Account Switching Service
"**CMA**"	Competition and Markets Authority
"**FCA**"	Financial Conduct Authority
"**FLA**"	Finance and Leasing Association
"**FSA**"	Financial Services Authority
"**GVA**"	gross value added
"**HSBC**"	HSBC Bank plc
"**ICG**"	individual capital guidance
"**IRB**"	internal ratings based approach
"**IRHP**"	interest rate hedging products
"**Lloyds**"	Lloyds Banking Group, which includes the Lloyds Bank, Halifax and Bank of Scotland brands
"**MMR**"	Mortgage Market Review
"**NAGE**"	National Australia Group Europe Limited
"**PCAs**"	personal current accounts
"**PNFCs**"	private non-financial companies
"**PPI**"	payment protection insurance
"**RBS**"	Royal Bank of Scotland Group plc, which includes the RBS, NatWest and Ulster Bank brands
"**RWAs**"	risk weighed assets
"**Santander**"	Santander UK plc
"**SMEs**"	micro, small and medium-sized enterprises

Unaudited historical financial information

National Australia Group Europe Limited

For the six months ended 31 March 2015

Company Number: 2108635

NOTE ON THE BASIS OF PREPARATION FOR UNAUDITED HISTORICAL FINANCIAL INFORMATION OF NATIONAL AUSTRALIA GROUP EUROPE LIMITED FOR THE SIX MONTHS ENDED 31 MARCH 2015

The unaudited consolidated historical financial statements and selected financial information (collectively the “Historical Financial Information” or “HFI”) of National Australia Group Europe Limited (the “Company”) for the six months ended 31 March 2015 has been prepared in accordance with the International Financial Reporting Standards as issued by the International Accounting Standards Board, and as adopted by the European Union and IFRIC Interpretations. The HFI has been prepared in accordance with the accounting policies as outlined in Notes 2 and 3 of the HFI, and differs to the accounting policies previously applied for the years ended 30 September 2014, 30 September 2013 and September 2012 as presented in the Company’s audited annual report and consolidated financial statements. The main differences can be summarised as follows:

- Reclassifications of income statement data between line items including the reclassification of Payment Protection Insurance redress costs and FSCS levy from Other Operating Income to Other Operating Expenses. The change in respect to the reclassification of Payment Protection Insurance redress costs was first applied in the audited annual report for the year ended 30 September 2014. The comparative information for the year ended 30 September 2013 was retrospectively adjusted. This change was not applied in the audited annual reports for the years ended 30 September 2013 and 30 September 2012. The change in respect to the reclassification of FSCS levy was first applied in the HFI for the six months ended 31 March 2015. This change was not applied in the audited annual reports for the years ended 30 September 2014, 30 September 2013 and 30 September 2012;

- Reclassification of income between categories of non-interest income. This change was first applied in the six months ended 31 March 2015 and is not reflected in the audited annual reports for the years ended 30 September 2014, 30 September 2013 and 30 September 2012;

- Reclassification of pension amounts and associated tax between the income statement and other comprehensive income as a result of the adoption of IAS 19: Employee Benefits. The revised IFRS requirements were first applied in the audited annual report for the year ended 30 September 2014. The comparative information for the year ended 30 September 2013 was retrospectively adjusted. This change was not applied in the audited annual reports for the years ended 30 September 2013 and 30 September 2012; and

- Reclassification of accrued interest between assets and liabilities, and other items within categories of assets and liabilities, including the netting of derivative balances in accordance with accounting standard requirements. This change was first applied in the audited annual report for the year ended 30 September 2014. The comparative information for the year ended 30 September 2013 was retrospectively adjusted. This change was not applied in the audited annual reports for the years ended 30 September 2013 and 30 September 2012.

UNAUDITED HISTORICAL FINANCIAL INFORMATION FOR THE SIX MONTHS ENDED 31 MARCH 2015 AND 31 MARCH 2014

Consolidated income statements for the six months ended 31 March 2015 and 31 March 2014

	Notes	Six months ended 31 March 2015	Six months ended 31 March 2014
		£m	
Interest income and similar income		554	566
Interest expense and similar charges		(164)	(181)
Net interest income	6	**390**	**385**
Gains less losses on financial instruments at fair value		6	(6)
Other operating income		150	102
Non—interest income	7	**156**	**96**
Total operating income		**546**	**481**
Personnel expenses		(120)	(143)
Depreciation expense		(40)	(38)
Other operating and administrative expenses		(191)	(160)
Restructuring expenses		(12)	—
Total operating and administrative expenses	8	**(363)**	**(341)**
Operating profit before impairment losses		**183**	**140**
Impairment losses on credit exposures	18	(28)	(50)
Profit on ordinary activities before tax		**155**	**90**
Analysed as:			
Profit before tax, Gain on capital restructuring, Pension benefits, PPI complaint handling fine and restructuring expenses		111	90
Net gain on capital restructuring	13	59	—
Pension increase exchange gain	8	18	—
PPI complaint handling fine	8	(21)	—
Restructuring expenses	8	(12)	—
Profit on ordinary activities before tax		**155**	**90**
Tax (expense)	9	(18)	(16)
Profit for the period		**137**	**74**
Attributable to:			
Equity holders of the parent		137	66
Non—controlling interest		—	8
		137	**74**
Earnings per share			
Basic earnings per share (pence)	11	6.6	4.1
Diluted earnings per share (pence)	11	6.6	4.1

All material items dealt with in arriving at the gain/(loss) before tax for the above periods relate to continuing activities.
Notes 1 to 41 form an integral part of this historical financial information.

Consolidated statements of comprehensive income for the six months ended 31 March 2015 and 31 March 2014

	Notes	Six months ended 31 March 2015	2014
		£m	
Profit for the period		**137**	**74**
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
Gains/(losses) during the period		8	(4)
Transfers to the income statement		(11)	(25)
Taxation thereon		—	6
		(3)	(23)
Change in available for sale investments reserve			
Gains/(losses) during the period		9	(2)
Transfers to the income statement		—	—
Taxation thereon		(2)	—
		7	(2)
Total items that may be reclassified to the income statement		**4**	**(25)**
Items that will not be reclassified to the income statement			
Remeasurement of defined benefit pension plans	31	(6)	(30)
Taxation thereon		1	7
		(5)	(23)
Change in asset revaluation reserve			
Transfer to retained profits		(1)	—
Taxation thereon		—	—
		(1)	—
Total items that will not be reclassified to the income statement		**(6)**	**(23)**
Other comprehensive losses, net of tax		**(2)**	**(48)**
Total comprehensive income for the period		**135**	**26**
Attributable to:			
Equity holders of the parent		135	18
Non—controlling interest		-	8
		135	**26**

Notes 1 to 41 form an integral part of this historical financial information.

Consolidated balance sheet as at 31 March 2015

	Note	As at 31 March 2015
		£m
Assets		
Cash and balances with central banks	12	7,084
Due from related entities	13	883
Due from other banks		227
Investments – available for sale	14	1,197
Other financial assets at fair value	15	1,347
Derivative financial instruments	16	385
Loans and advances to customers	17	26,763
Due from customers on acceptances		5
Current tax assets		5
Property, plant and equipment	20	111
Investment properties	21	38
Property inventory	22	2
Investments in controlled entities and associates	23	2
Intangible assets	24	237
Deferred tax assets	25	316
Defined benefit pension assets	31	91
Other assets	26	232
Assets held for sale		—
Total assets		**38,925**
Liabilities		
Due to other banks	27	1,032
Other financial liabilities at fair value	15	79
Derivative financial instruments	16	620
Due to customers	28	25,251
Liabilities on acceptances		5
Current tax liabilities		—
Provisions	29	756
Due to related entities	13	1,792
Bonds and notes	30	4,096
Retirement benefit obligations	31	4
Deferred tax liabilities	25	18
Other liabilities	32	2,098
Liabilities associated with assets held for sale		—
Total liabilities		**35,751**
Equity		
Share capital	33,34	2,232
Other equity instruments	34	450
Share premium	34	—
Other reserves	34	—
Retained earnings	34	492
Total parent entity interest		3,174
Non—controlling interest	34	—
Total equity		3,174
Total liabilities and equity		**38,925**

Notes 1 to 41 form an integral part of this historical financial information.

Statements of changes in equity for the six month periods to 31 March 2015 and 31 March 2014

	Note	Share capital	Share premium account	Capital redemption reserve	Other equity instruments	Share option reserve	Asset revaluation reserve	Available for sale investments reserve	Cash flow hedge reserve	Retained earnings	Total parent entity interest	Non-controlling interest	Total equity
							£m						
As at 30 September 2014	33, 34	**1,882**	**—**	**100**	**300**	**2**	**2**	**8**	**(16)**	**260**	**2,538**	**—**	**2,538**
Profit for the period		—	—	—	—	—	—	—	—	137	137	—	137
Other comprehensive (losses)/income, net of tax		—	—	—	—	—	(1)	7	(3)	(5)	(2)	—	(2)
Total comprehensive (losses)/income for the period		—	—	—	—	—	(1)	7	(3)	132	135	—	135
Distribution		—	—	—	—	—	—	—	—	—	—	—	—
Capital redemption		—	—	—	—	—	—	—	—	—	—	—	—
Capital note issued		—	—	—	150	—	—	—	—	—	150	—	150
Shares redeemed		—	—	—	—	—	—	—	—	—	—	—	—
Shares issued		350	—	—	—	—	—	—	—	—	350	—	350
Share options expensed		—	—	—	—	4	—	—	—	—	4	—	4
Transfer from capital redemption reserve		—	—	(100)	—	—	—	—	—	100	—	—	—
Share options settled		—	—	—	—	(3)	—	—	—	—	(3)	—	(3)
As at 31 March 2015	33, 34	**2,232**	**—**	**—**	**450**	**3**	**1**	**15**	**(19)**	**492**	**3,174**	**—**	**3,174**

	Note	Share capital	Share premium account	Capital redemptio n reserve	Other equity instruments	Share option reserve	Asset revaluation reserve	Available for sale investments reserve	Cash flow hedge reserve	Retained earnings	Total parent entity interest	Non-controlling interest	Total equity
							£m						
As at 30 September 2013		**1,682**	**—**	**—**	**—**	**2**	**2**	**5**	**23**	**535**	**2,249**	**200**	**2,449**
Profit for the period		—	—	—	—	—	—	—	—	66	66	8	74
Other comprehensive losses, net of tax		—	—	—	—	—	—	(2)	(23)	(23)	(48)	—	(48)
Total comprehensive (losses)/income for the period		—	—	—	—	—	—	(2)	(23)	43	18	8	26
Distribution		—	—	—	—	—	—	—	—	—	—	(8)	(8)
Capital redemption		—	—	—	—	—	—	—	—	—	—	(200)	(200)
Capital note issued		—	—	—	300	—	—	—	—	—	300	—	300
Shares redeemed		(100)	—	—	—	—	—	—	—	—	(100)	—	(100)
Shares issued		300	—	—	—	—	—	—	—	—	300	—	300
Share options expensed		—	—	—	—	3	—	—	—	—	3	—	3
Transfer to capital redemption reserve		—	—	100	—	—	—	—	—	(100)	—	—	—
Share options settled		—	—	—	—	—	—	—	—	—	—	—	—
As at 31 March 2014		**1,882**	**—**	**100**	**300**	**5**	**2**	**3**	**—**	**478**	**2,770**	**—**	**2,770**

Notes 1 to 41 form an integral part of this historical financial information.

Statements of cash flows for the six month periods to 31 March 2015 and 31 March 2014

	Note	Six months ended 31 March 2015	2014
		£m	
Operating activities			
Profit on ordinary activities before tax		155	90
Adjustments for:			
Non-cash or non-operating items included in profit before tax	36	(327)	(297)
Changes in operating assets	36	(1,024)	(185)
Changes in operating liabilities	36	1,237	(301)
Interest received		577	552
Interest paid		(203)	(153)
Tax (paid)/received—group relief		(13)	4
Net cash provided by/(used in) by operating activities		**402**	**(290)**
Cash flows from investing activities			
Interest received		4	4
Proceeds from sale or maturity of investments		—	50
Proceeds from sale of tangible fixed assets [(1)]		8	14
Purchase of tangible fixed assets [(1)]		(5)	(6)
Purchases of investments		—	(251)
Purchase of intangible assets		(51)	(35)
Investment in controlled entities		—	—
Net cash (used in) investing activities		**(44)**	**(224)**
Cash flows from financing activities			
Interest received		2	2
Interest paid		(64)	(67)
Proceeds from ordinary shares issued	33	350	300
Redemption of preference shares		—	(100)
Proceeds from other capital issued	34	150	300
Redemption of non-controlling interest		—	(200)
Redemption of subordinated debt	13	(650)	—
Maturity of medium term notes		—	—
Other movements in bonds and notes		—	—
Redemption, principal repayment and other movements on residential mortgage backed securities and covered bonds	19	(123)	(151)
Issuance of residential mortgage backed securities and covered bonds	19	709	601
Net increase in amounts due from related entities		588	191
Net decrease in amounts due to related entities		(143)	(294)
Amounts paid to non-controlling interest		—	(8)
Dividends paid		—	—
Net cash provided by financing activities		**819**	**574**
Net increase in cash and cash equivalents		**1,177**	**60**
Cash and cash equivalents at the beginning of the period		5,895	6,550
Cash and cash equivalents at the end of the period	**36**	**7,072**	**6,610**

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

Notes 1 to 41 form an integral part of this historical financial information.

Notes to the Historical Financial Information

1. General information

Corporate information

National Australia Group Europe Limited (the "**Company**") is incorporated and registered in England and Wales. The registered office is 88 Wood Street, London, EC2V 7QQ and the registered number is 02108635. The Company together with its controlled entities comprise the National Australia Group Europe Limited Group (the "**Group**").

2. Basis of preparation

The Historical Financial Information ("**HFI**") comprises the financial information of the Group for the six months ended 31 March 2015 and 31 March 2014.

The consolidated HFI has been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("**IASB**"), and as adopted by the European Union and IFRIC Interpretations (together "**IFRS**"). References to IFRS hereafter should be construed as references to IFRS as adopted by the European Union.

The HFI has been prepared under the historical cost convention as modified by the revaluation of land and buildings, investment properties, derivative financial instruments, available for sale financial assets and certain other financial assets and liabilities held at fair value through profit or loss. The accounting policies set out in note 3 have been applied consistently to all periods presented in the HFI.

Going concern

The HFI is prepared on a going concern basis. In preparing the HFI the Directors have satisfied themselves that it is reasonable for them to conclude that it is appropriate to adopt the going concern basis.

The Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources. It is required to maintain a sufficient buffer over regulatory liquidity and capital requirements in order to continue to be authorised to carry on its business.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention and including stress testing and scenario analysis, show that the Group will be able to operate at adequate levels of both liquidity and capital for the foreseeable future. After making due enquiries the Directors are satisfied that the Group has adequate resources to continue its business for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the HFI.

3. Accounting policies

Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. An assessment of control is performed on an ongoing basis. For details of material controlled entities refer to note 23.

Controlled entities are consolidated from the date on which control is established by the Company until the date that control ceases. The acquisition method of accounting is used to account for the acquisition of controlled entities. Balances and transactions between entities within the Group and any unrealised gains and losses arising from those transactions are eliminated in full upon consolidation. The consolidated financial statements have been prepared using uniform accounting policies and are based on the same accounting period as National Australia Bank Group ("**NAB Group**").

New accounting standards and interpretations adopted in the HFI

The financial information has been prepared in accordance with the accounting standards endorsed at the date of this HFI that are effective for financial years beginning on or after 1 October 2014. Therefore, in preparing this financial information, the Group has adopted the following IASB pronouncements relevant to the Group:

- '*Annual Improvements to IFRS 2010-2012 cycle*', issued December 2013 and effective for financial years beginning on or after 1 July 2014 (with the application date for EU entities being financial years beginning on or after 1 February 2015). The IASB have made amendments to the following standards that are relevant to the Group: IFRS 2 '*Share based payments*', IFRS 3 '*Business Combinations*', IFRS 8 '*Operating Segments'*, IFRS 13 '*Fair Value Measurement'*, IAS 16 '*Property, Plant and Equipment*', IAS 24 '*Related party disclosures*' and IAS 38 '*Intangible assets*'. The impact of these amendments is not considered to be material to the Group. The Group has elected to early adopt these amendments.

- '*Annual Improvements to IFRS 2011-2013 cycle*', issued December 2013 and effective for financial years beginning on or after 1 July 2014 (with the application date for EU entities being financial years beginning on or after 1 January 2015). The IASB have made amendments to the following standards that are relevant to the Group: IFRS 3 *'Business Combinations*', IFRS 13 '*Fair value measurement*' and IAS 40 '*Investment Property*'. The impact of these amendments is not considered to be material to the Group. The Group has elected to early adopt these amendments.

- IAS 39 *'Novation of Derivatives and Continuation of Hedge accounting – Narrow Scope Amendment'*, issued June 2013 and effective for financial years beginning on or after 1 January 2014. This amends IAS 39 to permit the continuation of hedge accounting in specified circumstances where a derivative, which has been designated as a hedging instrument, is novated from one counterparty to a central counterparty as a consequence of laws or regulations. The impact of these amendments is not considered to be material to the Group.

- Amendments to IAS 32 '*Financial instruments – Presentation*', issued December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment adds application guidance to IAS 32 '*Financial instruments presentation'* to address inconsistencies identified in applying some of the offsetting criteria of IAS 32, including clarifying the meaning of 'currently has a legally enforceable right of set—off' and that some gross settlement systems may be considered equivalent to net settlement. The impact of these amendments is not considered to be material to the Group.

- Amendments to IAS 36 *'Recoverable Amount Disclosures for Non-Financial Assets'* issued May 2013 and effective for financial years beginning on or after 1 January 2014. This amends the disclosure requirements of IAS 36 to include additional information about the fair value measurement where the recoverable amount of the impaired asset is based on fair value less costs of disposal. The impact of these amendments is not considered to be material to the Group.

- '*Defined benefit plans: Employee Contributions (Amendments to IAS 19)*', issued November 2013 and effective for financial years beginning on or after 1 July 2014 (with the application date for EU entities being financial years beginning on or after 1 February 2015). This amendment to IAS 19 permits certain contributions from employees or third parties (only those contributions that are independent of the number of years of service) to be recognised as a reduction in the service cost in the period in which the employee's services are rendered, rather being attributed to periods of service as a 'negative benefit'. The impact of these amendments is not considered to be material to the Group. The Group has elected to early adopt this amendment.

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

- IFRS 9 '*Financial Instruments*', issued July 2014 and effective for financial years beginning on or after 1 January 2018. This standard replaces IAS 39 '*Financial instruments: Recognition and measurement*' and contains new requirements for the recognition and measurement of financial assets and liabilities, the recognition of impairment, and hedge accounting.

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

  The impairment of financial assets under IFRS 9 will be based on expected credit losses rather than incurred credit losses as at present.

  Hedge accounting proposals will amend existing IAS 39 approaches for micro hedge accounting. Accounting for dynamic risk management (macro hedge accounting) has been decoupled from IFRS 9 and is now subject to separate consultation.

  IFRS 9 will introduce significant changes in the way the Group accounts for financial instruments. The Group's ultimate parent, which resides outside the EU, has adopted IFRS 9, effective 1 October 2014. Accordingly, IFRS 9 is used in determining the results of the Group's operating segments in the period ended 31 March 2015 and adjusted to reach the Group's results (note 5).

- IFRS 15 '*Revenue from Contracts with Customers*', issued May 2014 and effective for financial years beginning on or after 1 January 2017. This standard establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard provides a single, principles based five step model to be applied to all contracts with customers.

- Amendments to IAS 16 and IAS 38: '*Clarification of acceptable methods of depreciation and amortisation*', issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation are not appropriate.

- Amendments to IAS 27: '*Equity Method in Separate Financial Statements*', issued August 2014 and effective for financial years beginning on or after 1 January 2016. The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

- '*Annual improvements to IFRS 2012-2014 cycle*', issued September 2014 and effective for financial years beginning on or after 1 January 2016. The IASB have made amendments to the following standards that are relevant to the Company: IFRS 5 '*Non-current assets held for sale and discontinued operations*', IFRS 7 '*Financial instruments: Disclosures*', IAS 19 '*Employee Benefits*' and IAS 34 '*Interim financial reporting*'.

- Amendments to IAS 1: '*Disclosure initiative*', issued December 2014 and effective for financial years beginning on or after 1 January 2016. Narrow scope amendments providing clarification to existing IAS 1 'Presentation of financial statements' requirements.

- Amendments to IFRS 11: '*Accounting for acquisitions of joint ventures and associates*', issued May 2014 and effective for financial years beginning on or after 1 January 2016. The amendments address how a joint operator should account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business. It requires that such transactions shall be accounted for using the principles related to business combinations accounting for IFRS 3 '*Business Combinations'* and other standards.

Foreign currency

Functional and presentation currency

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

Transactions and balances

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

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

Revenue recognition

Net interest income

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

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

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

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

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

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

Fees and commissions

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

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

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

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

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

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

Financial assets and liabilities designated at fair value through profit or loss recognise fair value movements (excluding interest) on those items designated as fair value through profit or loss.

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

Income tax

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

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

Current tax

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

Deferred tax

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

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

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

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

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

Cash and cash equivalents

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

Repurchase and reverse repurchase agreements

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

Securities purchased under agreements to resell ("**reverse repos**") are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the financial statements. Securities borrowed are not recognised in the financial statements unless they are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Financial instruments

Recognition and derecognition of financial instruments

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

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

The Group classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and amortised cost.

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

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

Offsetting financial instruments

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

Financial instruments designated at fair value through profit or loss

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

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

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

- if a host contract contains one or more embedded derivatives, the Group may designate the entire contract as being held at fair value;

- designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (i.e. eliminate an accounting mismatch) that would otherwise arise from measuring related assets or liabilities on a different basis; or

- assets and liabilities are both managed and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

Financial assets held for trading

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

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of: (i) fair value through profit or loss; (ii) loans and receivables; or (iii) held to maturity.

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

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

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities and an immaterial investment in equity securities.

Held to maturity financial assets

Held to maturity investments are non-derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

Financial liabilities

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

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

Fair value measurement

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

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

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

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

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

Derivative financial instruments and hedge accounting

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

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

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

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

Fair value hedge

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

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the year in which the hedged item will affect profit or loss.

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

Derivatives that do not qualify for hedge accounting

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

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

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

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

Loans and advances

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

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

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value and not within loans and advances. When a loan is held at fair value, a statistical—based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Impairment of financial assets other than fair value loans

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

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

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

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

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

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

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

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

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

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

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

Equity and debt instruments – classed as available for sale

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

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

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

Leases

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

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

As lessee

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

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

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

As lessor

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

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within depreciation expense in the income statement consistent with the nature of the asset (refer to note 20, Property plant and equipment).

Property, plant and equipment

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

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

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

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

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

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

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

Goodwill and other intangibles assets

Goodwill

Goodwill arises on the acquisition of an entity and represents the excess of the aggregate of the fair value of the purchase consideration and the amount of any non-controlling interest in the entity over the fair value of the Group's share of the identifiable net assets at the date of the acquisition. If the Group's interest in the fair value of the identifiable net assets of the acquired entity is greater than the aggregate of the fair value of the purchase consideration and amount of any non-controlling interest, the excess is recognised in the income statement on acquisition date and no goodwill is recognised.

Goodwill is assessed for impairment annually, or more frequently if there is indication that goodwill may be impaired. For the purposes of impairment testing, goodwill is allocated to cash generating units. Each cash generating unit or group of cash generating units to which goodwill is allocated is the lowest level within the Group at which goodwill is monitored by management. Impairment is assessed by comparing the carrying amount of the cash generating unit or group of units, including the goodwill, with its recoverable amount. An impairment loss is recognised in the income statement if the carrying amount of the cash generating unit or group of units is greater than its recoverable amount. Impairment losses recognised for goodwill are not subsequently reversed.

Other intangible assets

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

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

Impairment of non-financial assets

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment, and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount.

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

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to identify cash generating units.

Investment properties

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

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

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

Property inventory

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

Provisions

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

Pension and post retirement costs

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

Defined contribution pension scheme

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

Defined benefit pension scheme

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

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

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

Subordinated liability and related entity balances

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

Debt issues

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

Financial guarantees

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

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

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

Contingent liabilities

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

Equity

Share option reserve

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

Cash flow hedge reserve

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

Other equity instruments

Other equity instruments represent Additional Tier 1 notes. These are perpetual capital notes with no fixed maturity or redemption date and are classified as equity instruments.

Preference shares

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

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

Where preference shares do not satisfy the above conditions, they are classified as a financial liability. The Company's preference shares which were redeemed on 19 December 2013 met the criteria for classification as equity.

Dividends on ordinary and preference shares

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

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

Equity based compensation

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

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

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

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

Business combinations and disposals

Combination of businesses

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

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

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

When subsidiaries are sold or the Group ceases to control an entity, the difference between the proceeds (plus the fair value of any investment retained) and the total assets less total liabilities disposed of and goodwill is recognised in the consolidated income statement.

4. ***Critical accounting estimates and judgements***

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

Fair value of financial instruments

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

The most significant judgement is in relation to the Group's fair value loan portfolio. The significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected repayment profile of the loans. Sensitivity analysis indicating the impact of reasonable possible changes in these inputs on the fair value is included within note 38.

The valuation of these financial instruments is described in more detail in note 15.

Impairment losses on loans and advances

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

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate price indices, country risk and the performance of different individual groups). To the extent that the probabilities of default improve from those presently used within the Group's provisioning models by 5 per cent. the impairment provision on loans and advances would decrease by £4 million per year. Alternatively, if probabilities of default deteriorate by 5 per cent., the impairment provision on loans and advances would increase by £4 million per year. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5 per cent., the impairment provision on loans and advances would decrease by £12 million per year. Alternatively, if recovery rates deteriorate by 5 per cent., the impairment provision on loans and advances would increase by £19 million per year. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The impairment loss on loans and advances is disclosed in more detail in note 18.

Payment Protection Insurance redress provision and other conduct related matters

Disclosures in relation to the Group's payment protection insurance redress provision can be found in note 29 with the Group holding a provision of £481 million at 31 March 2015. Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates (how many claims are, or may be, upheld in the customer's favour) and redress costs (the average payment made to customers). The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position. Consequently, the provision calculated may be subject to change in future periods as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. Sensitivity analysis indicating the impact of reasonable possible changes in key assumptions on the PPI provision is included within note 29.

There are similar uncertainties and judgements for other conduct risk related matters disclosed in note 29 however the level of liability for each matter is lower.

Retirement benefit obligations

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Further details on the assumptions used and key sensitivities are provided in note 31.

5. ***Segment information***

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

The Group's business is organised into two principal operating segments: Business & Private Banking (including Business Banking centres, small business and private banking customers) and Retail Banking. Business & Private Banking provides a range of banking products and services to segments of business and private customers, including loans and finance, day to day banking, wealth management, international services and treasury solutions. Retail Banking provides a range of banking products and services to personal customers, including current accounts, mortgages, overdrafts, personal loans, savings accounts, insurances and financial planning.

The Group's Central Functions are Customer Trust & Confidence, Finance, Risk, Operations & IT, Legal & Governance, CEO Office Support, Customer Experience, Products & Marketing, Strategy & Transformation, Treasury and People & Communications, together with other functions which are not considered to be separate reportable operating segments.

UK Banking is NAB Group's UK management reporting entity. It comprises Business & Private Banking, Retail Banking and Central Functions, along with the UK-based wealth management business of NAB Group.

The reconciliation from UK Banking to statutory results table below shows other segments and adjustments, which includes deductions for the wealth management business which is not part of the Group. Also included are adjustments to incorporate Wholesale Banking business written on the Group's balance sheet not included within UK Banking.

Further details of the NAB Group's operating segments including UK Banking and how they are evaluated are contained within note 2 of NAB Group's annual report and consolidated financial statements for the year ended 30 September 2014. The segment information in the tables below has been prepared on the same basis. The accounting policies of the operating segments are consistent with those described in note 2 to the NAB Group financial statements for the year ended 30 September 2014, with the exception of the adoption by NAB of IFRS 9 in relation to the impairment of credit exposures from 1 October 2014. As IFRS 9 is not available for adoption in the European Union these amounts are reversed and replaced with the impairment charge on an IAS 39 basis in the other segments and adjustments column to reach the Group charge.

Major customers

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

Geographical areas

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

Operating segments Period to 31 March 2015	Business & Private	Retail	Central and other functions	UK Banking
			£m	
Net interest income	141	230	15	386
Other operating income [1]	36	46	11	93
Operating income	177	276	26	479
Operating and administrative expenses	(41)	(58)	(238)	(337)
Impairment losses on credit exposures	(16)	(9)	1	(24)
Segment operating profit/(loss)	120	209	(211)	118
Tax (expense)/credit	(25)	(43)	49	(19)
Segment cash earnings after tax	**95**	**166**	**(162)**	**99**
Average interest-earning assets	**11,333**	**16,849**	**7,276**	**35,458**

[1] Other operating income for segmental and UK Banking reporting is the equivalent of Non-interest income on the consolidated income statement excluding credit valuation and fair value and hedge ineffectiveness adjustments.

Operating segments Period to 31 March 2014	Business & Private	Retail	Central and other functions	UK Banking
			£m	
Net interest income	156	221	3	380
Other operating income	37	55	13	105
Operating income	193	276	16	485
Operating and administrative expenses	(39)	(64)	(238)	(341)
Impairment losses on credit exposures	(42)	(16)	3	(55)
Segment operating profit/(loss)	112	196	(219)	89
Tax (expense)/credit	(25)	(43)	52	(16)
Segment cash earnings after tax	**87**	**153**	**(167)**	**73**
Average interest-earning assets	**12,149**	**14,445**	**7,281**	**33,875**

Reconciliation between segment and statutory results 6 months ended 31 March 2015	UK Banking	Non-cash earnings items	Other segments and adjustments	NAGE Group
		£m		
	386	-	4	390
Other operating income	93	-	63	156
Operating income	479	-	67	546
Operating and administrative expenses...............	(337)	-	(26)	(363)
Impairment losses on credit exposures	(24)	-	(4)	(28)
Segment operating profit	118	-	37	155
Tax (expense)/credit	(19)	-	1	(18)
	99	-	38	137
Items outside of UK Banking cash earnings after tax:				
PPI complaint handling fine	(21)	-	21	-
Net gain on capital restructure	59	-	(59)	-
Profit after tax	**137**	**-**	**-**	**137**
Average interest-earning assets	**35,458**	**-**	**(115)**	**35,343**

Reconciliation between segment and statutory results 6 months ended 31 March 2014	UK Banking	Non-cash earnings items	Other segments and adjustments	NAGE Group
		£m		
Net interest income...	380	-	5	385
Other operating income	105	-	(9)	96
Operating income	485	-	(4)	481
Operating and administrative expenses...............	(341)	-	-	(341)
Impairment losses on credit exposures	(55)	-	5	(50)
Segment operating profit	89	-	1	90
Tax (expense)	(16)	-	-	(16)
Profit after tax	**73**	**-**	1	74
Average interest-earning assets	**33,875**	**-**	**(144)**	**33,731**

6. *Net interest income*

	Six months ended 31 March	
	2015	**2014**
	£m	
Interest income and similar income		
Loans and advances to other banks	13	12
Available for sale investments	4	4
Loans and advances to customers	514	522
Financial assets at fair value through profit or loss	20	25
Due from related entities (note 13)	2	2
Other interest income	1	1
Total interest income and similar income	**554**	**566**
Less: Interest expense and similar charges		
Due to other banks	4	2
Financial liabilities at fair value through profit or loss	-	1
Due to customers	96	112
Bonds and notes	42	40
Due to related entities (note 13)	22	26
Other interest expense	-	-
Total interest expense and similar charges	**164**	**181**
Net interest income	**390**	**385**

7. *Non-interest income*

	Six months ended 31 March	
	2015	**2014**
	£m	
Gains less losses on financial instruments at fair value		
Interest rate derivatives	(7)	40
Other assets and liabilities at fair value	3	(48)
Ineffectiveness arising from fair value hedges (note 16)	8	1
Ineffectiveness arising from cash flow hedges (note 16)	2	1
	6	**(6)**
Other operating income		
Fees and commission	72	85
Margin on foreign exchange derivative brokerage	11	9
Net fair value movement on investment properties	-	-
Gain on disposal of tangible fixed assets[1]	-	-
Other income	67	8
	150	**102**
Total non-interest income	**156**	**96**

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

In the period ended 31 March 2015, other income includes a gain of £61 million on the December 2014 capital restructure which was undertaken in order to replace instruments that were non-compliant for CRD IV purposes with CRD IV compliant instruments. A loss of £2 million is included in related entity charges (notes 8 and 13). The net gain was a result of the repurchase of £650 million of subordinated liabilities at fair value (note 13). The subordinated debt has been replaced by £450 million of Additional Tier 1 instruments.

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

8. *Operating and administrative expenses*

	Six months ended 31 March	
	2015	**2014**
	£m	
Personnel expenses		
Salaries, wages and non-cash benefits	82	86
Related personnel expenses	10	11
Defined contribution pension expense	8	7
Defined benefit pension (credit)/expense (note 31)	(3)	16
Equity based compensation	4	3
Other personnel expenses	19	20
	120	**143**
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (note 20)	13	11
Amortisation of intangible assets (note 24)	27	27
	40	**38**
Other operating and administrative expenses		
Operating lease rental	14	16
Other occupancy charges	20	19
Related entity charges (note 13)	9	4
Impairment losses on goodwill (note 24)	-	-
Impairment losses on software (note 24)	-	-
Payment Protection Insurance redress (note 29)	-	-
Other operating expenses	148	121
	191	**160**
Restructuring expenses (note 29)	12	-
Total operating and administrative expenses	**363**	**341**

During the period the Group's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After taking of independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change has resulted in a credit to the income statement of £18 million, resulting in a reduction in the defined benefit pension expense to a credit of £3 million.

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

Related entity charges includes a loss on capital restructuring of £2 million on the redemption of £75 million subordinated loans with NAB Group (note 13).

Auditor's remuneration

Included within other operating and administrative expenses:

	Six months ended 31 March	
	2015	**2014**
	£k	
Audit of financial statements	121	121
Other fees to the auditor:		
Audit of Group pension scheme	-	75
Local statutory audits for subsidiaries	737	692
Other assurance including regulatory compliance based work	258	141
	1,116	**1,029**

9. ***Taxation***

	Six months ended 31 March	
	2015	**2014**
	£m	
Current tax		
UK corporation tax		
Current year	(4)	-
Adjustment in respect of prior periods	(19)	(3)
Other overseas taxation	-	-
	(23)	**(3)**
Deferred tax (note 25)		
Current year	28	19
Adjustment in respect of prior years	13	-
	41	**19**
Tax expense for the period	**18**	**16**

The tax assessed for the period differs from the standard rate of corporation tax in the UK of 20.5 per cent (March 2014: 22 per cent). A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	Six months ended 31 March	
	2015	**2014**
	£m	
Profit on ordinary activities before tax	**155**	**90**
Tax expense based on the standard rate of Corporation Tax in the UK of 20.5 per cent. (comparatives above)	32	20
Effects of:		
Expenses not deductible for tax purposes	4	1
Income not taxable	(12)	-
Bank Levy	-	-
Amounts not subject to UK Tax	-	(1)
Chargeable gains	-	-
Rate differences	(1)	(2)
Adjustments in respect of prior years	(6)	(3)
Other	1	1
Tax expense for the period	**18**	**16**

The gain on capital restructuring of £61 million (note 7) for the period to 31 March 2015 is not subject to taxation and has reduced the Group's effective tax rate for the period.

10. ***Dividends paid***

	31 March 2015
Preference dividends paid	-

11. ***Earnings per share***

The Group presents basic and diluted earnings per share ("**EPS**") data in relation to the Ordinary shares of the Company. Basic earnings per share is calculated by dividing the profit attributable to Ordinary shareholders by the weighted average number of Ordinary shares outstanding during the period. The diluted earnings per share is calculated by adjusting the profit or loss that is attributable to Ordinary shareholders and the weighted average number of Ordinary shares outstanding for the effects of all dilutive potential Ordinary shares. No such dilutive potential Ordinary shares have been identified in the periods presented.

	Six months ended 31 March	
	2015	**2014**
	£m	
Profit attributable to equity holder of the parent for continuing and discontinuing operations	137	66
Distribution to non-cumulative preference share holders	-	-
Profit attributable to equity holders for the basis of basic and diluted EPS	**137**	**66**

	Six months ended 31 March	
	2015	**2014**
Basic and diluted weighted average number of shares in issue (thousands)	**2,058,936**	**1,582,013**

	Six months ended 31 March	
	2015	**2014**
	pence	
Basic and diluted earnings per share	**6.6**	**4.1**

12. ***Cash and balances with central banks***

	31 March 2015
	£m
Cash assets	1,316
Balances with central banks (including EU payment systems)	5,768
	7,084
Less mandatory deposits with central banks[1]	(42)
Included in cash and cash equivalents (note 36)	**7,042**

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

13. *Related party transactions*

The ultimate parent undertaking, and ultimate controlling party is NAB Group, a company incorporated in the State of Victoria, Australia. NAB Group also heads the largest group in which the results of the Group are consolidated. The immediate parent of the Company is National Equities Limited, a company incorporated in the State of Victoria, Australia.

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

The Group provides a range of services to related parties, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, forward exchange and interest cover.

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

	31 March
	2015
	£m
Amounts due from related entities	
Loans	
Ultimate parent	675
	675
Other receivables	
Ultimate parent	208
Controlled entities of the ultimate parent	-
	208
Total amounts due from related entities	**883**
Interest income on the above amounts was as follows:	
Ultimate parent (note 6)	**2**

	31 March 2015
	£m
Amounts due to related entities	
Deposits and funding arrangements	
Ultimate parent	786
Controlled entities of the ultimate parent	112
	898
Bonds and notes	
Ultimate parent (note 19)	396
Subordinated liabilities	
Ultimate parent	478
Immediate parent	-
	478
Other payables	
Ultimate parent	16
Immediate parent	-
Controlled entities of the ultimate parent	4
	20
Total amounts due to related entities	**1,792**
Interest expense on the above amounts was as follows (note 6):	
Ultimate parent	19
Immediate parent	1
Controlled entities of ultimate parent	2
	22

Derivatives

The following derivative positions are held with the ultimate parent:

	31 March 2015
	£m
Derivative financial assets	
Designated as hedging instruments (note 16)	126
Designated as held for trading (note 16)	101
	227
Derivative financial liabilities	
Designated as hedging instruments (note 16)	242
Designated as held for trading (note 16)	343
	585

Other transactions with related entities

	31 March 2015
	£m
Gain on redemption of subordinated debt (note 7)	**61**
Non-interest income received	
Ultimate parent	-
Controlled entities of the ultimate parent	2
	2
Other operating and administrative expenses (note 8)	
Ultimate parent	6
Controlled entities of the ultimate parent	3
	9

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

Details of subordinated liabilities in excess of 10 per cent. of the total balance of the subordinated loans of the Group are disclosed below. The rates of interest stated below apply at 31 March 2015:

	31 March 2015
	£m
10 year, non-call 5 year with a final maturity of 20 December 2023	
- LIBOR +3.41%.	300
10 year, non-call 5 year with a final maturity of 25 January 2021	
- LIBOR + 4.42%.	175
Undated subordinated notes – LIBOR + 0.2%.	-
Undated subordinated notes – LIBOR + 0.48%.	-
	475
Other subordinated notes and accrued interest payable	3
Total subordinated liabilities	**478**

On 29 December 2014, the Group repaid its £232.0 million of subordinated liabilities to its ultimate parent at a market value of £205.9 million, resulting in a gain on capital restructure of £26.1 million included within other income (note 7). A further £343.4 million was repaid to the immediate parent at a market value of £308.8 million, resulting in a gain of £34.6 million (note 7). The Group also repaid £75 million subordinated liabilities to the ultimate parent at a market value £76.8 million, resulting in a loss on capital restructure of £1.8 million included within other operating and administrative expenses – ultimate parent (note 8). In total the Group has repurchased £650 million of subordinated liabilities at fair value and the net gain is therefore £59 million.

Offset within Administrative expenses paid to the ultimate parent, from October 2012, are amounts received by the Group in relation to expenses incurred in the provision of services to the NAB UK Commercial Real Estate ("**CRE**") portfolio.

Securitisation

The Group has securitised part of its residential mortgage portfolio, and the cash raised from the issue of residential mortgage backed securities (“RMBS”) through structured entities (‘SE”) forms part of the Group's medium term funding. A portfolio of buy to let mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £396 million of the securities issued are held by the Group's ultimate parent (includes accrued interest).

*Compensation of key management personnel ("**KMP**")*

For the purposes of IAS 24 Related Party Disclosures KMPs comprise Directors of the Company, members of the UK Executive Committee and PRA approved persons with a control function of 1 to 29.

	31 March 2015
	£m
Other transactions with related entities	
Salaries and other short-term benefits	5
Share based payments	1
	6

Transactions with key management personnel

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

	31 March 2015
	£m
Group	
Loans and advances	9
Deposits	1

No provisions have been recognised in respect of loans provided to KMPs in any period. There were no debts written off or forgiven during in any period. Included in the above are ten loans totalling £8 million made to Directors and their related parties.

In addition to the above, there are guarantees of £0.1 million made to Directors.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.1 million in the period ended 31 March 2015 were charged to the Group sponsored Scheme. The Group has deposits of £6.9 million at the period end placed by the Scheme at market rates.

Pension contributions of £45 million were made during the period to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (see note 31).

14. **Investments**

	31 March 2015
	£m
Available for sale – listed	1,190
Available for sale – unlisted	7
	1,197

Included in the available for sale ("**AFS**") listed securities are £1.09 billion in UK Government Gilts and £0.1 billion of European Investment Bank debt securities.

£318 million of available for sale securities were encumbered under sale and repurchase agreements (see note 27 for details of the associated liabilities). These assets were not derecognised as the Group retained substantially all the risks and rewards of ownership.

In addition to the above, AFS listed securities includes items with a carrying value of £247 million which have been pledged as collateral under UK payment schemes.

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

	31 March 2015
	£m
Credit quality of investments	
Available for sale	
Senior investment grade	1,190
Other	7
	1,197

15. **Other financial assets and liabilities at fair value**

	31 March 2015
	£m
Other financial assets at fair value through profit or loss	
Loans and advances	1,335
Accrued interest receivable	12
Total loans and advances	**1,347**
Other financial liabilities at fair value through profit or loss	
Due to customers – term deposits	76
Accrued interest payable	3
Total due to customers – term deposits	**79**

Derivatives that are related to loans held at fair value through profit or loss are accounted for as Held for Trading derivative financial instruments (note 16).

Loans and advances

Included in other financial assets at fair value is a portfolio of loans. Interest rate risks associated with these loans are managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £1,347 million. The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £58 million and the change for the current period is a gain of £16 million. The Group ceased further sales of this suite of loan products with effect from 30 April 2012 with the loans being classified as Level 3 in the fair value hierarchy (see note 38).

Due to customers – term deposits

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

The Company is contractually obligated to pay £5 million less than the carrying amount at maturity to the deposit holder.

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

16. Derivative financial instruments

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

	31 March 2015
Group	*£m*
Fair value of derivative financial assets or loss	
Designated as hedging instruments – related entities (note 13)..	126
Designated as held for trading..	158
Designated as held for trading – related entities (note 13)..	101
	385
Fair value of derivative financial liabilities	
Designated as hedging instruments – related entities (note 13)..	242
Designated as held for trading..	35
Designated as held for trading – related entities (note 13)..	343
	620

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

Total derivative contracts as at 31 March 2015	Contract amount	Fair value of assets	Fair value of liabilities
		£m	
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	13,580	35	64
Cross currency swaps	683	-	67
	14,263	35	131
Fair value hedges			
Interest rate swaps	1,253	61	69
Cross currency swaps	876	30	42
	2,129	91	111
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	1,931	71	62
Cross currency swaps	454	32	6
Options	325	7	7
	2,710	110	75
Interest rate related contracts			
Swaps	2,630	128	274
Swaptions	76	-	1
Options	407	3	10
	3,113	131	285
Commodity related contracts	167	18	18
Total derivative contracts	**22,382**	**385**	**620**

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

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

The derivative notional contract amount has reduced from £39,601 million at September 2014 to £22,382 million at March 2015. This is partly due to a consolidation exercise, whereby £4,225 million of broadly offsetting derivative contracts with the parent were redeemed at market value. In addition, £8,600 million of derivatives which were transacted to hedge basis risk matured during the half and were not replaced. This reflected a reduction in the proportion of the mortgage book which is priced at a variable rate.

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

	31 March 2015
	£m
Nominal values per time period	
0 to 6 months	1,163
6 to 12 months	4,310
1 to 2 years	6,061
2 to 5 years	2,729
	14,263

The Group has hedged the following forecast future cash flows, which vary with interest or foreign exchange rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows	Forecast payable cash flows
	Mar 2015	**Mar 2015**
	£m	
Within one year	30	124
Between one and two years	28	86
Between two and three years	16	218
Between three and four years	10	270
Between four and five years	8	2
	92	**700**

	Six months ended 31 March
	2015
	£m
Gain/(loss) arising from fair value hedges (note 7)	
Hedging instruments	85
Hedged item attributable to the hedged risk	(77)
	8
Gain/(loss) from cash flow hedges recognised in income statement due to hedge ineffectiveness (note 7)	**2**

17. Loans and advances to customers

	31 March
	2015
	£m
Overdrafts	1,662
Credit cards	363
Lease finance	407
Mortgages	19,642
Other term lending – business	4,035
Other term lending – retail	806
Other lending	37
Gross loans and advances to customers	26,952
Accrued interest receivable	76
Unearned income	(26)
Deferred and unamortised fee income	(23)
Impairment provisions on credit exposures (note 18)	(216)
	26,763

The Group has transferred £5,916 million of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 19). The mortgages do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements the Group continues to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £3,335 million.

Included within Group loans and advances to customers are £2,253 million of mortgages assigned to a bankruptcy remote structured entity, Clydesdale Covered Bonds No. 2 LLP (note 19). These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet At 31 March 2015 there were £1,125 million of covered bonds in issue under the covered bond programmes.

The Group also has a portfolio of fair valued business loans and advances (note 15). Combined with the above this is equivalent to total loans and advances of £28,110 million.

Lease finance

The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The costs of assets acquired by the Group during the period for the purpose of letting under finance leases and hire purchase contracts amounted to £1 million and £151 million respectively. The total receivables from finance leases and hire purchase contracts were £7 million and £375 million respectively.

	31 March 2015
	£m
Finance lease and hire purchase receivables	
Gross investment in finance lease and hire purchase receivables	
Due within one year	179
Due within one to five years	224
Due after more than five years	4
	407
Unearned income	(25)
Net investment in finance lease and hire purchase receivables	**382**

There are specific provisions of £1 million in relation to finance lease receivables.

Maximum exposure to credit risk

The maximum exposure to credit risk is disclosed in note 39.

Distribution of loans and advances by credit quality

	Retail overdrafts	Credit Cards	Lease finance	Mortgages	Business Lending [1]	Other retail lending	Total
				£m			
As at 31 March 2015							
Gross loans and advances:							
Neither past due nor impaired	78	350	399	19,298	5,419	705	26,249
Past due but not impaired	7	13	3	289	131	16	459
Impaired	-	-	5	55	184	-	244
	85	**363**	**407**	**19,642**	**5,734**	**721**	**26,952**

[1] Business lending includes business overdrafts.

Credit quality of loans and advances

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

Distribution of loans and advances neither past due nor impaired

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

The table below presents an analysis of business lending credit quality of loans and advances that are neither past due nor impaired. It includes lease finance:

	31 March
	2015
	£m
Senior investment grade	1,136
Investment grade	1,626
Sub-investment grade	3,056
	5,818

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

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

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

	31 March
	2015
Less than 50 per cent.	29
50 per cent. to 75 per cent.	49
76 per cent. to 80 per cent.	7
81 per cent. to 85 per cent.	5
86 per cent. to 90 per cent.	3
91 per cent. to 95 per cent.	2
96 per cent. to 100 per cent.	1
Greater than 100 per cent.	-
Unknown	4
	100

Loans and advances which were past due but not impaired

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

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

31 March 2015	Retail overdrafts	Credit Cards	Lease finance	Mortgages	Business Lending (1)	Other retail lending	Total
				£m			
1 to 29 days past due	6	6	3	83	62	5	165
30 to 59 days past due ..	-	2	-	84	11	3	100
60 to 89 days past due ..	-	1	-	15	3	2	21
Past due 90 days and over	1	4	-	107	55	6	173
	7	**13**	**3**	**289**	**131**	**16**	**459**

18. Impairment provisions on credit exposures

31 March 2015	Retail overdrafts	Credit cards	Lease finance	Mortgages	Business lending (1)	Other retail lending	Total
				£m			
Opening balance	8	10	2	27	185	13	245
(Credit)/charge for the period............................	(1)	2	1	1	19	6	28
Amounts written off........	(3)	(5)	(1)	(3)	(43)	(8)	(63)
Recoveries of amounts written off in previous years	2	1	-	-	4	1	8
Other (2)..........................	-	-	-	-	(2)	-	(2)
Closing balance	**6**	**8**	**2**	**25**	**163**	**12**	**216**
Specific..........................	-	-	1	15	69	-	85
Collective	6	8	1	10	94	12	131
	6	**8**	**2**	**25**	**163**	**12**	**216**

(1) Business lending includes business overdrafts.
(2) Other includes the unwind of net present value element of specific provisions and other minor movements.

	31 March 2015
	£m
Amounts included in	
Loans and advances to customers (note 17)	216
Non-accrual loans	
Loans and advances to customers	244
Specific provisions	(85)
	159

19. Securitisations and covered bonds

Securitisations

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

The loans do not qualify for derecognition because the Group remains exposed to the majority of the risks and rewards of the mortgage portfolio, principally the credit risk associated with the underlying mortgage portfolio. The securitisation structured entities are consolidated and the securitised mortgage loans retained on the Group's balance sheet. The securitised notes in issue are included within bonds and notes (note 30).

Covered bonds

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

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

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

31 March 2015	**Securitised notes**	**Covered bonds**	**Total**
		£m	
At 1 October 2014	2,370	1,063	3,433
Issuance of debt	709	—	709
Repayments	(123)	—	(123)
Other movements	(16)	62	46
At 31 March 2015	**2,940**	**1,125**	**4,065**
Securitised assets	**5,916**	**2,253**	**8,169**

Further information on bonds and notes can be found in note 30.

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

In addition to the securitised notes and covered bonds disclosed above, there are £396 million of Lannraig debt securities including accrued interest which are held by NAB Group and disclosed as a related party transaction (note 13). The assets which support the Lannraig debt are disclosed in the securitised assets line in the table above.

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

	31 March 2015	
	Securitisation	*Covered bonds*
	£m	
Carrying amount of transferred assets (note 17)	**5,916**	**2,253**
Carrying amount of associated liabilities (excluding accrued interest) (note 17)	**3,335**	**1,125**

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

	31 March 2015	
	Securitisation	*Covered bonds*
	£m	
Transferred assets (note 17)................	5,916	—
Associated liabilities...........................	3,335	—
	2,581	**—**

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

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

Securitisation vehicles

The Group provides credit support to the structured entities via reserve funds through subordinated loan arrangements. Exposures totalled £Nil at 31 March 2015. The Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities as at the reporting date of £1,191 million.

The Group has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Group has made no such repurchases in the current period.

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

Covered bonds

The Group has a regulated covered bond programme. A Limited Liability Partnership was established and a ring fenced mortgage portfolio assigned to provide a guarantee under the terms of the covered bonds. At 31 March 2015 the nominal level of over-collateralisation was £1,250 million of the outstanding covered bonds. From time-to-time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

Clydesdale Bank PLC has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. Clydesdale Bank PLC has made no such repurchases in the current year.

20. **Property, plant and equipment**

	Freehold land and buildings	Long-term leasehold land and buildings	Building improvements	Fixtures and equipment	Total
			£m		
Cost or valuation					
At 30 September 2014	**11**	**3**	**161**	**114**	**289**
Additions	—	—	1	4	5
Disposals	(1)	—	—	(6)	(7)
At 31 March 2015	**10**	**3**	**162**	**112**	**287**
Accumulated depreciation					
At 30 September 2014	**1**	**—**	**92**	**75**	**168**
Charge for the period	—	—	7	6	13
Disposals	—	—	—	(5)	(5)
At 31 March 2015	**1**	**—**	**99**	**76**	**176**
Net book value					
At 31 March 2015	**9**	**3**	**63**	**36**	**111**

Valuations

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

There has been no change to the valuation technique during the period. There were no transfers between levels of the fair value hierarchy during the period. A comparison of the carrying value under the revaluation basis and if the historical cost basis had been used is shown below:

	31 March 2015
	£m
Carrying value as included under the revaluation basis	12
Carrying value if the historical cost basis had been used	**11**

21. **Investment properties**

	31 March 2015
	£m
At 1 October	44
Additions	—
Disposals	(6)
Deficit on revaluation	—
At 31 March 2015	**38**

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

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

During the period 99 per cent. of the investment properties generated total rental income of £1 million and incurred operating and administrative expenses of £1 million. The operating and administrative expenses of the investment properties that did not generate rental income were £Nil.

22. Property inventory

	31 March 2015
	£m
At 1 October 2014	2
Additions	—
Disposals	—
Write down of property inventory	—
At 31 March 2015	**2**

All properties within property inventory are complete and available for sale. No properties are under construction.

23. Investments in controlled entities and associates

	31 March 2015
	£m
Investments in controlled entities and associates	**2**

The principal controlled entities are as follows:

Wholly owned subsidiary undertakings as at 31 March 2015	Nature of business	Country of incorporation
Clydesdale Bank PLC	Banking	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	England
National Australia Group Europe Services Limited	IT and group services	Scotland

Structured entities

The Group sponsors the formation of structured entities, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well defined objectives. Although the Company has no direct or indirect ownership interest in these entities, where it is exposed, or has rights to, variable returns from its involvement with the entities and has the ability to affect those returns through its power over the entity, they are regarded as controlled entities as described in note 3 and are consolidated in the Group's financial statements.

In the current and prior periods all structured entities which the Group sponsors, or in which the Group holds an interest, are consolidated. Detail of the Group's interests in consolidated structured entities are set out in note 19.

The following companies are consolidated structured entities:

Other controlled entities as at 31 March 2015	Nature of business	Country of incorporation
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

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

Associates

Associates are undertakings over which the Company exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at the relevant period end. The associated undertaking is The Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is the provision of finance and the Group's interest of 33.33 per cent. in the issued equity capital is held by Clydesdale Bank PLC. The associated undertaking has a 31 March year end.

Significant restrictions

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

Contractual requirements – asset encumbrance

The Group uses its financial assets to raise finance in the form of securitisations and to conduct regular market repo transactions in accordance with PRA regulatory liquidity requirements. Once encumbered, the assets are not available for transfer around the Group. The assets affected are disclosed in notes 14 and 19.

24. Goodwill and other intangible assets

Other intangible assets – Capitalised software costs

	31 March 2015
	£m
Cost	
At 1 October	354
Additions	51
Disposals	(41)
Write down	—
At 31 March 2015	**364**
Accumulated amortisation	
At 1 October	141
Disposals	(41)
Charge for the period (note 8)	27
Impairment	—
At 31 March 2015	**127**
Net book value at 31 March 2015	**237**

Additions of £51 million relate predominantly to the Group's continuing investment in new systems to meet the requirements of the business. To the extent that the systems are in use within the business amortisation has been charged at the rates set out in note 3.

Management perform impairment testing of capitalised software assets in accordance with IFRS. The impairment charge, if any, follows a detailed review of the recoverable amount of the various assets. Where the benefits associated with the software are substantially reduced from what had originally been anticipated, the software is written down to its recoverable amount. An impairment of £Nil (note 8) has been recognised in the six months to 31 March 2015.

25. **Deferred tax**

Movement in net deferred tax asset

	31 March 2015
	£m
Opening balance	339
Recognised in the income statement (note 9)	(41)
Recognised directly in equity	—
Transferred to assets held for sale	—
Other	—
Closing balance	**298**

The Group recognises deferred tax attributable to the following items:

	31 March 2015
	£m
Deferred tax assets	
Defined benefit pension deficit	—
Impairment provision on credit exposures	6
Employee equity based compensation	1
Tax losses carried forward	210
Provisions	13
Decelerated capital allowances	81
Cash flow hedge reserve	5
Other	—
	316
Deferred tax liabilities	
Defined benefit pension surplus	18
Net gain on revaluation of properties	—
Cash flow hedge reserve	—
Other	—
	18
Net deferred tax asset	**298**

The Group considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The largest deferred tax asset held within the Group relates to tax losses carried forward. The tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses. The Group expects that the recognised deferred tax asset of £210 million in respect of tax losses will be recovered within six to eight years.

The statutory rate of UK corporation tax reduced to 21 per cent. on 1 April 2014. The enactment of Finance Act 2013 in July 2013 further reduced the corporation tax rate to 20 per cent. from 1 April 2015. Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Accordingly, as the future reductions of the corporation tax rate to 21 per cent. and 20 per cent. were enacted on 17 July 2013, the deferred tax balances at 31 March 2015 have been reflected at the tax rates they are expected to be realised or settled.

From 1 April 2015 a maximum of 50 per cent. of taxable profits in an accounting period can be covered by tax losses brought forward from earlier periods. The utilisation of the deferred tax assets referred to above takes account of all substantively enacted legislation as at 31 March 2015 including the new loss utilisation rules.

On 18 March 2015 the Chancellor announced the Government's intention to limit the deductibility of payments by banks for compensation for mis-selling. These changes, if enacted, would be expected to reduce the period over which deferred tax assets will be recoverable. At the current time the impact of the proposed changes cannot be quantified.

26. Other assets

	31 March 2015
	£m
Prepayments and accrued income	33
Other	199
	232

Other includes items in the course of collection.

27. Due to other banks

	31 March 2015
	£m
Transaction balances with other banks	
Securities sold under agreements to repurchase	722
Deposits from other banks	310
	1,032

28. Due to customers

	31 March 2015
	£m
Non-interest bearing demand deposits	1,866
Interest bearing demand deposits	17,865
Term deposits	5,313
Other wholesale deposits	89
	25,133
Accrued interest payable	118
	25,251

29. Provisions

	31 March 2015
	£m
Payment Protection Insurance redress provision	
Opening balance........................	515
Charge to the income statement (note 8)	—
Provision utilised.......................	(34)
Closing balance	**481**
Customer redress and other provisions	
Opening balance........................	413
Charge to the income statement [(1)]	—
Provision utilised.......................	(167)
Closing balance	**246**
Restructuring provision	
Opening balance........................	18
Charge to the income statement .	12
Provision utilised.......................	(5)
Transfer to surplus lease space provision	(1)
Closing balance	**24**
Surplus lease space provision	
Opening balance........................	6
Charge to the income statement..	—
Provision utilised.......................	(2)
Transfer from restructuring provision	1
Closing balance	**5**
Total provisions	**756**

(1) The income statement effect of the interest rate hedging products provisioning is nil as it is offset by a receivable from NAB Group.

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

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

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

Payment Protection Insurance ("PPI") redress

The Group has reassessed the level of provision that is considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and has concluded that no changes in provision are required. The total provision raised to date in respect of PPI is £806 million with £481 million of this remaining as at 31 March 2015.

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. On 14 April 2015, the FCA issued Clydesdale Bank PLC with a fine of £21 million for failings in its PPI complaint handling process between May 2011 and July 2013. The costs of the fine were accrued and included within other liabilities at 31 March 2015. The PPI redress provisions above relate solely to customer redress and processing costs.

The Group implemented a comprehensive new PPI complaint handling process from August 2014. A full review of past PPI complaints prior to August 2014 will begin in July 2015 to ensure fair outcomes for all impacted customers following a pilot programme.

The provision is based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies), the number of those claims that ultimately will be upheld, the amount that will be paid in respect of those claims, any additional amounts that may need to be paid in respect to previously handled claims, and any requirements to undertake further proactive customer contact. The requirement for further proactive customer contact will be determined by the Group undertaking a past business review. Where systemic sales failings are identified and there was a risk of mis-sale, proactive mailing to customers will be undertaken. At this stage the extent to which proactive mailings will be required as a result of the past business review is unknown. It has therefore not been possible to reliably estimate the extent of additional liabilities, if any, which may result and these matters are considered to be contingent liabilities.

These factors mean that the eventual costs of PPI redress and complaint handling may therefore differ materially from that estimated and further provision could be required. Accordingly, the final amount required to settle the Group's potential PPI liabilities remains uncertain.

The table below sets out the key assumptions and the effect on the provision at 31 March 2015 of future, potential, changes in key assumptions:

Assumptions	**Change in assumption**	**Sensitivity**[(1)]
Number of expected future customer initiated complaints	+/-10%	£13m
Uphold rates:		
Future complaints yet to be received	+/-10%	£21m
Existing complaints to be reviewed	+/-10%	£50m
Customer contact response rate [(2)]	-10%	£(24)m
Average redress costs	+/-10%	£59m

(1) There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged.

(2) Existing complaints review.

The Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop.

Customer redress and other provisions

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

On 29 June 2012 the Financial Services Authority ("FSA") announced that it had reached agreement with a number of UK banks in relation to a review and redress exercise on sales of certain interest rate hedging products to small and medium businesses. The Group agreed to participate in this exercise, as announced by the FSA on 23 July 2012, and has implemented a program to identify small and medium sized customers that may have been affected and where due, pay financial redress. The exercise incorporates certain of the Group's tailored business loan ("TBL") products as well as the standalone hedging products identified in the FSA's notice. On 31 March 2015 the FCA confirmed the closure of the formal industry wide redress program to new entrants.

In addition, the Group has undertaken a review of all past fixed-rate TBL complaints relating to TBLs not currently in scope of the review noted above. This exercise has been undertaken to ensure that each complaint has been considered appropriately applying the learnings from the reviews noted above.

Where the complaint assessment has identified a different outcome, the customer has been contacted and, if appropriate, redress offered. The Group is also dealing with a number of new claims by customers in relation to certain fixed rate TBLs not currently within the scope of the review. Any new complaints from January 2014 have been assessed on a consistent basis.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for these matters and concluded that no change to the level of provision held is appropriate at this time. The provision balance at 31 March 2015 was £212 million. The total provisions raised in respect of interest rate hedging products at 31 March 2015 is £431 million.

The ultimate cost to the Group of these matters are driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs for interest rate hedging products and in-scope TBLs, and the complaints led review of certain fixed rate TBLs. These factors could result in a total cost of the review and redress exercise and associated costs varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in this matter is therefore materially uncertain and further provision could be required. The income statement effect of these provisions is nil due to the recognition of an offsetting receivable from NAB Group.

Other provisions include amounts provided in respect of legal proceedings, a number of individually less significant conduct related matters, and claims arising in the ordinary course of the Group's business. No charge was recognised in the period to 31 March 2015.

Restructuring provision

Following the announcement of the results of the UK banking strategic review on 30 April 2012, a restructuring provision of £149 million was raised. The provision covers redundancy payments, property vacation costs and associated enablement costs. In the period to 31 March 2015, a further £12 million was charged to the income statement in relation to further ongoing restructure initiatives announced in the half and £5 million was utilised.

Surplus lease space provision

The Group provides for committed rental expense on surplus lease space in line with the expected years' exposure on individual leases where the property is unoccupied. The level of surplus lease space increased as a result of the UK banking strategic review as highlighted above and a number of property rationalisation activities undertaken since. The provision will be utilised over the remaining life of the leases or until the leases are assigned. The provision is measured at present values by discounting anticipated future cash flows.

30. **Bonds and notes**

	31 March 2015
	£m
Residential mortgage backed securities	2,953
Covered bonds	1,097
	4,050
Fair value hedge adjustments	15
Total securitised notes and covered bonds	4,065
Accrued interest payable	31
	4,096

On 11 December 2014, €550 million and £275 million of residential mortgage backed securities were issued through Lanark 2014-2.

Details of the terms and conditions of the notes issued by companies within the Group to parties outside of the NAB Group as at 31 March 2015 were as follows:

Issue date	Currency	Carrying value	Coupon rate	Maturity date
		£m		
Class A residential mortgage backed securities				
28 February 2012	EUR	284	3M EURIBOR + 1.95%	22 May 2015
27 July 2012	USD	395	3M USD LIBOR + 1.40%	22 May 2016
27 July 2012	GBP	524	3M GBP LIBOR + 1.63%	22 November 2017
13 July 2013	GBP	183	3M USD LIBOR + 0.50%	22 August 2016
13 July 2013	USD	316	3M GBP LIBOR + 0.45%	22 August 2016
19 March 2014	EUR	217	3M EURIBOR + 0.40%	22 August 2017
19 March 2014	GBP	349	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	EUR	397	3M EURIBOR + 0.40%	22 August 2018
11 December 2014	GBP	275	3M GBP LIBOR + 0.60%	22 February 2020
		2,940		
Covered Bonds				
31 May 2012	GBP	726	4.63%	08 June 2026
31 May 2012	GBP	399	3M GBP LIBOR + 1.70%	08 June 2015
		1,125		
		4,065		

31. **Retirement benefit obligations**

The Group operates both defined benefit and defined contribution arrangements. The Group is the sponsoring employer in one funded defined benefit scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the "**DB Scheme**"). The Scheme was established in 1951, and is currently governed by the Trust Deed and Rules dated 30 September 2009 following the merger of the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund. The assets of the Scheme are held in a trustee administered fund, the trustee is responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

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

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit post-retirement medical benefit pension obligation at 31 March 2015 by £0.3 million and would have no material impact upon service costs and interest costs.

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

	31 March 2015
	£m
Active members defined benefit obligation	(917)
Deferred members defined benefit obligation	(1,355)
Pensioner and dependent members defined benefit obligation	(1,388)
Total defined benefit obligation	(3,660)
Fair value of scheme assets	3,751
Net defined benefit pension asset	91
Post-retirement medical benefits obligations	(4)
Net retirements benefit asset	**87**
Disclosed as:	
Defined benefit pension asset	**91**
Defined benefit pension obligation	**(4)**

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

The Group has implemented a number of reforms to the Scheme to manage the liability. It closed the Scheme to new members in 2004 and has determined benefits accruing after April 2006 on a career average revalued earnings basis ("**CARE**"). The principal pension available to new employees since the closure of the Scheme is a defined contribution scheme, ("**Total Pension**"). The Total Pension income statement charge for the year is shown in note 8.

The Group implemented additional reforms to the Scheme which were effective from April 2012. These included changing the inflation index used to determine the basis on which "CARE fractions" increase from when they are earned to when a person leaves pensionable service. As an alternative to contributions, employees have the option of reducing their future annual rate of accrual from 1/60th of salary to 1/80th.

The last scheme funding valuation was at 30 September 2013 and estimated a deficit of £450 million. In the recovery plan dated 7 May 2014 the Group agreed to make the following contributions to eliminate the deficit: £65m on 1 October 2013; £150 million by 31 March 2014; £50 million on 1 October 2017; thereafter £50 million annually until 1 October 2021; and £55 million on 1 October 2022.

The following table provides a reconciliation of the net defined benefit pension asset/(liability) and defined benefit pension scheme assets and obligations:

	Six months ended 31 March	
	2015	**2014**
	£m	*£m*
Reconciliation of the net defined benefit pension asset/(liability)		
Opening net defined benefit pension scheme asset/(liability)..	49	(197)
Service cost....................................	3	(12)
Interest on net defined benefit asset/(liability)............................	2	(2)
Remeasurement effects recognised in SOCI	(6)	(30)
Employer contributions (note 13) ..	45	97
Administrative expenses................	(2)	(3)
Closing fair value of net defined benefit pension scheme asset/(liability)	**91**	**(147)**
Reconciliation of the defined benefit pension scheme assets		
Opening fair value of defined benefit pension scheme assets	3,269	2,718
Interest income on scheme assets at discount rate	66	64
Return on scheme assets greater than discount rate	414	48
Employer contributions (note 13) ..	45	97
Benefits paid..................................	(40)	(39)
Transfer payments	(1)	(1)
Administrative costs paid...............	(2)	(3)
Closing fair value of defined benefit pension scheme assets..	**3,751**	**2,884**
Reconciliation of the defined benefit pension scheme obligations		
Opening defined benefit pension scheme obligations.....................	(3,220)	(2,915)
Current service cost	(14)	(11)
Past service cost.............................	17	(1)
Interest expense on the defined benefit obligation	(64)	(66)
Actuarial gain – experience adjustments	39	4
Actuarial (loss) – demographic assumptions................................	—	—
Actuarial (loss) – financial assumptions................................	(459)	(82)
Benefits paid from scheme assets ..	40	39
Transfer payments	1	1
Closing defined benefit pension scheme obligations....................	**(3,660)**	**(3,031)**

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

	31 March 2015
	£m
Quoted	
Equities	951
Government bonds	1,660
Global sovereign bonds	105
Corporate bonds	740
Other [(1)]	72
Cash	35
Secure income alternatives	65
Unquoted	
Property	123
Fair value of defined benefit pension scheme assets	**3,751**

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

The Scheme is not invested in any of the Group's own financial instruments. The Property value above includes £16 million in respect of the Group's offices at Merrion Way, Leeds.

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

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

	Six months ended 31 March	
	2015	2014
	£m	*£m*
Amounts recognised in the income statement		
Current service cost	14	11
Past service cost	(17)	1
Interest on net defined benefit (asset)/ liability	(2)	2
Defined benefit expense for the year	**(5)**	**14**
Administration costs incurred	2	3
(Credit)/cost recognised in the income statement	**(3)**	**17**

For the period ending 31 March 2014, the past service cost relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements and these were fully offset in the income statement by a corresponding release from the restructure provision.

The following table provides a summary of the amounts recognised in the statement of comprehensive income and the actuarial assumptions:

	Six months ended 31 March	
	2015	**2014**
	£m	*£m*
Amounts recognised in the statement of comprehensive income		
Opening cumulative actuarial losses	(634)	(658)
Actuarial gain due to liability experience adjustments	39	4
Actuarial loss due to liability assumption changes	(459)	(82)
Return on scheme assets greater than discount rate	414	48
Other	—	—
Cumulative actuarial losses recognised in the statement of comprehensive income	**(640)**	**(688)**
Actuarial assumptions	% p.a.	% p.a.
Financial assumptions		
Discount rate	3.40	4.50
Inflation (RPI)	3.05	3.30
Inflation (CPI)	2.05	2.30
Career average revalued earnings ('CARE') revaluations:		
Pre 31 March 2012 benefits (RPI)	3.05	3.30
Post 31 March 2012 benefits (CPI capped at 5% per annum million)	2.05	2.30
Pension increases (capped at 2.5% per annum million)	2.10	2.25
Pension increases (capped at 5% per annum million)	3.00	3.15
Demographic assumptions	Years	Years
Post retirement mortality:		
Current pensioners at 60 – male	27.6	28.0
Current pensioners at 60 – female	29.5	28.5
Future pensioners at 60 – male	29.1	29.5
Future pensioners at 60 – female	31.0	30.0

The table below sets out the sensitivity of the defined benefit obligation and pension cost at 31 March 2015.

31 March 2015	**Impact on defined benefit obligation**	**Impact on pension cost**
	£m	
Assumption change		
Discount rate		
+0.25%	(190)	(9)
-0.25%	205	9
Inflation		
+0.25%	171	7
-0.25%	(160)	(7)
Life expectancy		
+0.25%	121	5
-0.25%	(122)	(5)

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

The discounted mean term of the defined benefit obligation at 31 March 2015 is 22 years. The expected contributions for the year ended 30 September 2015 are £50 million and expected benefit payments for the year ended 30 September 2015 are £81 million.

32. Other liabilities

	31 March 2015
	£m
Accruals and deferred income	118
Notes in circulation [1]	1,858
Other	122
	2,098

[1] £2.1 million of encumbered cash and balances with central banks (note 12) are ring fenced for the purpose of note cover in respect of notes in circulation and notes with potential to enter circulation.

33. Called up share capital

Allotted, called up and fully paid	**31 March 2015**
	£m
Ordinary shares of £1 each	
Opening ordinary share capital	1,882
Issued during the period	350
Closing ordinary share capital	**2,232**
Preference shares of £1 each	
Opening preference share capital	—
Redeemed during the year	—
Closing preference share capital	**—**
Closing called up and fully paid share capital	**2,232**

In accordance with the Articles of Association ("**Articles**") of the Company, with the non-objection of the Prudential Regulation Authority, obtained the consent of NAB Group (the "**Holder**") to redeem 100,000,000 non-cumulative preference shares of £1 issued on 17 December 2008. The preference shares were redeemed on 19 December 2013.

On 27 March 2014 300,000,000 ordinary shares of £1 were issued. A further 350,000,000 ordinary shares of £1 were issued on 29 December 2014. All ordinary shares issued in the period were at par and fully paid up.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Company. All shares in issue at 31 March 2015 rank equally with regard to the Company's residual assets.

There is also one non-voting income share of £1 in issue.

34. Total equity

	31 March 2015
	£m
Share capital (note 33)	2,232
Share premium account	—
	2,232
Other equity instruments	450
Capital redemption reserve	—
Share option reserve	3
Asset revaluation reserve	1
Available for sale investments reserve	15
Cash flow hedge reserve	(19)
Total other reserves	—
Retained earnings	492
Total parent entity interest	**3,174**
Non-controlling interest	—
Total equity	**3,174**

Other equity instruments

Other equity instruments represent Additional Tier 1("AT1") notes. On 20 December 2013, perpetual capital notes were issued with a principal amount of £300 million to NAB Group. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as Additional Tier 1 instruments under CRD IV. A further £150 million Perpetual Capital Notes were issued to NAB Group on 29 December 2014.

Share option reserve

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

Asset revaluation reserve

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

Available for sale investments reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale ("AFS") investments.

Cash flow hedge reserve

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

As at 31 March 2015 the cash flow hedge reserve comprises the remaining crystallised fair value gains arising from the de-designated cash flow hedge in 2013 (£6 million) offset by deferred losses on interest rate swaps in ongoing cash flow hedges (£29 million). The balance on the cash flow hedge reserve is net of tax.

£9 million was recycled into the income statement in relation to the de-designated hedge in the period. £2 million was transferred to the income statement due to ineffectiveness arising from cash flow hedges (note 7).

35. **Contingent liabilities and commitments**

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

	31 March
	2015
	£m
Contingent Liabilities	
Guarantees and assets pledged as collateral security:	
At call	—
Due in less than 3 months	23
Due between 3 months and 1 year	30
Due between 1 year and 3 years	7
Due between 3 years and 5 years	3
Due after 5 years	56
No specified maturity	7
	126
Other credit commitments	
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**8,052**

Capital commitments

The Group had future capital expenditure which had been contracted for but not provided for in the financial statements at 31 March 2015 of £1.0 million.

Operating lease commitments

	31 March
	2015
	£m
Leases as lessor	
Future minimum lease payments under non-cancellable operating leases are:	
within 1 year	2
between 1 year and 5 years	7
over 5 years	2
	11
Leases as lessee	
Future minimum lease payments under non-cancellable operating leases are:	
within 1 year	30
between 1 year and 5 years	96
over 5 years	129
	255

Other contingent liabilities

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme (“FSCS”) provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be largely repaid from the realisation of the assets of the institutions. During the year ended 30 September 2014, the

FSCS also invoiced institutions for the second of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings which remains after the three annual levies have been paid is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2015 and an accrual of £7 million is held for the Group's calculated liability to that date. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 29 reflecting the Group's current position in relation to redress for the PPI and interest rate hedging products. The final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

Legal claims

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

36. Notes to the statements of cash flows

	Six months ended 31 March	
	2015	2014
	£m	
Non-cash or non-operating items included in profit/(loss) before tax		
Interest receivable	(554)	(566)
Interest payable	164	181
Depreciation and amortisation (note 8)	40	38
Loss on revaluation of land and buildings	—	—
Transfer from available for sale reserve	—	—
Profit on sale of tangible fixed assets [(1)]	—	—
Transfer from cash flow hedge reserve	—	(1)
Loss on sale of AFS investments	—	—
Derivative financial instruments fair value movements	(6)	(2)
Impairment losses on credit exposures (note 18)	28	50
Impairment losses on goodwill (note 8)	—	—
Impairment losses on software (note 8)	—	—
Adjustment to carrying value of investments	—	—
Movement in share option reserve	1	3
	(327)	**(297)**
Changes in operating assets		
Net (increase)/decrease in:		
Balances with supervisory central banks	—	1
Due from other banks	(214)	164
Derivative financial instruments	(90)	44
Financial assets at fair value through profit or loss	235	313
Loans and advances to customers	(894)	(703)
Due from customers on acceptances	—	(2)
Other assets	(61)	(2)
Assets held for sale	—	—
	(1,024)	**(185)**
Changes in operating liabilities		
Net increase/(decrease) in:		
Due to other banks	119	770
Derivative financial instruments	67	(111)
Financial liabilities at fair value through profit or loss	(12)	(13)
Due to customers	1,232	(898)
Liabilities on acceptances	—	2
Provisions (note 29)	(196)	64
Defined benefit pension obligations	(48)	(80)
Other liabilities	75	(35)
Liabilities associated with assets held for sale	—	—
	1,237	**(301)**

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

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

	Six months ended 31 March	
	2015	**2014**
	£m	
Cash and balances with central banks (note 12)	7,042	6,714
Other assets	118	173
Due to other banks	(24)	(27)
Due to related entities	(28)	(148)
Other liabilities	(36)	(102)
	7,072	**6,610**

37. **Equity based compensation**

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

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

Short term incentive ("STI")

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

Recognition and retention shares

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

Commencement shares

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

UK Share Incentive Plan

The UK Share Incentive Plan is a tax qualifying share plan. Employees are entitled to purchase up to £1,800 worth of NAB Group shares each year through the Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on the market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,600 of free shares may be awarded by the employer to employees per annum.

General employee shares

Up to a target value of AUD1,000 of NAB Group shares are offered to each eligible employee when the NAB Group's performance is on target, measured against a scorecard of objectives for the financial year end. These shares are held in trust, restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Long-term Incentives

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

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

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

Each performance right is exchanged for one fully paid ordinary share in NAB Group Limited upon exercise, subject to standard adjustments for capital actions. No exercise price is payable by the holder on exercise of performance rights.

Historically, performance options were granted in addition to performance rights. No performance options were exercised during the period. There are no performance options outstanding at 31 March 2015.

	31 March 2015
Performance rights	
Outstanding at beginning of period	259,093
Granted during the period	136,812
Forfeited and lapsed during the period	—
Exercised during the period	—
Outstanding at end of period	**395,905**
Exercisable at end of period	—

No performance rights were exercised during the period. For performance rights outstanding at 31 March 2015, the weighted average remaining contractual life is 3.97 years. No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

No performance options were granted during the periods ended 31 March 2015. 136,812 performance rights were granted during the period ended 31 March 2015. Included within personnel expenses (note

8) is a fair value of goods or services to the value of £3.9 million, which was measured indirectly by reference to the fair value on the performance rights granted during the period.

38. **Fair value of financial instruments**

(a) *Fair value of financial instruments carried at amortised cost*

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

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

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

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

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

	31 March 2015				
			Fair Value measurement using:		
	Carrying value	***Fair value***	***Quoted market prices***	***Valuation techniques (observable inputs)***	***Valuation techniques (significant non-observable inputs)***
			(Level 1)	*(Level 2)*	*(Level 3)*
			£m		
Financial assets					
Loans and advances to customers	26,763	26,963	—	1,169	25,794
Financial liabilities					
Due to customers	25,251	25,163	—	25,163	—
Due to related entities	1,792	1,827	—	1,827	—
Bonds and notes	4,096	4,220	—	4,220	—

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

(a) *Loans and advances to customers* – The fair value of loans and advances is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity and incorporating behavioural adjustments where appropriate.

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

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

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

(b) *Fair value measurements recognised on the balance sheet*

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

	Fair value measurement as at 31 March 2015			
	Quoted market prices	**Valuation techniques (observable inputs)**	**Valuation techniques (significant non-observable inputs)**	
	(Level 1)	**(Level 2)**	**(Level 3)**	**Total**
		£m		
Financial assets				
Derivative financial assets.............................	—	385	—	385
Investments – available for sale – listed........	1,190	—	—	1,190
Investments – available for sale – unlisted....	—	—	7	7
Other financial assets at fair value	—	—	1,347	1,347
Total financial assets measured at fair value	**1,190**	**385**	**1,354**	**2,929**
Financial liabilities				
Derivative financial liabilities	—	620	—	620
Other financial liabilities at fair value	—	—	79	79
Total financial liabilities measured at fair value..	**—**	**620**	**79**	**699**

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

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

(b) *Other financial assets and liabilities at fair value* – Fair values are based on quoted market prices and data or valuation techniques based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument. Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 16).

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

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

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

	Six months ended 31 March 2015		
	Investments – available for sale	Other financial assets at fair value	Other financial liabilities at fair value
		£m	
Level 3 movements analysis			
Balance at the beginning of the period	7	1,583	91
Total gains/(losses)			
In profit or loss [1]	—	14	—
Settlements	—	(250)	(12)
Balance at the end of the period	**7**	**1,347**	**79**

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

There were no transfers out of Level 3 in the six months ended 31 March 2015.

Settlements for the period ended 31 March 2015 include a realised loss of £11 million relating to financial assets that are measured at fair value at the end of each reporting period. Such fair value gains or losses are included in non-interest income (note 7).

Quantitative information about significant unobservable inputs in Level 3 valuations

The tables below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs.

31 March 2015	Fair value	Valuation technique	Unobservable inputs	Low range	High range
	£m				
Financial assets					
Investments – available for sale					
Unlisted	7	Underlying/ net asset value	Price	Nil	£7m [1]
Other financial assets at fair value	1,347	Discounted cash-flow	Portfolio lifetime probability of default	5.0%	11.7%

[1] These shares are illiquid and fair value is the best estimate of the high range, which is equivalent to the recoverable amount of our share of the underlying assets.

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

The Group has £79 million of financial liabilities at fair value classed as Level 3 which represent a portfolio of term deposits that are directly linked to the customer loans, which are also held at fair value and classed as Level 3. Their relationship to the fair value assets is such that should the liability be settled, the amount payable would be net of the fair value asset.

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

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

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

The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected payment profile of the loans. If the loans were to be repaid six months earlier than currently predicted the loan carrying value would decline by £4 million. If lifetime expected losses were 20 per cent. greater than predicted, the carrying value of the loans would decrease by £12 million and vice versa. There are inter-dependencies between a number of the key assumptions which add to the complexity of the judgements the Group has to make which mean that no single factor is likely to move independent of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged.

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

39. Financial risk management

Strategy in using financial instruments

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

Fair value hedges

The Group hedges part of its existing interest rate and foreign currency risk, resulting from potential movements in the fair value of fixed rate assets and liabilities, attributable to both interest rate and foreign currency risk using interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 16. There were no transactions for which fair value hedge accounting had to be discontinued in the period.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate and foreign currency risk arising from variable interest rate assets and liabilities using cross currency and interest rate swaps. There were no transactions for which cash flow hedge accounting had to be discontinued in the period as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives entered into is also disclosed in note 16.

Credit risk

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

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

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

Derivatives

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

Master netting agreements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if a counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis.

Credit-related commitments

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

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

Forbearance

Identification and classification

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

A concession refers to either of the following actions:

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

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

For the year ended 30 September 2014, the Group implemented revised forbearance policies and definitions in order to align the reporting of forbearance with the guidance established by the European Banking Authority ("EBA") for FINREP reporting. The revised policies and definitions include an extension to the minimum period after which loans can exit forborne status (to two years), resulting in a number of loans which would have previously been deemed to have exited forbearance being brought into scope for disclosure. The Group recognises that forbearance alone is not necessarily an indicator of impaired status but is a trigger for the review of the customer's credit profile. The Group grants forbearance when it believes that there is a realistic prospect of the customer continuing to be able to repay all facilities in full. If there is any concern over future cash flows and the Group incurring a loss, then forborne loans will also be classified as impaired in accordance with the Group's impairment policy.

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

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

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

Exit from forbearance

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

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

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

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

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

Retail forbearance

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

Forbearance is exercised on retail customers in a number of different ways and is specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action. The Group has implemented appropriate policies and procedures to ensure consistent application of forbearance. The operation, maintenance and governance surrounding these policies are regularly reviewed to confirm they remain relevant, appropriate and, most importantly, of value to our retail customers who have been identified as requiring forbearance.

At an operational level, the majority of forbearance measures are granted by Mortgage Collections who seek to negotiate positive outcomes for customers who have fallen into arrears. Forbearance is also exercised from within a dedicated Financial Management and Customer Solutions Team ("**FMCST**"), part of whose remit is to assist retail customers in financial difficulty to manage their finances more effectively on a case by case basis. The support provided by FMCST is tailored specifically for individual customers and includes an income and expenditure assessment along with other relevant financial management support.

The Group classifies the forbearance measures offered to retail customers into the following categories:

Formal arrangements: A permanent change which could include capitalisation of arrears, or arrangement with the customer to repay arrears over a shorter period than capitalisation would involve;

Temporary arrangements: Short terms measures that allow a period of relief for customers in financial difficulty, these can include short-term payment holidays;

Interest only conversion: A permanent or temporary conversion to interest only repayments, allowing the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term;

Term extension: A permanent change to the loan term allowing the customer to make lower repayments whilst still repaying the outstanding balance in full, over a longer period;

Other: A segment of forbearance exposures which includes product switches;

Legal: Court mandated forbearance exposures;

Where the Group has made a demand for repayment, the customers' facilities have been withdrawn or where a debt repayment process has been initiated, the exposure is classified as forborne if the debt is subject to any of the forbearance concessions above.

Forbearance measures including formal arrangements and temporary arrangements, are exercised within Mortgage Collections, while other tools such as conversion to interest only payments, term extensions and other arrangements are part of the suite of forbearance available from FMCST.

Retail forbearance – Mortgage lending

The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. The Group reports retail forbearance at the exposure level. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

As at 31 March 2015[(1)(2)]	**Total loans and advances subject to forbearance measures**			**Impairment allowance on loans and advances subject to forbearance measures**	
	Number of loans	**Gross carrying amount**	**% of total portfolio**	**Impairment allowance**	**Coverage**
		£m	*%*	*£m*	*%*
Formal arrangements	2,104	177	0.90	3.4	1.93
Temporary arrangements	968	88	0.45	1.2	1.38
Interest only conversion	73	12	0.06	-	0.02
Term extension	105	10	0.05	-	0.06
Other	6	1	0.01	-	0.25
Legal	201	21	0.11	1.8	8.80
	3,457	**309**	**1.58**	**6.4**	**2.07**

(1) All forbearance is reported as at the balance sheet date.
(2) The revised exit criteria introduced as part of the EBA's FINREP reporting guidance and stated in the 'Exit from forbearance' section above has been applied retrospectively.

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to pro-actively track and facilitate pre-maturity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 31 March 2015, the Group had 145 customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £17 million.

A further forbearance reserve of £4 million is presently held within the overall collective provision.

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the period to 31 March 2015 there were 47 repossessions of which 12 were voluntary.

Retail forbearance – consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including money transmission accounts, unsecured loans and credit cards. Forbearance strategies implemented on consumer credit are of low financial significance in the context of the Group's overall lending operations. The Group reports consumer credit forbearance at the exposure level.

The Group has assessed the total loan balances subject to forbearance on other types of consumer credit to be £22 million at 31 March 2015, representing 1.88 per cent. of the total portfolio. Impairment provisions on forborne balances totalled £6 million at 31 March 2015, providing overall coverage of 27.27 per cent.

Non-retail forbearance

The Group reports non-retail forbearance at a customer level, with customers that have forbearance granted on one or more facilities recorded as a single customer, but at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Where a customer is part of a larger group, forbearance is exercised and reported across the group at the individual entity level. Forbearance is considered to exist where one or more of the following occurs, on a non-commercial basis, for reasons relating to the actual or apparent stress of a customer:

- *Term extension* – Extending of loan facility payment term or the term of an overdraft which is not fluctuating (e.g. where a term loan has matured and the balance passed to an overdraft which is then extended on a non-commercial basis, then forbearance is considered to exist).

- *Deferral of contracted capital repayments* – Includes capital repayment holiday, conversion to interest only for an extended period, or rescheduling, but still repaying within the remaining contracted term.

- *Reduction in the contracted interest rate* – Includes a reduction in the level of accrued interest or amendment to original fee structure.

- *Alternative forms of payment* – Including debt for equity, asset transfer and repayment made by taking possession of collateral;

- *Debt forgiveness* – Total or partial debt forgiveness by write-off of the debt.

- *Refinancing* – A complete or partial repayment of a loan with a new contract granted on or up to 3 months after the day when the original contract expires. In the case of partial repayment both the original and new loans shall be classified as forborne.

- *Covenant breach/reset* – Financial or non-financial covenant breach (whether waived or rights reserved) and financial covenant resets.

Where the Group has made a demand for repayment, where the customers facilities have been withdrawn or where a debt repayment process has been initiated this will be classified as forbearance if the debt is subject to any of the forbearance concessions above.

Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forborne.

The Group has identified a number of situations that in isolation are not considered to be forbearance:

- Facilities that have been temporarily extended pending review and no concession has been granted for reasons relating to the actual or apparent financial stress of a customer.
- A reduction in asset quality to a level where actual, or apparent, financial stress is not evident.
- Where changes are made to the terms of a borrower's interest structure or repayment arrangement on a commercial basis.
- Late provision of financial information, in the absence of other indicators of financial difficulty, is not in all cases considered a "non-commercial" breach of non-financial covenants.

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

As at 31 March 2015[(1)(2)(3)]	**Total loans and advances subject to forbearance measures**			**Impairment allowance on loans and advances subject to forbearance measures**	
	Number of loans	**Gross carrying amount**	**% of total portfolio**	**Impairment allowance**	**Coverage**
		£m	*%*	*£m*	*%*
Term extension	551	410	5.46	40.0	9.75
Deferral of contracted capital repayments	162	157	2.09	20.3	12.90
Reduction in contracted interest rate	22	21	0.29	3.1	14.51
Alternative forms of payment	5	18	0.24	8.0	44.36
Debt forgiveness	32	62	0.83	11.9	19.05
Refinancing	46	69	0.92	5.5	8.00
Covenant breach/waiver	94	292	3.88	19.1	6.55
	912	**1,029**	**13.71**	**107.9**	**10.48**

(1) All forbearance is reported at the balance sheet date.

(2) The revised 2 year exit criteria introduced as part of the EBA's FINREP reporting guidance and stated in the 'Exit from forbearance' section above in the note has been applied retrospectively.

(3) Where the Group has made a demand for repayment, where the customers' facilities have been withdrawn or a debt repayment process initiated this will be classified as forbearance if the debt is subject to any of the forbearance concessions above.

Included in other financial assets at fair value is a portfolio of loans which are included in the above table. The value of fair value loans subject to forbearance at 31 March 2015 is £174 million, representing 2.32 per cent. of the total non-retail portfolio. Impairment allowances on these amounts totalled £24 million, a coverage of 13.83 per cent.

Maximum exposure to credit risk

The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

	31 March
	2015
	£m
Cash and balances with central banks (note 12)	7,084
Due from related entities (note 13)	883
Due from other banks	227
Investments – available for sale (note 14)	1,197
Other financial assets at fair value (note 15)	1,347
Derivative financial assets (note 16)	385
Loans and advances to customers (note 17)	26,763
Due from customers on acceptances	5
Assets held for sale	-
	37,891
Contingent liabilities (note 35)	126
Other credit commitments (note 35)	8,052
Commitments relating to assets held for sale	-
Maximum credit risk exposure	**46,069**

Offsetting of financial assets and liabilities

The table below illustrates the amounts for financial instruments that have been offset on the balance sheet and also those amounts that are covered by enforceable netting arrangements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. Loans and advances).

The "net amounts" presented in the table are not intended to represent the Group's exposure to credit risk, as the Group will use a wide range of strategies to mitigate credit risk in addition to netting and collateral.

The offsetting and collateral arrangements and other credit risk mitigation strategies are further explained in the preceding sections of this note:

31 March 2015	Amounts subject to enforceable netting arrangements						Amounts not subject to enforceable netting arrangements
	Effect of offsetting on balance sheet			Related amounts not offset			
	Gross amount	Amount offset	Net amount reported on balance sheet	Financial instruments (1) (2) (3)	Cash collateral (2) (3)	Net amount	
				£m			
Assets							
Derivative financial instruments[4]	227	-	227	(227)	-	-	158
Securities purchased under agreement to resell [6]	103	-	103	(103)	-	-	-
Total assets	**330**	**-**	**330**	**(330)**	**-**	**-**	**158**
Liabilities							
Derivative financial instruments[4]	585	-	585	(227)	(299)	59	35
Securities sold under repurchase agreements[5]	722	-	722	(722)	-	-	-
Total liabilities	**1,307**	**-**	**1,307**	**(949)**	**(299)**	**59**	**35**

(1) Financial instruments include both recognised financial instruments and unrecognised financial instruments (i.e. non-cash collateral).
(2) Amounts relate to master netting and collateral agreements which have been determined to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.
(3) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order not to include any over-collateralisation.
(4) Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.
(5) Securities sold under repurchase agreements are reported on the Group's Balance Sheet within Due to other banks.
(6) Securities purchased under agreements to resell are reported on the Group's Balance Sheet within Due from other banks.

Derivative assets and liabilities

Derivative financial instrument contracts are typically subject to International Swaps and Derivatives Association ("**ISDA**") master netting agreements, as well as Credit Support Annexes ("**CSA**"), where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house. The amounts included in Financial Instruments column refers to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement.

Repurchase agreements

Repurchase agreements will typically be subject to Global Master Repurchase Agreements (GMRAs) or similar agreements whereby all outstanding transactions with the same counterparty can be offset and closed out upon a default or insolvency event (i.e. close out netting).

Where the Group has a right of offset on default or insolvency only, the related financial instruments comprise of highly liquid securities pledged, which can be realised in the event of a default or insolvency by the counterparty.

Credit quality of financial assets

An assessment of the credit quality of loans and advances to customers can be found in note 17 with an assessment of the credit quality of investments contained in note 14.

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to business rules and confidence levels. The loan to value ratio of our mortgage portfolio is disclosed in note 17.

Commercial property

Commercial property is the Group's main source of collateral on commercial lending and means of mitigating loss in the event of default credit risk inherent in its commercial portfolios. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

Non-property related collateral

Apart from Residential and Commercial Property based security, the Group also takes other forms of collateral when lending and this can involve obtaining security against the underlying loan through the use of cash collateral and/or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan through the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

Corporates is the largest sector for other risk mitigation techniques, with all three methods utilised dependent on credit quality. The extent to which these will be used will be dependent on the specific circumstances of the customer.

Risk concentration

Concentration of risk is managed by client/counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to limit exposure to a single entity/counterparty.

Eurozone risk

The Group has no material operations outside the UK and has no direct sovereign exposure to any Eurozone countries. The Group has an exposure to the European Investment Bank of £100 million at 31 March 2015.

Industry concentration of assets

The following tables show the levels of industry concentration of credit risk at the dates indicated:

Gross loans and advances to customers including loans designated at fair value through profit or loss and assets held for sale at 31 March 2015 [(1)]	**31 March**
	2015
	£m
Government and public authorities	36
Agriculture, forestry, fishing and mining	1,590
Financial, investment and insurance	445
Property – construction	351
Manufacturing	666
Instalment loans to individuals and other personal Lending (including credit cards)	1,652
Property – mortgage	19,642
Asset and lease financing	407
Other commercial and industrial	3,591
	28,380

[(1)] Includes balance due from customers on acceptances.

Contingent liabilities and credit related commitments	**31 March**
	2015
	£m
Government and public authorities	2
Agriculture, forestry, fishing and mining	999
Financial, investment and insurance	26
Property – construction	65
Manufacturing	179
Instalment loans to individuals and other personal Lending (including credit cards)	3,677
Property – mortgage	1,997
Other commercial and industrial	1,233
	8,178

Available for sale and held to maturity investments	**31 March**
	2015
	£m
Government and public authorities	1,190
Financial, investment and insurance.............................	7
	1,197

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Group's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

*Interest rate risk in the banking book ("**IRRBB**")*

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with NAB Group IRRBB policy. Risk measurement techniques include: VaR, EaR, interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- Historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a statistical basis: 99 per cent. confidence level; three month holding period.
- Economic capital is allocated for IRRBB based on a higher confidence interval and a longer holding period.
- EaR utilises a twelve month forecast period.
- Eight years of business day historical data.
- VaR methodology is based on proportional rather than absolute changes in historical interest rates.
- Investment term for capital is modelled with an established benchmark term of between one and five years.
- Investment term for core "non-interest" bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between one and five years.

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of the UK Asset & Liability Committee ("**UK ALCO**").

Interest rate risk	Value at risk	Earnings at risk
	31 Mar	31 Mar
	2015	2015
	£m	
As at 31 March	23	6
Average value during the period..................	24	5
Minimum value during the period	19	2
Maximum value during the period...............	29	8

Prepayment risk

Customers may prepay certain loans and advances ahead of the contractual repayment schedule. This form of optionality gives rise to prepayment risk for the Group whereby the expected timing of cashflows from loan repayments differs from the actual experience. The impact on the Group would differ according to changes in the level of interest rates.

The Group assesses the risks arising from prepayment behaviour in order to show the potential impact on future cashflows. The impact is also managed through terms and conditions within loans and advances.

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

31 March 2015	**Call**	**3 months or less**	**3 to 12 months**	**1 to 5 years**	**Over 5 years**	**No specified maturity**	**Total**
				£m			
Assets							
Cash and balances with central banks	5,768	-	-	-	-	1,316	7,084
Due from related entities	870	-	-	13	-	-	883
Due from other banks	124	103	-	-	-	-	227
Investments – available for sale	-	102	-	791	298	6	1,197
Other financial assets at fair value	1	17	72	894	363	-	1,347
Derivative financial assets	2	47	117	84	135	-	385
Loans and advances to customers	2,272	290	726	3,882	19,230	363	26,763
Due from customers on acceptances	-	5	-	-	-	-	5
All other assets	119	92	43	-	-	780	1,034
Total assets	**9,156**	**656**	**958**	**5,664**	**20,026**	**2,465**	**38,925**
Liabilities							
Due to other banks	-	632	400	-	-		1,032
Other financial liabilities at fair value	-	7	1	70	1	-	79
Derivative financial liabilities	2	86	50	233	249	-	620
Due to customers	19,417	1,778	1,911	2,145	-	-	25,251
Liabilities on acceptances	-	5	-	-	-	-	5
Due to related entities	140	16	338	823	475	-	1,792
Bonds and notes	-	709	465	2,196	726	-	4,096
All other liabilities	1,894	111	75	-	-	796	2,876
Total liabilities	**21,453**	**3,344**	**3,240**	**5,467**	**1,451**	**796**	**35,751**
Off balance sheet items							
Contingent liabilities	-	23	30	10	56	7	126
Other credit commitments	8,052	-	-	-	-	-	8,052
Total off balance sheet items	**8,052**	**23**	**30**	**10**	**56**	**7**	**8,178**

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

31 March 2015	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity	Total
				£m			
Due to other banks	-	632	400	-	-	-	**1,032**
Other financial liabilities at fair value	-	11	3	83	1	-	**98**
Derivative financial liabilities	2	52	40	80	282	-	**456**
Due to customers	19,417	1,798	1,937	2,177	-	-	**25,329**
Liabilities on acceptances	-	5	-	-	-	-	**5**
Bonds and notes	-	789	513	2,375	926	-	**4,603**
All other financial liabilities	1,858	-	-	-	-	-	**1,858**
Hedging derivatives							
Contractual amounts payable	-	367	524	835	8	-	**1,734**
Contractual amounts receivable	-	(324)	(481)	(695)	-	-	**(1,500)**
Total liabilities	**21,277**	**3,330**	**2,936**	**4,855**	**1,217**	**-**	**33,615**

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

40. **Capital management overview**

Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support its business strategy against losses, inherent risks and stress events. In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks.

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, in line with the EU Capital Requirements Directive (referred to as CRD IV) which implements Basel III in Europe. CRD IV legislation became effective from 1 January 2014. The Group is committed to maintaining a strong capital base and has complied with all capital requirements set by the regulators throughout the period.

The Group's capital position is summarised below. For the period to 31 March 2015 the table shows the capital position on a CRD IV "transitional" basis and includes grandfathered legacy Tier 2 instruments under the transitional rules implemented by the PRA.

Regulatory Capital	31 March
	CRD IV 2015
	£m
CET1 capital	
Capital instruments	2,232
Retained earnings and other reserves[(1)]	453
Share premium account	-
Structured entities reserves[(1)]	-
Prudent valuation adjustment[(2)]	(2)
Intangible assets[(3)]	(237)
Deferred tax asset ("**DTA**") relying on future profitability[(4)]	(210)
Defined benefit pension fund assets (net of deferred tax liabilities)[(5)]	(73)
Pension fund deficit adjustment[(6)]	-
	2,163
Tier 1 capital	
Additional Tier 1 capital instruments	450
Perpetual non-cumulative preference shares	-
Hybrid Tier 1 capital	-
	450
Total Tier 1 capital	2,613
Tier 2 capital	
Subordinated loans[(7)]	475
Credit risk adjustments[(8)]	128
Revaluation reserve[(9)]	-
Excess Tier 2 capital[(10)]	(5)
Qualifying and material holding Tier 2 deductions[(11)]	-
Total Tier 2 capital	598
Total capital	3,211
Capital ratios	
CET 1 ratio[(12)]	11.9. per cent
Tier 1 ratio[(13)]	14.4. per cent
Total capital ratio[(14)]	17.6. per cent

(1) Under Capital Requirements Regulation ("**CRR**") the cash flow hedge, available for sale and asset revaluation reserves now form part of regulatory capital resources. Structured entities reserves' are excluded for regulatory capital purposes.

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

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

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

(5) Under CRD IV, defined benefit pension fund assets shall be deducted from CET1 capital (net of deferred tax liability).

(6) For regulatory capital purposes under Basel II, the pension fund deficit is added back to regulatory capital and substituted with an estimate of additional pension fund contributions to be made over the next five years, adjusted for deferred tax. CRD IV does not allow the pension fund deficit to be added back to regulatory capital.

(7) Subordinated loans reflect the principal outstanding and does not include accrued interest.

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

(9) Under CRD IV, the revaluation reserve is classified as CET1 capital.

(10) Under Basel II, lower tier 2 capital instruments were restricted to 50 per cent. of Total Tier 1.

(11) Material and qualifying holdings deducted under Basel II, are now risk weighted under CRD IV rules.

(12) CET1 capital is Tier 1 capital excluding perpetual non-cumulative preference shares and perpetual notes. CET1 ratio is defined as common equity tier 1 capital divided by risk-weighted assets at a given date.

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

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

The table below sets out the Group's risk weighted assets as at the dates indicated.

Risk-weighted assets[1]	31 March
	CRD IV
	2015
	£m
Retail mortgages	7,264
Business lending	7,387
Other retail lending	976
Other lending	719
Credit risk	**16,346**
Credit valuation adjustment	137
Operational risk	1,565
Counterparty risk	152
Market risk	
	18,200

(1) Risk weighted assets are calculated under the standardised approach.

41. **Events subsequent to the reporting date**

On 7 May 2015, NAB Group announced its intention to pursue a demerger and initial public offering of NAGE Limited and its subsidiaries. The target date for completion of the transaction is calendar year 2015. Whilst significant progress has been made, there is no certainty a transaction will occur and it remains subject to a range of matters including shareholder and regulatory approvals. The PRA has advised that in order to demerge NAGE Limited, NAB Group will be required to provide capital support to NAGE Limited against potential losses related to legacy conduct costs. On 7 May 2015, NAB Group confirmed its intention to provide this support as part of any transaction. The amount of this capital support has been capped at £1.7bn on the basis that the transaction occurs before 31 December 2015. The form and duration of the capital support remains subject to ongoing regulatory discussion.

On 28 May 2015, the Company reduced the nominal value of its Ordinary shares from £1.00 to £0.10 each.

On 19 June 2015, 1 Ordinary Share was issued by the Company to National Equities Limited for a Nominal Value of £0.10 and a Premium of £49,999,999.90. In addition, 50,000,000 Ordinary Shares were issued by Clydesdale Bank PLC to the Company at a Price of £1 Per Share.

Annual report & consolidated financial statements

National Australia Group Europe Limited

For the year ended 30 September 2014

Company Number: 2108635

National Australia Group Europe Limited

Annual report and consolidated financial statements

For the year ended 30 September 2014

Contents

Overview

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

Forward looking statements

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

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

National Australia Group Europe Limited

Officers and professional advisers

Directors	Chairman	James Pettigrew
	Non-executive	David Allvey * # David Browne * # Richard Gregory OBE, Senior Independent Director * # ~ Barbara Ridpath # ~ Teresa Robson-Capps (appointed 8 October 2014) Alexander Shapland # ~
	Executive	David Thorburn, Chief Executive Officer Debbie Crosbie Richard Sawers (National Australia Bank)
UK Executive Committee		David Thorburn, Chief Executive Officer Debbie Crosbie, Executive Director Ian Smith, Chief Financial Officer (appointed 1 November 2014) David Gillespie, Distribution Director ^ Eric Gunn, Chief Risk Officer James Peirson, General Counsel ^ Lynn McManus, People & Communications Director Helen Page, Customer Experience & Marketing Director Kevin Page, Strategy & Transformation Director Paul Shephard, Business & Private Bank Director John Shovelin, Operations & IT Director
Company Secretary		Lorna McMillan
Registered Office		88 Wood Street London, EC2V 7QQ
Auditor		Ernst & Young LLP 1 More London Place London, SE1 2AF

* Member of the Boards' Audit Committee
# Member of the Boards' Risk Committee
~ Member of the Boards' Governance and Nomination Committee
^ Appointment subject to Regulatory approval

The Directors of the Company with its subsidiary undertakings (which together comprise "the Group") present their Strategic Report for the year ended 30 September 2014.

The Strategic Report is a statutory requirement under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, replacing the previous Business Review, and is intended to be fair and balanced, and to provide information that enables the Directors to be satisfied that they have complied with s172 of the Companies Act 2006 (which sets out the Directors' duty to promote the success of the company).

Our business model

The Group operates a full service UK-focused retail and commercial banking business under the brand names "Clydesdale Bank" and "Yorkshire Bank", in Scotland, the North of England and selected other sites. The Group delivers these services through a network of 298 retail branches, 42 Business & Private Banking centres (including 23 sites co-located with retail branches), direct and online banking. The Group employs 7,224 staff. The Group is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").

Operating environment

The UK economy continues to show signs of improvement, having experienced seven consecutive quarters of output growth. The economy expanded by 0.7% in the September quarter and by 0.9% in the three months to June. The Q3 2014 GDP figures were enhanced by expansion in the service, production and construction industries. While the slowdown in the pace of growth has raised concerns that the economic recovery will stall as a result of the issues facing the Eurozone, the UK is still forecast to be the fastest growing advanced economy in 2014. The UK unemployment rate as at September 2014 was 6%, its lowest level since late 2008, with 1.96m people unemployed at that point, a reduction of 115,000 from the previous quarter.

The inflation rate (as measured by annualised growth in the Consumer Prices Index) reduced to 1.2% in September 2014, its lowest level for five years, and is below the Bank of England target of 2.0%. The Bank of England Bank Rate has remained at 0.5% since March 2009, and the spread between Bank Rate and 3 month LIBOR has remained relatively narrow throughout the year.

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

- The PRA, in partnership with the FCA, issued two consultation papers in July 2014, covering a range of factors associated with the regulatory framework and remuneration. This included a new "Senior Managers Regime" to replace the current Approved Persons regime, a set of "Conduct Rules" to replace the existing Codes of Practice, and new remuneration rules to strengthen the alignment between risk and reward. Implementation of these rules is anticipated during 2015 and the Group is assessing the impacts.
- The Payment Accounts Directive ("Directive"). This Directive was published in the Official Journal on 28 August 2014. The Bank has two years to implement the requirements which encompass measures on transparency of fees and charges, access to basic bank accounts across the EU and arrangements to facilitate the provision of information to customers and transfer of balances if they wish to switch accounts between EU member states.
- The Mortgage Credit Directive ("Directive"). The Directive was published in the Official Journal on 28 February 2014. The FCA issued a consultation paper on 25 September 2014 which outlined the key changes that will be required to be made regarding the mortgage sales process as well as documentation to be made available to customers. The UK is required to implement these rules by March 2016 and the Group is assessing their impact.

Operating environment (continued)

- Under the Financial Services (Banking Reform) Act 2013 ("FSBRA 2013"), the FCA has been tasked with setting up a new UK payment systems regulator. This change is as the result of Government concerns around UK payment systems. The regulator's work is expected to cover issues such as access to the payments systems, the terms offered for access and the industry's pace of innovation. The Treasury published a consultation on 14 October 2014 which set out which payment systems it intends to be regulated by the new rules, with a final decision to be confirmed in time for designation to be effective from April 2015.
- In October 2014, the PRA issued a consultation paper on the implementation of ring fencing of retail banks in the UK. The Government has stated that its intention is for ring-fencing to be implemented from 1 January 2019. The PRA is expected to undertake further consultation during 2015, and publish its rules and supervisory statements during 2016. Clydesdale Bank PLC is expected to qualify as a ring-fenced bank under the criteria of the FSBRA 2013 and the Group is considering potential impacts.
- The European Union implemented Basel III through the Capital Requirements Directive IV ("CRD IV") package published in June 2013. The PRA published its final rules on the UK implementation of CRD IV during December 2013 in Policy Statement 7/13. These introduced a wide range of measures commencing on 1 January 2014. The Group currently complies with the inforce measures and is working with the regulator to ensure it continues to meet capital requirements throughout the progressive implementation of these rules.
- The PRA issued a consultation paper in August 2014 to implement the Financial Policy Committee's ("FPC") recommendation on loan-to-income ("LTI") and affordability stress requirements. The proposals ensure that mortgage lenders limit the number of mortgage loans made at or greater than four and a half times LTI, to no more than 15% of their total number of new mortgage loans. The Group already conformed to this requirement. The PRA's final rules came into force on 1 October 2014.
- The Basel Committee have issued proposals for consultation on the Net Stable Funding Ratio ("NSFR") with a final standard due by the end of 2014. The NSFR aims to reduce reliance on short term funding by ensuring that banks hold a sufficient amount of stable funding to match the maturity characteristics of their different business activities. It is anticipated that the NSFR will become a minimum standard with all banks required to maintain an indicative NSFR of greater than 100% by 1 January 2018. The Group will continue to monitor its NSFR in light of this development.

Our goal and strategic priorities

The Group's goal is to be a strong, customer-focused bank for the communities it serves.

To achieve this, we are pursuing four strategic priorities:

1. Putting the customer at the heart of our business

The customer is rightly at the heart of everything we do as an organisation.

During the course of the year, we have made improvements in the experience that we offer to our customers. This has involved a range of initiatives including a mortgage transformation programme which has delivered a 20% reduction in the end-to-end mortgage processing timeframe, and a personal current account opening review which has reduced the time spent opening an account by 40%. Our new Service proposition announced in June 2014 provides customers with a named contact with the aim of driving an improved service experience. Progress has also been made towards resolving a number of legacy conduct issues during the year.

A major part of responding to changing customer needs has centred on the reshaping of our Retail Branch network. In March 2014, we announced a programme which resulted in the closure of 28 unsustainable branches and the relocation of three branches to improved locations. Six flagship branches will be launched in heartland locations with access to new in-house facilities, services and technology. This investment, combined with the expansion of mobile banking and improvements to internet banking and text alerts, will allow us to offer the choice and flexibility which both existing customers and prospective customers demand.

Our goal and strategic priorities (continued)

We have continued to build on our "We Care About Here" branding, through regular advertising and an improved digital presence, reflecting our belief that we can and do make a positive difference in the communities we operate in.

2. Embedding strong management of risk and controls

We have strengthened our overall risk and control framework in recent years, and will continue to do so, to ensure that material risks which we face are appropriately managed.

Central to this work has been the embedding of an effective conduct risk management framework across all activities. The Customer Trust and Confidence function was established during the year to ensure clear accountability and dedicated focus on fair outcomes for customers.

Further information about the Group's approach to management of risk can be found in note 40.

3. Building sustainable returns

While the economic, regulatory and legacy conduct environment remains challenging, we aim to deliver appropriate returns for our shareholder, through controlled and efficient growth of our Retail and Business & Private Banking franchises within agreed risk appetite settings.

In executing this strategy, we have continued to focus on providing support to Retail and SME customers. Strong asset growth in mortgage lending nationally, the continued management of the lower yielding assets and the benefits of actions taken in the year to reduce funding costs have delivered net interest margin improvements and had a positive impact on returns. The risk profile of our portfolio has also been reduced during the year with improvements seen across all key asset quality metrics.

4. Employee engagement and enablement

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

The recent SUSU results were pleasing and provide a good indicator of where improvements can be made to strengthen our employee proposition. 87% of employees responded to the voluntary survey. Whilst the measure of engagement changed in 2014, a like for like comparison using the previous measure showed an overall improvement. In particular, employee advocacy, pride and motivation to go beyond what is expected had all improved. Furthermore, our staff are now more aware of how their role contributes to the Group's strategy, which is something we have worked hard on since the previous survey. The results also indicated a very strong customer focus and a similar risk and compliance culture across our staff. We will continue to work proactively on the insights that are derived from SUSU to ensure we understand and act on areas where improvements can be made.

Our goal and strategic priorities (continued)

The following table highlights our progress to date (as at 30 September 2014) in relation to the key performance indicators ("KPI") that we have identified to measure progress against our strategic goals:

Priority	*Strategic goal*	*KPI*	*Comments*
The Customer	"We Care About Here" is how we put customers at the heart of our business. We listen to customers to learn how to become a better bank, act in a way that shows we are all accountable to them, and design every product and service to meet their expectations.	Net promoter score	The Group launched its new Service proposition offering customers a single named contact, supported by ongoing investment in our brand and advertising. We also announced the reshaping of our Retail branch network, including new concept branches, refurbishments and relocations to improved sites. These investments, combined with improvements to our mobile and internet banking services, are designed to enhance the overall customer experience.
Risk & Control Framework	Embed a strong risk culture in our staff that consistently delivers the right customer outcomes and take informed risk and reward decisions that maintain the financial strength of the Group while protecting our customers, staff, assets and earnings.	Adherence to risk appetite settings	The Group continues to operate within its credit risk tolerance while the number of operational risk loss events has reduced in the year. Other than in respect to legacy conduct issues, we are within operational risk tolerance in all other measures.
Sustainable Returns	Maintain capital, liquidity and funding ratios within risk appetite while returning the UK business to sustainable profit and return on equity measures. Through the execution of detailed strategic initiatives, targets for capital, funding, liquidity and cash earnings will be achieved and deliver sustainable and satisfactory returns to shareholders.	Capital, liquidity, and funding ratios, together with a sustainable profit and return on equity	Financial performance measures continue to be affected by legacy conduct issues but underlying measures continue to show improvements (see pages 6, 7, and 11 to 16).
People	Provide a compelling employee proposition that motivates, equips and rewards staff and encourages appropriate behaviours; demonstrated through increased employee satisfaction and our ability to develop and attract talent.	Employee engagement survey scores	Recruiting, retaining and developing people is one of the Bank's key strategic priorities. There was a significant increase in employee engagement and enablement scores in the 2014 SUSU survey. We have also designed a dedicated People Programme that will deliver positive change over the next two years, ranging from changes to our reward and remuneration schemes to a brand new Intranet site.

Financial analysis

The Group made a loss after tax of £190m compared to a loss after tax of £44m for the year to September 2013.

The impact of dealing with legacy conduct matters continues to have an impact on statutory results, with £433m of additional provisions raised in the year (2013: £180m). An impairment charge of £23m for capitalised software assets was also incurred in the year. Underlying performance has improved significantly, with a £131m increase in profit before tax. The key driver in this has been a material reduction in impairment losses on credit exposures reflecting improving economic conditions. This was supported by an improvement in net interest margin.

The Group's Common Equity Tier 1 ("CET1") capital ratio decreased to 9.4% (from 10.7% at 30 September 2013), with the key drivers being the impact of additional capital requirements as a result of CRD IV introduction in January 2014 and the financial loss incurred in the year. These impacts were partially offset by an increase in ordinary share capital.

The Group has actively managed its customer deposits during the year to achieve an efficient customer balance sheet position. The Customer Funding Index ("CFI") reduced from 90.2% in September 2013 to 86.2% at September 2014 and the Stable Funding Index ("SFI") reduced from 108.5% to 102.5% in the same period.

The Group delivered on its strategy to grow the retail mortgage portfolio with the business achieving mortgage growth of 9.6% over the prior year compared to system growth of 1.1% * while maintaining the quality of our underwriting standards.

Summarised Income Statement	2014 £m	2013 £m As restated[(2)]	2014 vs 2013 %
Net interest income	772	756	2.1%
Non-interest income	197	190	3.7%
Total operating income	969	946	2.4%
Total operating and administrative expenses	(1,129)	(851)	(32.6%)
Operating (loss)/profit before impairment losses	(160)	95	Large
Impairment losses on credit exposures [(1)]	(74)	(144)	48.7%
Loss on ordinary activities before tax	(234)	(49)	Large
Analysed as:			
Profit before tax, Payment Protection Insurance redress expense, impairment of intangible assets, FSCS levy and bank levy	223	92	
Payment Protection Insurance redress expense	(420)	(130)	
Impairment of intangible assets	(23)	-	
FSCS levy and bank levy	(14)	(11)	
Loss on ordinary activities before tax	(234)	(49)	
Tax credit	44	5	
Loss for the year	(190)	(44)	

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

(2) The comparative period 30 September 2013 has been restated to incorporate the IAS 19 pension changes disclosed in note 1 to the financial statements and to reclassify the charge for PPI from non-interest income to operating expenses.

* Source: Bank of England – September 2014.

Financial analysis (continued)

Key measures

	2014	2013	2014 vs 2013
Net interest margin	2.26%	2.14%	12bp
Cost to income ratio [(2)]	116.5%	90.0%	(265)bp
CET1 ratio	9.4%	10.7%	(130)bp
Gross loans and acceptances [(3) (4)] (£bn)	26.9	27.1	(0.8)%
Interest earning assets [(3)] (£bn)	34.1	35.3	(3.4)%
Total assets [(3)] (£bn)	36.9	38.0	(3.0)%
Customer deposits [(3) (5)] (£bn)	23.4	24.7	(5.0)%

New key measures for 2014

	2014
Return on assets	(0.5)%
Leverage ratio	5.2
Liquidity coverage ratio ("LCR") [(6) (8)]	109.6%
Net Stable Funding Ratio ("NSFR") [(7) (8)]	107.8%

(3) Average volumes.

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

(5) Customer deposits include current accounts, savings accounts, term deposits and business deposits.

(6) In January 2013, the Basel Committee on Banking Supervision ("BCBS") published its final guidance for calculating the LCR. Following adoption by the EU, this is currently expected to come into effect from October 2015 on a phased basis until 1 January 2018. The Group monitors the LCR based on its own interpretations of current guidance available for CRD IV LCR reporting. Therefore, the reported LCR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

(7) In October 2014, the BCBS published its final guidance for calculating the NSFR. Following adoption by the EU, this will be subject to an observation period before coming into effect from 1 January 2018. The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

(8) Reported at the Defined Liquidity Group level.

September 2014 v September 2013

Net interest income increased by £16m (2.1%). The key driver in this increase was higher mortgage lending income and lower term deposit costs. This was partially offset by lower business lending income as a result of portfolio attrition.

Average gross loans and acceptances, which incorporate loans accounted for at fair value, decreased by £0.2bn (0.8%) to £26.9bn. Business lending balances reduced by £1.7bn or 16.7%, driven by the subdued demand for credit, risk appetite settings and the impact of business restructuring. Mortgage growth of £1.5bn or 9.6%, was higher than system growth of 1.1%* in the period and largely offset the decline in business lending balances.

Average customer deposits decreased by £1.3bn or 5.0%. This reflected the managed rebalancing of the retail deposit book, with a reduction in higher cost term deposits partially offset by growth in current and savings accounts.

* Source: Bank of England – September 2014.

Financial analysis (continued)

The net interest margin increased by 12bps to 2.26% (2013: 2.14%). This was driven by an improved retail deposit mix and a reduction in low yielding liquid assets, partially offset by lower lending margins and a decline in the earnings rate on non-interest bearing deposits and capital.

Non-interest income increased by £7m (3.7%). The key drivers in this increase were favourable movements in fair value and in hedging ineffectiveness. This was partially offset by lower fees and commissions as a result of our strategy to reduce account fees to improve customer outcomes, competitive positioning and the impacts of subdued business credit growth.

Operating and administrative expenses increased by £278m (32.6%) over the prior year. Costs related to legacy conduct related matters continue to have an impact on expenses, with £433m (2013: £180m) of additional provisions charged in the year. An impairment charge of £23m for capitalised software assets was also incurred in the year. Excluding these impacts, underlying operating and administrative expenses were broadly flat in the year. Personnel costs were lower due to a reduction in average FTEs following business restructuring, with occupancy costs lower following property rationalisation. This was partially offset by an increase in marketing costs to support customer acquisition and an increase in project related investment activity.

Impairment losses on credit exposures decreased by £70m (48.7%) over the prior year. This was primarily driven by a reduction in business lending losses as a result of asset quality improvements aligned to a more stable UK economy. Mortgage losses remained stable despite continued growth in the portfolio.

Investment spend

The Group continues to maintain its investment in the business with expenditure focused on regulatory and compliance, efficiency and simplification, and revenue generation activities.

Significant progress has been made during the year including adding payments functionality to our mobile application. The Group has also delivered mandatory reporting capabilities for Foreign Account Tax Compliance Act (FATCA) and European Banking Authority Harmonisation Rules. The second half of the year saw the implementation of our new mortgage processing platform and a refresh of the desktop and laptop estate as part of the Employee Enablement programme. This period also saw the launch of projects to implement the Bank's digital strategy and further enhance our customer proposition.

Asset quality

Provisions on credit exposures (£m)	2014	2013
Specific provision for doubtful debts	110	134
Collective provision for doubtful debts	135	155

Credit risk adjustments on loans at fair value (£m)	2014	2013
Individually assessed credit risk adjustments on loans at fair value	30	23
Collectively assessed credit risk adjustments on loans at fair value	44	54

Past due and impaired assets (£m)	2014	2013
90+ Days Past Due ("DPD") assets (1)	182	157
Gross impaired assets (2)	375	426

Asset quality measures (%)	2014	2013
90+ DPD plus gross impaired assets to gross loans and acceptances (2)	2.01%	2.20%
Specific provision to gross impaired assets (2)	37.5%	36.7%
Net write-offs to gross loans and acceptances	0.43%	0.57%
Total provision as a percentage of net write-offs (3)	279%	239%
Total provision to gross loans and acceptances (3)	1.15%	1.38%
Impairment losses on credit exposures to credit risk-weighted assets	0.45%	0.80%

Impairment provisions on credit exposures (£m)	2014	2013
Business lending (including lease finance)	186	221
Retail lending	59	68
	245	289

Impairment losses on credit exposures	2014 £m	2013 £m
Business lending (including lease finance)	45	102
Retail lending	29	42
	74	144
Of which:		
Specific	95	163
Collective	(21)	(19)
	74	144

(1) September 2014 balance includes UK mortgage defaulted customers not previously disclosed as past due, where the contractual repayment date has passed but customers continue to pay interest due, where an agreed arrangement is in place or where the customer is deceased, totalling £39m. The September 2014 disclosure reflects changes in Group and Regulatory practices. Prior year comparatives have not been restated. For information, the comparative year 90+ DPD balance at September 2013 would have been £222m.

(2) Gross impaired assets for September 2014 and September 2013 include £56m and £63m gross impaired fair value assets respectively.

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

Asset quality (continued)

The UK economy is showing steady signs of improvement, having experienced seven consecutive quarters of output growth.

Retail asset quality continues to improve with lower default rates observed across all unsecured lending. Housing lending impaired loan levels have remained subdued against a growing portfolio due to the prolonged period of low interest rates and recovery in residential property prices. The 90+ DPD levels for housing lending shows a steady reduction with continued improvements in the unsecured portfolios through the 12 months to 30 September 2014.

While the non-retail portfolio remains sensitive to economic conditions, the recent improvement in the environment, combined with management actions, has had a positive impact on asset quality metrics. However, despite the growth in market confidence and the decline in gross impaired assets to £375m as at September 2014, the level of non-retail impaired assets at £311m (2013: £350m) remains elevated when compared with historical norms.

The overall collective provision for doubtful debts continues to decrease, reflecting the reduction in the business lending portfolio and stabilisation in non-retail asset quality. The personal lending collective provision also continues to reduce, driven by the improved delinquency profile of these portfolios.

The ratio of total provisions to gross loans and acceptances decreased by 23 basis points to 1.15% at 30 September 2014. The movement in the ratio reflects the lower risk profile of the book, with a reduced business lending portfolio and growth in the mortgage portfolio which has a lower provisioning requirement.

Capital position

The Group's CET1 ratio decreased from 10.7% in September 2013 to 9.4% in September 2014. The Group issued an additional £300m of ordinary shares in March 2014. Further capital benefits from balance sheet optimisation resulted in a reduction in credit risk weighted assets. While these impacts resulted in a strengthening of the CET1 ratio, they have been offset by additional capital requirements arising from the introduction of CRD IV rules in January 2014, coupled with the financial loss incurred in the year. Despite the reduction in the CET1 ratio, the Group continues to be fully compliant with the PRA's regulatory capital requirements.

The Group's capital position at 30 September 2014 is summarised on page 11. This table shows the capital position on a CRD IV "transitional" basis and includes grandfathered legacy Tier 2 instruments under the transitional rules implemented by the PRA.

Capital position (continued)

Regulatory capital

CET1 capital	CRD IV 2014 £m	Basel II 2013 £m
Capital instruments	1,882	1,582
Retained earnings and other reserves (1)	346	535
Structured entities reserves (1)	(4)	-
Prudent valuation adjustment (2)	(2)	(3)
Intangible assets (3)	(213)	(215)
Deferred tax asset ("DTA") relying on future profitability (4)	(223)	-
Defined benefit pension fund assets (net of deferred tax liabilities) (5)	(39)	-
Pension fund deficit adjustment (6)	-	2
	1,747	1,901
Tier 1 capital		
Additional Tier 1 capital instruments	300	-
Perpetual non-cumulative preference shares (7)	-	100
Hybrid Tier 1 capital (8)	-	200
	300	300
Total Tier 1 capital	2,047	2,201
Tier 2 capital		
Subordinated loans (9)	1,125	1,125
Credit risk adjustments (10)	135	155
Revaluation reserve (11)	-	2
Excess Tier 2 capital (12)	-	(24)
Qualifying and material holding Tier 2 deductions (13)	-	(3)
	1,260	1,255
Total capital	3,307	3,456

(1) Under Capital Requirements Regulation ("CRR") the cash flow hedge and asset revaluation reserves now form part of regulatory capital resources. Structured entities reserves are also excluded for regulatory capital purposes.

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

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

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

(5) Under CRD IV, defined benefit pension fund assets shall be deducted from CET1 capital (net of deferred tax liability).

(6) For regulatory capital purposes under Basel II, the pension fund deficit is added back to regulatory capital and substituted with an estimate of additional pension fund contributions to be made over the next five years, adjusted for deferred tax. CRD IV does not allow the pension fund deficit to be added back to regulatory capital.

(7) During the year, perpetual non-cumulative preference shares were redeemed and replaced with CET1 ordinary shares.

(8) During the year Hybrid tier 1 capital instruments were redeemed and replaced with CET1 ordinary shares.

(9) Subordinated loans reflect the principal outstanding and does not include accrued interest.

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

(11) Under CRD IV, the revaluation reserve is classified as CET1 capital.

(12) Under Basel II, lower tier 2 capital instruments were restricted to 50% of Total Tier 1.

(13) Material and qualifying holdings deducted under Basel II, are now risk weighted under CRD IV rules.

Capital position (continued)

Risk-weighted assets [1]	2014 £m	2013 £m
Retail mortgages	6,917	6,319
Business lending	7,961	9,694
Other retail lending	1,030	1,071
Other lending	855	878
Credit risk	16,763	17,962
Credit valuation adjustment	137	-
Operational risk	1,564	1,684
Counterparty risk	181	170
Market risk	-	1
	18,645	19,817

Capital ratios		
CET1 ratio [2]	9.4%	10.7%
Tier 1 ratio	11.0%	11.1%
Total capital ratio	17.7%	17.5%

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

[2] CET1 capital is Tier 1 capital excluding perpetual non-cumulative preference shares and perpetual notes.

Regulatory capital to statutory total equity reconciliation	2014 £m	2013 £m
Regulatory Tier 1 capital	2,047	2,201
Reverse pension regulatory adjustments	39	(2)
Reverse deductions from capital	215	218
Share option reserve	2	2
Asset revaluation reserve	-	2
Available for sale reserve	8	5
Cash flow hedge reserve	-	23
SPV reserves	4	-
DTA relying on future profitability	223	-
Statutory total equity	2,538	2,449

Minimum Pillar 1 capital requirements	2014 £m	2013 £m
Credit risk	1,341	1,437
Operational risk	125	135
Counterparty risk	14	14
Credit valuation adjustment	11	-
Tier 1 Regulatory Capital	1,491	1,586

Capital position (continued)

Regulatory capital flow of funds	CRD IV 2014 £m	Basel II 2013 £m
CET1 capital		
CET1 capital at 1 October	1,901	2,050
Share capital: ordinary share new issuance	300	-
Share premium	-	(893)
Retained earnings and other reserves (including structured entities)	(193)	833
Prudent valuation adjustment	1	(1)
Intangible assets	2	(17)
DTA relying on future profitability	(223)	-
Defined benefit pension fund assets	(39)	-
Pension fund deficit adjustment	(2)	(71)
	1,747	1,901
Tier 1 capital		
Tier 1 capital at 1 October	300	300
Share capital redeemed: perpetual non-cumulative preference shares	(100)	-
Share capital redeemed: Hybrid Tier 1 capital	(200)	-
Capital instruments issued: Additional Tier 1 capital perpetual note	300	-
	300	300
Total Tier 1 capital	2,047	2,201
Tier 2 capital		
Tier 2 capital at 1 October	1,255	1,454
Credit risk adjustments	(20)	(175)
Revaluation reserve	(2)	1
Excess Tier 2 Capital	24	(24)
Qualifying and material holding Tier 2 deductions	3	(1)
	1,260	1,255
Total capital	3,307	3,456

Risk-weighted assets flow statement	£m
Risk-weighted assets at 1 October 2013	19,817
Book size	(382)
Book quality	(399)
Methodology and policy	(391)
Other	-
Risk-weighted assets at 30 September 2014	18,645

Methodology and policy includes the implementation of the new CRR rules which came into effect on 1 January 2014. Additionally, in the period a new reporting platform was implemented for the calculation of Credit Risk-Weighted Assets.

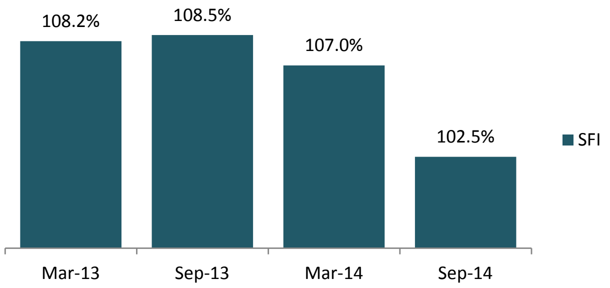
Capital position (continued)

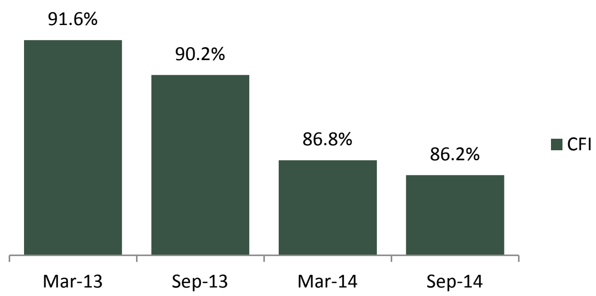
Capital requirements for calculating RWAs	30 September 2014 Capital required £m	RWA £m	Exposure £m
Central Governments or Central Banks	-	-	5,105
Regional Governments or Local Authorities	2	22	112
Public Sector Entities	-	3	3
Multilateral development banks	-	-	50
Institutions	18	224	1,006
Corporates			
Term lending – Business	134	1,676	1,715
Other lending	110	1,373	1,419
Overdrafts	25	315	363
Lease	26	328	355
	295	3,692	3,852
Retail			
Term lending - Retail	46	577	769
Credit cards	21	263	355
Other unsecured including overdrafts	12	154	213
	79	994	1,337
Secured by mortgages on residential property			
Mortgages	541	6,761	18,872
Term lending - Business	64	795	1,345
	605	7,556	20,217
Secured by mortgages on commercial real estate			
Term lending – Business	189	2,356	2,585
Overdrafts	51	640	723
	240	2,996	3,308
Exposures in Default	49	611	493
Claims on Institutions and Corporates with a Short-Term Credit Assessment	-	3	15
Claims in the form of CIU	-	3	3
Equity Exposures	1	12	8
Other	52	647	1,991
	1,341	16,763	37,500
Operational risk	125	1,564	
Counterparty risk	14	181	
Credit valuation adjustment	11	137	
	1,491	18,645	

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

Funding and liquidity

Stable funding and customer funding indices





The Group's customer deposits have been managed lower during the year to achieve an efficient customer balance sheet position. The Customer Funding Index (CFI) reduced from 90.2% in September 2013 to 86.2% at September 2014 and the Stable Funding Index (SFI) reduced from 108.5% to 102.5% in the same period.

The Group has continued to raise term funding through its Covered Bond and Securitisation programmes, with c.£600m raised in March 2014. It remains diversified in terms of the type of instrument and product, currency, counterparty, term structure and markets, available through such programmes.

In May 2014, Standard and Poors changed the outlook of Clydesdale Bank PLC from negative to stable, and on 9 August 2014 it affirmed its BBB+/A-2 credit rating. On 21 October 2014, Moody's affirmed the Clydesdale Bank PLC rating at Baa2/P-2, while maintaining a stable outlook.

Clydesdale Bank PLC's long-term credit ratings are summarised below:

	Outlook as at 17 November 2014	2014	2013
Fitch	Stable	A	A
Moody's	Stable	Baa2	Baa2
Standard & Poor's	Stable	BBB+	BBB+

Liquid reserve	2014 £m	2013 £m
Cash and balances with central banks	5,986	6,720
Encumbered cash balances	(2,133)	(2,161)
	3,853	4,559
Investments – available for sale	1,168	975
Encumbered AFS investments	(878)	(268)
	290	707
Total unencumbered liquid assets	4,143	5,266

In addition to the above, as at 30 September 2014, the Group had £3.6bn (2013: £3.2bn) of gross eligible collateral pre-positioned with the Bank of England for potential use in its liquidity facilities.

Funding and liquidity (continued)

	At 30 September 2014		
	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,133	3,853	5,986
Investments – available for sale	878	290	1,168
Loans and advances to customers	6,770	19,131	25,901
	9,781	23,274	33,055

Encumbered cash and balances with central banks	
Note cover	2,088
Cash ratio deposit	42
Dutch central bank – EU payment system collateral	3
	2,133
Encumbered investments - available for sale	
Payment system collateral [1]	232
Repurchase ("repo") transaction collateral [1]	646
	878
Encumbered loans and advances to customers	
Structured Programme collateral – Lanark Master Trust	3,211
Structured Programme collateral – Regulated Covered Bond	2,007
Structured Programme collateral – Lannraig Master Trust	1,552
	6,770

(1) Market value of securities posted as collateral.

Liquid assets	2014 £bn	2013 £bn
UK Government Treasury Bills and Gilts	1.1	0.9
Cash and cash at central bank	3.9	4.6
Note cover [1]	2.0	2.1
Interbank lending	0.1	0.3
Liquid assets	7.1	7.9

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

The Group has reduced its holding of highly liquid assets during the year due to reduced reliance on short-term wholesale funding.

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

Customers, employees and community

The Group continues to support its customers and the communities it serves.

The Yorkshire and Clydesdale Bank Foundation provides financial support to a large number of charities across the UK. In the last 12 months the Foundation has distributed over £812,000 to over 320 worthy causes. The second year of the annual Spirit in the Community Awards saw £150,000 being donated to 24 charities in June 2014. The charity relationship with Help the Hospices is now in its seventh year and over £3.7m has been raised in this time, including matching donations from the Group. In addition, 20% of employees currently donate to their chosen charities through Payroll Giving and the Group's Employee Volunteering Policy offers all employees the opportunity to take two days paid leave to work in the local community.

During the year, the Group won a "Moneynet Personal Finance" award for "Best New Current Account" following the launch of its Current Account Direct product. The Group also won a "National Payroll Giving Excellence" award for having the most successful sustained scheme by a large employer.

Business model challenges and top emerging risks

The primary areas of risk to the Group's business model are outlined below. Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the Group's risk appetite statement ("RAS") process. The position against the various RAS settings is monitored and reported to the Group's various management and Board governance committees as set out in note 40 to the financial statements.

- *Credit risk*: this is the risk of financial loss if a customer or counterparty fails to meet their contractual payments. This risk applies to both customer facing segments of the business (Retail and Business & Private Bank) as well as our treasury operations and is continually assessed as the Group's business and key initiatives evolve. Bank lending activities account for most of the Group's credit risk, with a strategic focus on managing the acceptance of a range of potential credit risk exposures. Further detail on the Group's approach to the management of credit risk is included in note 39 to the financial statements.
- *Conduct risk*: this is the risk that the Group's behaviours (culture, governance, systems and controls) lead to inappropriate outcomes for customers, exposing the Group to customer redress costs and the potential for regulatory action. The Group, in common with the rest of the financial services industry, has faced a number of conduct risk challenges in relation to a range of industry wide issues including PPI and Interest Rate Hedging Products. The Group continues to review these challenges in light of on-going customer and regulatory feedback and action. The Group continues to address legacy conduct related matters and is also reviewing new product designs, sales practices and remuneration policies to ensure the potential for future conduct related issues is mitigated. Further detail on the Group's approach and exposures to conduct risk related matters can be found in notes 3, 27, 33 and 40 to the financial statements.
- *Operational risk (excluding conduct risk):* this is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The Group regards operational risks as a core component of doing business as they arise from day-to-day operational activities as well as from organisational changes such as projects and business change initiatives. The Group has focused on improving these areas over recent years with an emphasis on control effectiveness and improvements in the control environment (processes), enhancing skills and appropriate resource allocation (people) and improvements in system resilience and availability. Service interruption and financial crime are two important constituent parts of operational risk. The Group recognises the impact that any service interruption issues may cause to our customers, as well as potential losses or reputational damage resulting from financial crime events. As such, the Group continues to assess and manage its current technical systems landscape and to develop contingency plans to manage and mitigate these risks.
- *Pension risk*: the Group is the sponsoring employer in one defined benefit pension scheme ("the Scheme") and is exposed to the risk that, at any point in time, the Scheme is in deficit (i.e. the Scheme's liabilities outweigh its assets). The Scheme's asset values and liabilities are affected by a number of factors including, but not limited to, the discount rate used to calculate the liability net present value, the long-term inflation assumption and other actuarial assumptions (including mortality rates). The Group has implemented a number of reforms in order to de-risk, as far as possible, the ultimate defined benefit pension obligation and liaises with the Scheme's independent Trustees and actuaries on a regular basis to assess the current liability estimate. Nevertheless, the Scheme exposes the Group to substantial future

Business model challenges and top emerging risks (continued)

liabilities and is a significant absorber of capital. Further detail on the Scheme (including the actuarial assumptions) is included in note 29 to the financial statements.

- *Financial management risk*: this falls into 3 broad categories:
  - *Capital risk:* this is the risk that the Group does not hold sufficient capital and reserves to meet regulatory requirements, achieve its strategic plans and objectives, or to cover the risks to which it is already exposed and to protect against unexpected losses. Changes in regulation have the potential to change the required level of capital that the Group is required to hold which may adversely impact the Group's financial performance and position.
  - *Funding and liquidity risk:* these are the risks that the Group is unable to raise short and long-term funding to support its strategic plans and objectives and is unable to meet its financial obligations as they fall due. The Group continues to monitor its stable and customer funding indices, holds significant levels of highly liquid assets and maintains the ability to access term funding through its Securitisation and Covered Bond programmes.
  - *Interest rate risk:* this is the risk to the Group's financial performance and position caused by changes in interest rates. As interest rates and yield curves change over time, the Group may be exposed to a loss in earnings and economic value due to the interest rate profile of its balance sheet. The Group actively monitors and manages interest rate risk principally through the use of interest rate swaps.

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

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

- *The UK and European economy:* while the UK economic recovery is currently gaining momentum it remains fragile and vulnerable to events and trends in Europe. The Group's future plans are linked to the UK economy achieving a current and prolonged period of economic growth and ultimately, in the medium term, to a resumption of more normalised interest rate conditions.
- *The potential for reconstitution of political arrangements for the UK*: the Group faces risks associated with the possible referendum on the UK withdrawing from the EU and implications of the 2015 General Election. The outcome of these events could have a material impact on the regulatory, fiscal and monetary regimes in the UK and in Europe. The potential effect of any change is uncertain but could have a significant impact on the Group's costs, capital requirements and future business.
- *The changing financial industry landscape:* the Group is subject to extensive regulation and changes to this may adversely impact the Group's financial performance and position. Regulations are designed to protect the interests of depositors and the banking and financial services system as a whole. Future changes in laws, regulations and other industry wide initiatives are unpredictable and beyond the Group's control and could adversely affect its business and operations. These changes are influenced by a number of different and competing drivers including evolving stakeholder expectations regarding transparency, competition, financial system stability and international harmonisation.
- *Competition:* there is substantial competition in the UK banking market. Increased competition for customers can have the effect of compressing profit margins, changing terms and conditions, increasing advertising and related expenses to attract and retain customers, increasing customer turnover, decreasing customer loyalty or driving loss of market share. As technology and customer attitudes are rapidly evolving, particularly in the digital arena, this increases the risk of competition including from new business entrants and the cost of doing business.

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

The Strategic Report was approved by the Board of Directors on 17 November 2014 and was signed on its behalf by:

David Thorburn.

David Thorburn
Chief Executive Officer

National Australia Group Europe Limited
Enhanced risk disclosure

In October 2012, the Enhanced Disclosures Task Force ("EDTF"), an industry-led initiative, reported to the Financial Stability Board on how the risk disclosures of banks could be improved to provide a greater level of transparency as well as improving comparability between banks. Their report included seven fundamental principles and 32 recommendations. The recommendations cover the following broad headings:

- general (recommendations 1 to 4);
- risk governance and risk management strategies/business model (recommendations 5 to 8);
- capital adequacy and risk-weighted assets (recommendations 9 to 17);
- liquidity and funding (recommendations 18 to 21);
- market risk (recommendations 22 to 25);
- credit risk (recommendations 26 to 30); and
- other risks (recommendations 31 to 32).

The EDTF noted that the fundamental principles are applicable to all banks but noted: "We have developed the recommendations for enhanced risk disclosures with large international banks in mind although they should be equally applicable to banks that actively access the major public equity or debt markets. We believe that many of the recommendations may be adopted in 2012 or 2013. However, some recommendations… will take longer to develop and implement… We would expect smaller banks and the subsidiaries of listed banks will adopt only those aspects of the recommendations that are relevant to them." In June 2013 the Financial Policy Committee (FPC) made a recommendation that all major UK banks and building societies should comply with the recommendations on a 'comply or explain' basis, under Section 9Q(3) of the Bank of England Act 1998 (as amended by the Financial Services Act 2012).

The Group agrees with and supports the primary objectives of the EDTF and is committed to ensuring compliance with the EDTF's principles and recommendations where possible against the backdrop of the Group's ownership, its position within the UK market and the globally systemic reach of the EDTF's objectives and aims, noting the more recent pronouncement of the FPC.

The Group already provides risk disclosures in accordance with International Financial Reporting Standards which can be found in notes 39, 40 and 41 to the financial statements, with the appropriate cross references made between these notes and the relevant EDTF recommendation as necessary to avoid duplicating information.

In its full year Pillar 3 Report for the year ended 30 September 2013, our ultimate Parent, National Australia Bank Limited, described the Group's principal subsidiary, Clydesdale Bank PLC, as its subsidiary in the United Kingdom, who is regulated by the Prudential Regulation Authority (PRA) and had been accredited to apply the standardised approach to operational and credit risk management in accordance with the regulatory requirements. As described in note 42 to the financial statements, the Group relies on references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations.

Accordingly, in assessing the EDTF's recommendations, the Group has taken all of these factors into consideration and applied a measured and proportionate approach with the recommended disclosures. We have applied those recommendations we believe are of more direct relevance to our stated position as a wholly owned subsidiary applying a standardised approach to operational and credit risk management. The additional disclosures included are designed to increase the reader's understanding of our financial position and risk governance and management.

The table and disclosures from pages 137 to 141 provide a brief description of the EDTF recommendations with the accompanying narrative cross referring to other disclosures provided in the financial statements (where relevant) and/or the additional detail (both quantitative and qualitative where necessary) we believe satisfy the EDTF requirements.

The Directors of the Company with its subsidiary undertakings (which together comprise “the Group") submit their report and consolidated financial statements for the year ended 30 September 2014.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2014 amounted to £234m (2013: loss of £49m). The loss attributable to the shareholders for the year ended 30 September 2014 amounted to £198m (2013: loss of £44m). No dividends were paid on the ordinary shares during the year ended 30 September 2014 (2013: £Nil). The Directors do not recommend the payment of a final dividend in respect of this financial year (2013: £Nil). Preference share dividends of £Nil (2013: £Nil) were paid during the year.

The Group's strategic highlights and business developments are set out in the Strategic Report on pages 2 to 18.

Financial instruments

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

Directors and Directors' interests

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

Directors' interests

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

Appointments

Debbie Crosbie was appointed as a Director of the Company on 12 May 2014.
Teresa Robson-Capps was appointed as a Director of the Company on 8 October 2014.

Resignations

Mark Joiner resigned as a Director of the Company on 31 December 2013.
Cameron Clyne resigned as a Director of the Company on 1 August 2014.
John Hooper resigned as a Director of the Company on 31 October 2014.
Jennifer Darbyshire resigned as Company Secretary on 1 October 2014.

Directors' liabilities

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

Employee involvement

The Group regularly communicates with staff to keep them informed of business objectives and results using methods including the intranet site and all employee telephone calls with the Executive Committee.

Employee involvement (continued)

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

During the year, under the UK National Share Incentive Plan, NAB gifted ordinary shares of A$900 in total to each eligible employee based on Group performance in respect of the 2013 financial year. A similar offer of A$1,000 for the 2014 financial year has been announced and is based on Group performance.

Equality of employment opportunities

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

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

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

Political donations

No political donations were made during the year (2013: £Nil).

Corporate governance

The Group confirms that its principal subsidiary, Clydesdale Bank PLC complies with the Prudential Regulation Authority's Senior Management Arrangements, Systems and Controls sourcebook ("SYSC") 4.3A.11R requiring a firm that maintains a website to explain on the website how it complies with certain requirements of SYSC relating to governance. Statements of compliance are included in the Corporate Governance section of the Group's website at www.cbonline.co.uk/corporategovernance and www.ybonline.co.uk/corporategovernance.

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

Management of risk

The Group has a well-established Boards' Risk Committee for the consideration of risks. The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals. The NAB Group publishes an annual and half-yearly "Risk and Capital Report" which provides extensive and rigorous coverage of all aspects of risk considered relevant including the position in the UK. Further disclosure on the Group's risk management structure in the UK is included in note 40.

Going concern

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

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

Events after the balance sheet date

There have been no subsequent events which have occurred since 30 September 2014 that would require disclosure in the annual report and financial statements of National Australia Group Europe Limited.

Auditors

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

Directors' statement as to disclosure of information to the auditor

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

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

By order of the Board

Lorna McMillan
Company Secretary
17 November 2014

National Australia Group Europe Limited
Statement of Directors' responsibilities

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

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

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

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

Lorna McMillan
Company Secretary
17 November 2014

Building a better
working world

Independent auditor's report to the members of National Australia Group Europe Limited

We have audited the financial statements of National Australia Group Europe Limited for the year ended 30 September 2014 which comprise the Consolidated Income Statement, the Group and Company Statements of Comprehensive Income, the Group and Company Balance Sheets, the Group and Company Statements of Changes in Equity, the Group and Company Statements of Cash Flow and the related notes 1 to 43. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 23, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group and Company's affairs as at 30 September 2014 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Ernst & Young LLP

Javier Faiz (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
17 November 2014

National Australia Group Europe Limited
Consolidated financial statements
Contents

National Australia Group Europe Limited
Consolidated income statement
for the year ended 30 September 2014

	Note	2014 £m	2013 £m As restated
Interest income and similar income		1,135	1,209
Interest expense and similar charges		(363)	(453)
Net interest income	5	772	756
Gains less losses on financial instruments at fair value		11	(14)
Other operating income		186	204
Non-interest income	6	197	190
Total operating income		969	946
Personnel expenses		(287)	(302)
Depreciation expense		(78)	(75)
Other operating and administrative expenses		(764)	(474)
Total operating and administrative expenses before impairment losses	7	(1,129)	(851)
Operating (loss)/profit before impairment losses		(160)	95
Impairment losses on credit exposures	16	(74)	(144)
Loss on ordinary activities before tax		(234)	(49)
Analysed as:			
Profit before tax, Payment Protection Insurance redress expense, impairment of intangible assets, FSCS levy and bank levy		223	92
Payment Protection Insurance redress expense	27	(420)	(130)
FSCS levy and bank levy		(14)	(11)
Loss on impairment of intangible assets	22	(23)	-
Loss on ordinary activities before tax		(234)	(49)
Tax credit	8	44	5
Loss for the year		(190)	(44)
Attributable to			
Equity holders of the parent		(198)	(44)
Non-controlling interest		8	-
		(190)	(44)

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

The notes on pages 33 to 136 form an integral part of these financial statements.

National Australia Group Europe Limited
Statements of comprehensive income
for the year ended 30 September 2014

	Notes	Group 2014 £m	Group 2013 £m As restated	Company 2014 £m	Company 2013 £m
Loss for the year		(190)	(44)	(386)	(89)
Items that may be reclassified to the income statement					
Change in cash flow hedge reserve					
Gains/(losses) during the year		1	(81)	-	-
Transfers to the income statement		(50)	(51)	-	-
Tax thereon		10	31	-	-
		(39)	(101)		-
Change in available for sale investments reserve					
Gains/(losses) during the year		4	(13)	-	-
Taxation thereon		(1)	6	-	-
		3	(7)	-	-
Total items that may be reclassified to the income statement		(36)	(108)	-	-
Items that will not be reclassified to the income statement					
Actuarial gains on defined benefit pension plans	29	24	21	-	-
Restatement in respect of rate change/tax thereon		(2)	(37)	-	-
		22	(16)	-	-
Change in asset revaluation reserve					
Restatement in respect of rate change/tax thereon		1	1	-	-
		1	1	-	-
Total items that will not be reclassified to the income statement		23	(15)	-	-
Other comprehensive losses, net of tax		(13)	(123)	-	-
Total comprehensive losses for the year		(203)	(167)	(386)	(89)
Attributable to:					
Equity holders of the parent		(211)	(167)	(386)	(89)
Non-controlling interest		8	-	-	-
		(203)	(167)	(386)	(89)

The notes on pages 33 to 136 form an integral part of these financial statements.

National Australia Group Europe Limited

Balance sheets

as at 30 September 2014

	Note	Group 2014 £m	Group 2013 £m As restated	Company 2014 £m	Company 2013 £m
Assets					
Cash and balances with central banks	10	**5,986**	6,720	**15**	5
Due from related entities	11	**1,487**	1,390	**776**	769
Due from other banks		**13**	184	-	-
Investments – available for sale	12	**1,168**	975	-	-
Other financial assets at fair value	13	**1,583**	2,171	-	-
Derivative financial instruments	14	**220**	244	-	-
Loans and advances to customers	15	**25,901**	23,960	-	-
Due from customers on acceptances		**5**	4	-	-
Current tax assets		-	3	-	6
Property, plant and equipment	18	**121**	133	-	-
Investment properties	19	**44**	63	-	-
Property inventory	20	**2**	6	-	-
Investments in controlled entities and associates	21	**2**	3	**2,577**	2,654
Intangible assets	22	**213**	215	-	-
Deferred tax assets	23	**349**	273	-	-
Defined benefit pension assets	29	**49**	-	-	-
Other assets	24	**249**	404	-	-
Total assets		**37,392**	36,748	**3,368**	3,434
Liabilities					
Due to other banks	25	**914**	521	-	-
Other financial liabilities at fair value	13	**91**	123	-	-
Derivative financial instruments	14	**548**	651	-	-
Due to customers	26	**24,073**	24,355	-	-
Liabilities on acceptances		**5**	4	-	-
Current tax liabilities		**32**	-	**1**	-
Provisions	27	**952**	315	-	-
Due to related entities	11	**2,677**	3,036	**1,082**	1,263
Bonds and notes	28	**3,453**	3,085	-	-
Retirement benefit obligations	29	**4**	202	-	-
Deferred tax liabilities	23	**10**	7	-	-
Other liabilities	30	**2,095**	2,000	-	-
Total liabilities		**34,854**	34,299	**1,083**	1,263
Equity					
Share capital	31, 32	**1,882**	1,682	**1,882**	1,682
Other equity instruments	32	**300**	-	**300**	-
Other reserves	32	**96**	32	**100**	-
Retained earnings	32	**260**	535	**3**	489
Total parent entity interest		**2,538**	2,249	**2,285**	2,171
Non-controlling interest	32	-	200	-	-
Total equity		**2,538**	2,449	**2,285**	2,171
Total liabilities and equity		**37,392**	36,748	**3,368**	3,434

The notes on pages 33 to 136 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 17 November 2014 and were signed on its behalf by:

David Thorburn.

David Thorburn
Chief Executive Officer

Company number: 2108635

National Australia Group Europe Limited
Statements of changes in equity
for the year ended 30 September 2014

Group

	Note	Share capital £m	Share premium account £m	Capital redemption reserve £m	Other equity instruments £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m As restated	Total parent entity interest £m	Non-controlling interest £m	Total equity £m As restated
As at 1 October 2012		1,682	893	-	-	5	1	12	124	(298)	2,419	200	2,619
Loss for the year		-	-	-	-	-	-	-	-	(44)	(44)	-	(44)
Other comprehensive losses, net of tax		-	-	-	-	-	1	(7)	(101)	(16)	(123)	-	(123)
Total comprehensive losses for the year		-	-	-	-	-	1	(7)	(101)	(60)	(167)	-	(167)
Share premium cancellation		-	(893)	-	-	-	-	-	-	893	-	-	-
Share options expensed		-	-	-	-	3	-	-	-	-	3	-	3
Share options settled		-	-	-	-	(6)	-	-	-	-	(6)	-	(6)
As at 30 September 2013	31, 32	1,682	-	-	-	2	2	5	23	535	2,249	200	2,449
(Loss)/profit for the year		-	-	-	-	-	-	-	-	(198)	(198)	8	(190)
Other comprehensive losses, net of tax		-	-	-	-	-	-	3	(39)	23	(13)	-	(13)
Total comprehensive losses for the year		-	-	-	-	-	-	3	(39)	(175)	(211)	8	(203)
Distribution		-	-	-	-	-	-	-	-		-	(8)	(8)
Capital redemption		-	-	-	-	-	-	-	-	-	-	(200)	(200)
Capital note issued		-	-	-	300	-	-	-	-	-	300	-	300
Shares redeemed		(100)	-	-	-	-	-	-	-	-	(100)	-	(100)
Shares issued		300	-	-	-	-	-	-	-	-	300	-	300
Share options expensed		-	-	-	-	6	-	-	-	-	6	-	6
Transfer to capital redemption reserve		-	-	100	-	-	-	-	-	(100)	-	-	-
Share options settled		-	-	-	-	(6)	-	-	-	-	(6)	-	(6)
As at 30 September 2014	31, 32	1,882	-	100	300	2	2	8	(16)	260	2,538	-	2,538

The notes on pages 33 to 136 form an integral part of these financial statements.

National Australia Group Europe Limited
Statements of changes in equity (continued)
for the year ended 30 September 2014

Company

	Note	Share capital £m	Share premium account £m	Capital redemption reserve £m	Other equity instruments £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total parent entity interest £m
As at 1 October 2012		1,682	893	-	-	-	-	-	-	(315)	2,260
Loss for the year		-	-	-	-	-	-	-	-	(89)	(89)
Other comprehensive income, net of tax		-	-	-	-	-	-	-	-	-	-
Total comprehensive losses for the year		-	-	-	-	-	-	-	-	(89)	(89)
Share premium cancellation		-	(893)	-	-	-	-	-	-	893	-
As at 30 September 2013	31, 32	1,682	-	-	-	-	-	-	-	489	2,171
Loss for the year		-	-	-	-	-	-	-	-	(386)	(386)
Other comprehensive losses, net of tax		-	-	-	-	-	-	-	-	-	-
Total comprehensive losses for the year		-	-	-	-	-	-	-	-	(386)	(386)
Capital note issued		-	-	-	300	-	-	-	-	-	300
Shares redeemed		(100)	-	-	-	-	-	-	-	-	(100)
Shares issued – ordinary		300	-	-	-	-	-	-	-	-	300
Transfer to capital redemption reserve		-	-	100	-	-	-	-	-	(100)	-
As at 30 September 2014	31, 32	1,882	-	100	300	-	-	-	-	3	2,285

The notes on pages 33 to 136 form an integral part of these financial statements.

National Australia Group Europe Limited
Statements of cash flows
for the year ended 30 September 2014

	Note	Group 2014 £m	Group 2013 £m As restated	Company 2014 £m	Company 2013 £m
Operating activities					
Loss on ordinary activities before tax		(234)	(49)	(390)	(103)
Adjustments for:					
Non-cash or non-operating items included in loss before tax	34	(615)	(527)	368	88
Changes in operating assets	34	(1,177)	6,122	-	-
Changes in operating liabilities	34	562	(2,634)	-	-
Interest received		1,134	1,213	-	-
Interest paid		(257)	(317)	-	-
Tax received-group relief		18	30	11	17
Net cash (used in)/provided by operating activities		(569)	3,838	(11)	2
Cash flows from investing activities					
Dividends received		-	-	14	77
Interest received		8	8	-	-
Proceeds from sale or maturity of investments		50	50	-	-
Proceeds from sale of tangible fixed assets [(1)]		41	39		-
Purchase of tangible fixed assets [(1)]		(23)	(37)	-	-
Purchases of investments		(251)	(50)	-	-
Purchase of intangible assets		(75)	(69)	-	-
Investment in controlled entities		-	-	(300)	4,176
Net cash (used in)/provided by investing activities		(250)	(59)	(286)	4,253
Cash flows from financing activities					
Interest received		4	5	10	13
Interest paid		(131)	(131)	(16)	(54)
Proceeds from ordinary shares issued	31	300	-	300	-
Redemption of preference shares		(100)	-	(100)	-
Proceeds from other capital issued		300	-	300	-
Redemption of non-controlling interest		(200)	-	-	-
Redemption, principal repayment and other movements on residential mortgage backed securities and covered bonds	17	(216)	(613)	-	-
Issuance of residential mortgage backed securities and covered bonds	17	601	541	-	-
Net increase in amounts due from related entities		(91)	(125)	(6)	(21)
Net decrease in amounts due to related entities		(295)	(4,859)	(181)	(4,191)
Amounts paid to non-controlling interest		(8)	-	-	-
Net cash provided by/(used in) financing activities		164	(5,182)	307	(4,253)
Net (decrease)/increase in cash and cash equivalents		(655)	(1,403)	10	2
Cash and cash equivalents at the beginning of the year		6,550	7,953	5	3
Cash and cash equivalents at the end of the year	34	5,895	6,550	15	5

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

The notes on pages 33 to 136 form an integral part of these financial statements.

1. Basis of preparation

Reporting entity

The Company is incorporated in the UK and registered in England and Wales. The consolidated financial statements comprise the Company and its controlled entities (together the "Group"). The Group's principal controlled entities are listed in note 21.

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

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with IFRSs as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. As permitted by section 408 of the Companies Act 2006, no Income Statement is presented for the Company.

The consolidated financial statements of the Group for the year ended 30 September 2014 were authorised for issue by the Board of Directors on 17 November 2014.

Basis of measurement

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

Going concern

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

The Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

1. Basis of Preparation (continued)

Prior year restatement

Payment Protection Insurance ("PPI") redress

Consistent with its ultimate parent, the Group has reclassified costs related to PPI redress from Other operating income to Other operating and administrative expense within the consolidated income statement. This change has been applied retrospectively in these financial statements and the prior year comparative disclosures restated accordingly.

The impact on the Group's result for the year ended 30 September 2013 was an increase in other Operating income of £130m, with a corresponding increase in Other operating and administrative expense of £130m. In addition, note 6 'Non-interest income' and note 7 'Operating and administrative expenses' have been impacted by the restatement. There has been no impact on the Group's or Company's total assets, net assets or reserves as a result of the change.

Amendments to IAS 19 'Employee benefits

As detailed in note 2 'Accounting Policies', the Group has adopted amendments to IAS 19 '*Employee Benefits'* in the current financial year. This change has been applied retrospectively and comparatives restated accordingly.

In the comparative period to 30 September 2013, the personnel expenses line in the consolidated income statement has been increased by £21m (with a tax effect of £4m) with an offsetting adjustment to the actuarial gains/(losses) on defined benefit plans in the statement of comprehensive income. In addition, note 8 'Taxation', note 23 'Deferred tax', note 29 'Retirement benefit obligations' and note 34 'Notes to the statement of cash flows' have been impacted by the restatement. There has been no impact on the Group or Company's total assets, net assets or reserves at 30 September 2013 as a result of the change.

Accrued interest

Consistent with other UK banks and financial institutions, from 11 November 2014 the Group will submit financial reporting information ("FINREP") to the Prudential Regulatory Authority ("PRA") in a European Banking Authority ("EBA") prescribed format. The first reporting date is 30 September 2014. Where this does not require a change in accounting policy, the Group has chosen to conform the classification convention of items in the consolidated financial statements with the FINREP reporting format. This decision has been taken in order to assist comparability and minimise reconciliation differences between the financial statements and FINREP reporting.

The principal changes are the reclassification of certain interest receivable and payable amounts on the balance sheet from other assets and other liabilities into the relevant line items of the underlying financial instruments; and the treatment of forbearance (note 39). Derivative interest receivable and payable have also been grouped at a trade level in order to reflect the net amount due to or from the derivative counterparty.

Prior year comparative disclosures have been amended to conform the classification of interest receivable and payable amounts with current year presentation. This has resulted in a reduction of total assets and total liabilities in the Group's balance sheet at 30 September 2013 of £139m, with no impact on the Company's balance sheet. Accrued interest reclassified within prior period comparative disclosures is shown within the notes to the financial statements for loans and advances due to customers (note 15); due to customers (note 26) and bonds and notes (note 28). The impact on the Group's prior period comparative disclosures for other balance sheet lines impacted is detailed below.

Amounts due from and to related entities increased by £9m and £10m respectively; investments - available for sale increased by £2m; other financial assets and liabilities at fair value increased by £16m and £3m respectively; derivative financial assets increased by £4m; derivative financial liabilities decreased by £12m; and other assets and other liabilities decreased by £235m and £362m respectively. These changes have no impact on the Group's and the Company's statements of income and comprehensive income for current and prior years.

2. Accounting policies

Basis of consolidation

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

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

New accounting standards and interpretations adopted during the year

The Group has adopted the following IASB pronouncements in the current financial year:

- Amendments to IAS 19 *'Employee Benefits'*, issued June 2011 and effective for financial years beginning on or after 1 January 2013. The amended accounting standard requires the amounts recorded in profit or loss to be limited to current and past service costs, gains or losses, settlements and net interest income/(expense). All other changes in the net defined benefit asset/(liability) including actuarial gains and losses, will be recognised in other comprehensive income with no subsequent recycling into profit or loss. The expected return on plan assets is no longer recognised in profit or loss. Instead, interest income is now measured using the same discount rate used to measure the defined benefit obligation. This change has been applied retrospectively and comparatives restated accordingly. A summary of the restatement impact is included in note 1 'Basis of Preparation'.
- Amendments to IFRS 7 *'Financial Instruments: Disclosures – Offsetting Financial Assets and Liabilities'*, issued December 2011 and effective for financial years beginning on or after 1 January 2013. The amendments require disclosures regarding the Group's financial instruments that are either offset in the consolidated statement of financial position or subject to an enforceable master netting agreement or similar arrangement, see note 39.
- *IFRS 13 'Fair Value Measurement'*, issued May 2011 and effective for financial years beginning on or after 1 January 2013. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. IFRS 13 applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for share-based payment transactions that are within the scope of IFRS 2 'Share-based Payment', leasing transactions that are within the scope of IAS 17 'Leases', and measurements that have some similarities to fair value but are not fair value (e.g. value in use for impairment assessment purposes).

  IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. IFRS 13 also includes extensive disclosure requirements.

  The application of IFRS 13 has not had any material impact on the amounts recognised in the consolidated financial statements, however additional disclosures have been incorporated in this financial report. In accordance with transitional provisions, comparatives have not been presented.
- *'Annual Improvements to IFRSs 2009 – 2011 cycle'*, issued May 2012 and effective for financial years beginning on or after 1 January 2013. The IASB made amendments to the following standards that are relevant to the Group: IAS 1 *'Presentation of financial statements'*, IAS 32 *'Financial Instruments Presentation'* and IAS 34 *'Interim financial reporting'*. The impact of these amendments is not considered to be material to the Group.

2. Accounting policies (continued)

New accounting standards and interpretations adopted during the year (continued)

The Group has elected to early adopt the following IASB pronouncements in the current year:

- IFRS 10 *'Consolidated Financial Statements'*, IFRS 11 '*Joint Arrangements*', IFRS 12 '*Disclosure of Interests in Other Entities*', issued May 2011 and effective for financial years beginning on or after 1 January 2013 (with the application date for EU entities being financial years beginning on or after 1 January 2014). The Group chose to early adopt these standards from 1 October 2013 to align with the ultimate parent company.

  IFRS 10 introduces a single control model to determine which investees should be consolidated. It defines control as consisting of three elements: power, exposure to variable returns and an investor's ability to use power to affect its amount of variable returns. This requires an analysis of all facts and circumstances and the application of judgement in making the control assessment. IFRS 11 introduces a revised model for accounting for joint arrangements. There has been no material impact to the Group as a result of adopting IFRS 10 and IFRS 11.

  IFRS 12 requires new disclosure requirements on interests held in subsidiaries and structured entities, which are included in notes 17 and 21.
- IAS 27 '*Consolidated and Separate Financial Statements*' and IAS 28 '*Investment in Associates and Joint Ventures*', issued May 2011 and effective for financial years beginning on or after 1 January 2013 (with the application date for EU entities being financial years beginning on or after 1 January 2014). The Group chose to early adopt this standard from 1 October 2013 to align with the ultimate parent company. There has been no material impact to the Group as a result of adopting IAS 27 and IAS 28.
- IFRIC Interpretation 21 *'Levies'* issued May 2013 and effective for financial years beginning on or after 1 January 2014. The Group has early adopted IFRIC 21 with effect from 1 October 2013. The IFRIC addresses the accounting for a liability to pay a levy recognised in accordance with IAS 37 '*Provisions, Contingent liabilities and Contingent assets*', and the liability to pay a levy whose timing and amount is certain. The revised interpretation has not had any material impact on the amounts recognised in the consolidated financial statements.

New accounting standards and interpretations not yet adopted

The following IASB pronouncements are relevant to the Group and were available for adoption in the European Union, but are not mandatory and have not been applied by the Group in the 30 September 2014 reporting year. The impact of these pronouncements is still being assessed by the Group. Except where otherwise stated, the Group does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the financial statements:

- IAS 39 *'Novation of Derivatives and Continuation of Hedge accounting – Narrow Scope Amendment'*, issued June 2013 and effective for financial years beginning on or after 1 January 2014. This narrow scope amendment addresses the question around whether hedge accounting can be continued if an entity novates its hedging derivative from one counterparty to a central clearing counterparty as a result of regulatory changes if specific conditions are met.
- Amendments to IAS 32 *'Financial instruments – Presentation'*, issued December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment provides clarification to the criteria that already exist for offsetting.
- Amendments to IAS 36 *'Recoverable Amount Disclosures for Non-Financial Assets'* issued May 2013 and effective for financial years beginning on or after 1 January 2014. This amends the disclosure requirements of IAS 36 to include additional information about the fair value measurement where the recoverable amount of the impaired asset is based on fair value less costs of disposal.

2. Accounting policies (continued)

New accounting standards and interpretations not yet adopted (continued)

The following IASB pronouncements are relevant to the Group but were not available for adoption in the European Union and have not been applied by the Group in the 30 September 2014 reporting year. The impact of these pronouncements is still being assessed by the Group. Except where otherwise stated, the Group does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the financial statements:

- IFRS 9 *'Financial Instruments'*, issued July 2014 and effective for financial years beginning on or after 1 January 2018. This standard replaces IAS 39 *'Financial instruments: Recognition and measurement'* and contains new requirements for the recognition and measurement of financial assets and liabilities, the recognition of impairment, and hedge accounting.

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

  The impairment of financial assets under IFRS 9 will be based on expected credit losses rather than incurred credit losses as at present.

  Hedge accounting proposals will amend existing IAS 39 approaches for micro hedge accounting. Accounting for dynamic risk management (macro hedge accounting) has been decoupled from IFRS 9 and is now subject to separate consultation.

  IFRS 9 will introduce significant changes in the way the Group accounts for financial instruments with the full impact on the Group's results still being assessed. There is currently no definitive date for the European Union endorsement of this standard.
- IFRS 15 *'Revenue from Contracts with Customers'*, issued May 2014 and effective for financial years beginning on or after 1 January 2017. This standard establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard provides a single, principles based five step model to be applied to all contracts with customers.
- *'Annual improvements to IFRS 2010-2012 cycle'* issued December 2013 and effective for financial years beginning on or after 1 July 2014. The IASB have made amendments to the following standards that are relevant to the Group: IFRS 2 *'Share based payments'*, IFRS 3 *'Business Combinations'*, IFRS 8 '*Operating Segments'*, IFRS 13 *'Fair Value Measurement,* IAS 16 *'Property, Plant and Equipment'*, IAS 24 *'Related party disclosures'* and IAS 38 *'Intangible assets'*.
- *'Annual improvements to IFRS 2011-2013 cycle'*, issued December 2013 and effective for financial years beginning on or after 1 July 2014. The IASB have made amendments to the following standards that are relevant to the Group: IFRS 3 *'Business Combinations'*, IFRS 13 *'Fair value measurement'* and IAS 40 *'Investment Property'*.
- *'Defined benefit plans: Employee Contributions (Amendments to IAS 19'),* issued November 2013 and effective for financial years beginning on or after 1 July 2014. This amendment to IAS 19 permits certain contributions from employees or third parties (only those contributions that are independent of the number of years of service) to be recognised as a reduction in the service cost in the period in which the employee's services are rendered, rather being attributed to periods of service as a 'negative benefit'.
- Amendments to IAS 16 and IAS 38: *'Clarification of acceptable methods of depreciation and amortisation'*, issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation are not appropriate.
- Amendments to IAS 27: *'Equity Method in Separate Financial Statements'*, issued August 2014 and effective for financial years beginning on or after 1 January 2016. The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

2. Accounting policies (continued)

Foreign currency

Functional and presentation currency

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

Transactions and balances

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

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

Revenue recognition

Net interest income

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

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

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

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

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

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

Fees and commissions

Fees and commissions not integral to the effective interest rate arising from services provided to customers and third parties are recognised once the service has been provided.

2. Accounting policies (continued)

Revenue recognition (continued)

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

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

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

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

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

Financial assets and liabilities designated at fair value through profit or loss recognise fair value movements (excluding interest) on those items designated as fair value through profit or loss.

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

Income tax

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

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

Current tax

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

Deferred tax

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

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

2. Accounting policies (continued)

Income tax (continued)

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

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

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

Cash and cash equivalents

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

Repurchase and reverse repurchase agreements

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

Securities purchased under agreements to resell ("reverse repos") are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the financial statements. Securities borrowed are not recognised in the financial statements unless they are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Financial instruments

Recognition and derecognition of financial instruments

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

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

The Group classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and amortised cost.

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

2. Accounting policies (continued)

Financial instruments (continued)

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

Offsetting financial instruments

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

Financial instruments designated at fair value through profit or loss

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

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

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

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

Financial assets held for trading

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

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of (i) fair value through profit or loss (ii) loans and receivables or (iii) held to maturity.

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

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

2. Accounting policies (continued)

Financial instruments (continued)

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities and an immaterial investment in equity securities.

Held to maturity financial assets

Held to maturity investments are non-derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

Financial liabilities

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

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

Fair value measurement

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

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

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

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

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

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting

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

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

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

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

Fair value hedge

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

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the year in which the hedged item will affect profit or loss.

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

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

Derivatives that do not qualify for hedge accounting

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

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

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

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

Loans and advances

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

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

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value and not within loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

2. Accounting policies (continued)

Impairment of financial assets other than fair value loans

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

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

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

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

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

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

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

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

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

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

2. Accounting policies (continued)

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

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

Equity and debt instruments – classed as available for sale

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

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

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

Leases

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

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

As lessee

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

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

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

As lessor

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

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within depreciation expense in the income statement consistent with the nature of the asset (refer to note 18, Property plant and equipment).

2. Accounting policies (continued)

Property, plant and equipment

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

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

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

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

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

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

Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale, are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Intangible assets

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

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

Investments in controlled entities and associates

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

2. Accounting policies (continued)

Investment properties

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

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

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

Property inventory

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

Provisions

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

Pension and post retirement costs

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

Defined contribution pension scheme

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

Defined benefit pension scheme

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

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

2. Accounting policies (continued)

Pension and post retirement costs (continued)

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

Subordinated liability and related entity balances

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

Debt issues

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

Financial guarantees

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

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

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

Contingent liabilities

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

Equity

Share option reserve

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

Cash flow hedge reserve

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

2. Accounting policies (continued)

Other equity instruments

Other equity instruments represent Additional Tier 1 (AT1) notes. These are perpetual capital notes with no fixed maturity or redemption date and are classified as equity instruments.

Preference shares

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

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

Where preference shares do not satisfy the above conditions, they are classified as a financial liability. The Company's preference shares which were redeemed on 19 December 2013 met the criteria for classification as equity.

Dividends on ordinary and preference shares

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

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

Equity based compensation

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

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

2. Accounting policies (continued)

Equity based compensation (continued)

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

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

3. Critical accounting estimates and judgements

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

Fair value of financial instruments

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

The most significant judgement is in relation to the Group's fair value loan portfolio. The significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected repayment profile of the loans. Sensitivity analysis indicating the impact of reasonable possible changes in these inputs on the fair value is included within note 38.

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

Impairment losses on loans and advances

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

3. Critical accounting estimates and judgements (continued)

Impairment losses on loans and advances (continued)

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate price indices, country risk and the performance of different individual groups). To the extent that the probabilities of default improve from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £4m. Alternatively, if probabilities of default deteriorate by 5%, the impairment provision on loans and advances would increase by £4m. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £12m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £20m. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

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

Payment Protection Insurance redress provision and other conduct related matters

Disclosures in relation to the Group's payment protection insurance redress provision can be found in note 27 with the Group holding a provision of £515m at 30 September 2014 (2013: £152m). Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates (how many claims are, or may be, upheld in the customer's favour) and redress costs (the average payment made to customers). The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2014. Consequently, the provision calculated may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. Sensitivity analysis indicating the impact of reasonable possible changes in key assumptions on the PPI provision is included within note 27.

There are similar uncertainties and judgements for other conduct risk related matters disclosed in note 27 however the level of liability for each matter is lower.

Retirement benefit obligations

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

Carrying value of investments

In accordance with the requirements of IAS 36, an impairment test was performed on the carrying value of Clydesdale Bank PLC in the Company at the Group's standard annual impairment test date in August 2014. The results of this test highlighted a reduction in the current carrying value of Clydesdale Bank PLC to £2,267m following an impairment charge of £377m (2013: charge of £123m) which has been recognised in these financial statements.

The key assumptions and sensitivities involved in these calculations are discussed further in note 21.

4. Segment information

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

The Group's business is organised into two principal operating segments: Business & Private Banking (including Business Banking centres, small business and private banking customers) and Retail Banking. Business & Private Banking provides a range of banking products and services to segments of business and private customers, including loans and finance, day to day banking, wealth management, international services and treasury solutions. Retail Banking provides a range of banking products and services to personal customers, including current accounts, mortgages, overdrafts, personal loans, savings accounts, insurances and financial planning.

The Group's Central Functions are Customer Trust & Confidence, Finance, Risk, Operations & IT, Legal & Governance, CEO Office Support, Customer Experience & Marketing, Strategy & Transformation, Treasury and People & Communications, together with other functions which are not considered to be separate reportable operating segments.

All of these operations are individually within Clydesdale Bank PLC, National Australia Group Europe's ("NAGE") principal subsidiary and no separate operating results for NAGE are reviewed by the CEO. Accordingly no separate reporting is included within these financial statements. The segmental reporting of Clydesdale Bank PLC can be found in note 4 of it's annual report and consolidated financial statement. This disclosure also incorporates the results of UK Banking, the NAB Group's UK management reporting entity.

5. Net interest income

	2014 £m	2013 £m
Interest income		
Loans and advances to other banks	25	31
Available for sale investments	8	8
Loans and advances to customers	1,052	1,100
Due from related entities (note 11)	4	5
Other interest income	1	1
	1,090	1,145
Financial assets at fair value through profit or loss	45	64
Total interest income	1,135	1,209
Less: Interest expense		
Due to other banks	5	2
Financial liabilities at fair value through profit or loss	1	2
Due to customers	212	305
Bonds and notes	81	75
Due to related entities (note 11)	50	57
Other interest expense (1)	14	12
Total interest expense	363	453
Net interest income	772	756

(1) Other interest expense includes the FSCS levy.

6. Non-interest income

	2014 £m	2013 £m As restated
Gains less losses on financial instruments at fair value		
Interest rate derivatives	47	147
Margin on foreign exchange derivative brokerage	19	21
Other assets and liabilities at fair value	(64)	(171)
Ineffectiveness arising from fair value hedges (note 14)	7	(8)
Ineffectiveness arising from cash flow hedges (note 14)	2	(3)
	11	(14)
Other operating income		
Fees and commission	172	193
Gain on disposal of tangible fixed assets [1]	7	1
Other income	7	10
	186	204
Total non-interest income	197	190

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

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

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

7. Operating and administrative expenses

	2014 £m	2013 £m As restated
Personnel expenses		
Salaries, wages and non-cash benefits	173	185
Related personnel expenses	22	21
Defined contribution pension expense	14	13
Defined benefit pension expense	29	40
Equity based compensation	7	4
Other personnel expenses	42	39
	287	302
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (note 18)	24	23
Amortisation of intangible assets (note 22)	54	52
	78	75
Other operating and administrative expenses		
Operating lease rental	31	32
Other occupancy charges	39	42
Related entity recharges (note 11)	8	1
Impairment losses on software (note 22)	23	-
Payment Protection Insurance redress (note 27)	420	130
Other operating and administrative expenses	243	269
	764	474
Total operating and administrative expenses	1,129	851

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

Auditor's remuneration

Included within other operating and administrative expenses:	2014 £'000	2013 £'000
Audit of the financial statements	242	242
Other fees to the auditor:		
Audit of the Group pension scheme	75	75
Local statutory audits for subsidiaries	1,453	1,635
Other assurance including regulatory compliance based work	141	141
	1,911	2,093

8. Taxation

	2014	2013
	£m	£m
Current tax		As restated
UK corporation tax		
Current year	21	10
Adjustment in respect of prior years	(1)	(5)
	20	5
Deferred tax (note 23)		
Current year	(60)	(9)
Adjustment in respect of prior years	(4)	(1)
	(64)	(10)
Tax credit for the year	(44)	(5)

The tax assessed for the year differs from the standard rate of corporation tax in the UK (22%). A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	2014	2013
	£m	£m
Loss on ordinary activities before tax	(234)	(49)
Tax credit based on the standard rate of Corporation Tax in the UK of 22% (2013: 23.5%)	(51)	(12)
Effects of:		
Expenses not deductible for tax purposes	3	4
Chargeable gains	3	-
Rate differences	6	9
Adjustments in respect of prior years	(5)	(6)
Tax credit for the year	(44)	(5)

9. Dividends paid

No dividends were paid during the year (2013: £nil).

10. Cash and balances with central banks

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Cash assets	1,317	1,212	15	5
Balances with central banks (including EU payment systems)	4,669	5,508	-	-
	5,986	6,720	15	5
Less mandatory deposits with central banks [1]	(42)	(43)	-	-
Included in cash and cash equivalents (note 34)	5,944	6,677	15	5

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

11. Related party transactions

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

The Group provides a range of services to related parties, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, forward exchange and interest cover.

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

Amounts due from related entities	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Loans				
Ultimate parent	1,104	1,278	-	-
Controlled entities of the Company	-	-	247	240
	1,104	1,278	247	240
Subordinated loans				
Controlled entities of the Company	-	-	526	526
Other receivables				
Ultimate parent	368	96	-	-
Controlled entities of the ultimate parent	15	16	-	-
Controlled entities of the Company	-	-	3	3
	383	112	3	3
Total amounts due from related entities	1,487	1,390	776	769
Interest income on the above amounts was as follows:				
Ultimate parent (note 5)	4	5	-	-
Controlled entities of the Company	-	-	11	12
	4	5	11	12

11. Related party transactions (continued)

Amounts due to related entities	Group		Company	
	2014	2013	2014	2013
	£m	£m	£m	£m
Deposits				
Ultimate parent	987	1,335	-	-
Controlled entities of the ultimate parent	110	100	100	100
Controlled entities of the Company	-		313	582
	1,097	1,435	413	682
Bonds and notes				
Ultimate parent	410	441	-	-
Subordinated liabilities				
Ultimate parent	787	782	322	232
Immediate parent	344	343	344	343
	1,131	1,125	666	575
Other payables				
Ultimate parent	36	22	-	-
Immediate parent	-	1	-	1
Controlled entities of the ultimate parent	3	12	3	5
	39	35	3	6
Total amounts due to related entities	2,677	3,036	1,082	1,263
Interest expense on the above amounts was as follows (note 5):				
Ultimate parent	43	50	2	2
Immediate parent	4	4	3	4
Controlled entities of ultimate parent	3	3	3	3
Controlled entities of the Company	-	-	8	46
	50	57	16	55

Repurchase agreements

Included in amounts due from related entities is £Nil (2013: £51m) for securities sold subject to repurchase agreements. The fair value of the securities sold under these terms as at 30 September 2014 amounts to £Nil (2013: £51m).

Derivatives

The following derivative positions are held with the ultimate parent:

	2014	2013
	£m	£m
Derivative financial assets		
Designated as hedging instruments (note 14)	13	7
Designated as held for trading (note 14)	75	95
	88	102
Derivative financial liabilities		
Derivative financial liabilities (note 14)	245	204
Designated as held for trading (note 14)	278	412
	523	616

11. Related party transactions (continued)

Subordinated liabilities

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

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

The rates of interest stated below apply at 30 September 2014:	2014	2013
	£m	£m
10 year, non-call with a final maturity of 20 December 2023 - LIBOR +3.41%	300	300
10 year, non-call with a final maturity of 25 January 2021 - LIBOR + 4.42%	250	250
Undated subordinated notes - LIBOR + 0.25%	285	285
Undated subordinated notes - LIBOR + 0.48%	258	258
	1,093	1,093
Other subordinated notes	38	32
Total subordinated liabilities	1,131	1,125

Securitisation

The Group has securitised part of its residential mortgage portfolio, and the cash raised from the issue of residential mortgage backed securities ("RMBS") through structured entities ("SE") forms part of the Group's medium term funding. A portfolio of buy to let mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £410m (2013: £441m) of the securities issued are held by the Group's ultimate parent.

Other transactions with related entities	Group	
	2014	2013
	£m	£m
Non-interest income received		
Ultimate parent	5	6
Controlled entities of the ultimate parent	6	7
	11	13
Administrative expenses (note 7)		
Ultimate parent	5	(2)
Controlled entities of the ultimate parent	3	3
	8	1

Offset within Administrative expenses paid to the ultimate parent are amounts received by the Group in relation to expenses incurred in the provision of services to the NAB UK Commercial Real Estate ("CRE") portfolio.

Compensation of key management personnel ("KMP")

For the purposes of IAS 24 Related Party Disclosures KMPs comprise Directors of the Company, members of the UK Executive Committee and PRA approved persons with a control function of 1 to 29.

Group	2014	2013
	£m	£m
Salaries and other short-term benefits	10	10
Share based payments	2	-
	12	10

Directors' emoluments are analysed in note 37.

11. Related party transactions (continued)

Transactions with key management personnel

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

Group	2014 £m	2013 £m
Loans and advances	1	2
Deposits	-	1

No provisions have been recognised in respect of loans provided to KMPs (2013: £Nil). There were no debts written off or forgiven during the year to 30 September 2014 (2013: £Nil). Included in the above are twelve (2013: six) loans totalling £0.1m (2013: £0.9m) made to Directors.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.5m in the year ended 30 September 2014 (2013: £0.3m) were charged to the Group sponsored Scheme. The Group has deposits of £3.4m (2013: £4.5m) at the year end placed by the Scheme at market rates.

Pension contributions of £252m (2013: £134m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (see note 29).

12. Investments

Group	2014 £m	2013 £m
Available for sale – listed	1,161	968
Available for sale – unlisted	7	7
	1,168	975

Included in the available for sale ("AFS") listed securities are £1.1bn (2013: £0.9bn) in UK Government Gilts and £0.1bn (2013: £0.1bn) in other banks' debt securities.

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

Credit quality of investments

	2014 £m	2013 £m
Available for sale		
Senior investment grade	1,161	968
Other	7	7
	1,168	975

13. Other financial assets and liabilities at fair value

Group	2014 £m	2013 £m
Other financial assets at fair value through profit or loss		
Loans and advances	1,583	2,171
Other financial liabilities at fair value through profit or loss		
Due to customers – term deposits	91	123

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

Loans and advances

Included in other financial assets at fair value is a portfolio of loans. Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £1,583m (2013: £2,171m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £74m (2013: £77m) and the change for the current year is a gain of £3m (2013: gain of £5m).

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

Due to customers - term deposits

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

The change in fair value attributable to changes in the Company credit risk is £Nil (2013: £Nil). The Company is contractually obligated to pay £8m (2013: £10m) less than the carrying amount at maturity to the deposit holder.

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

14. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, certain derivatives do not meet the hedging criteria within IAS 39 and are therefore accounted for as held for trading, although they are used for risk mitigation purposes. The tables below analyse derivatives between those held as hedging instruments and those that do not meet the hedging criteria within IAS 39.

Group	2014 £m	2013 £m
Fair value of derivative financial assets		
Designated as hedging instruments– related entities (note 11)	13	7
Designated as held for trading	132	142
Designated as held for trading – related entities (note 11)	75	95
	220	244
Fair value of derivative financial liabilities		
Designated as hedging instruments– related entities (note 11)	245	204
Designated as held for trading	25	35
Designated as held for trading – related entities (note 11)	278	412
	548	651

14. Derivative financial instruments (continued)

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

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

14. Derivative financial instruments (continued)

Group

Total derivative contracts as at 30 September 2013	Contract amount	Fair value of assets	Fair value of liabilities
Derivatives designated as hedging instruments	£m	£m	£m
Cash flow hedges			
Interest rate swaps	21,050	7	49
Fair value hedges			
Interest rate swaps	1,458	-	127
Cross currency swaps	1,194	-	28
	2,652	-	155
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,983	38	54
Cross currency swaps	460	50	2
Options	666	6	6
	5,109	94	62
Interest rate related contracts			
Swaps	20,506	130	357
Swaptions	176	2	2
Options	738	9	24
	21,420	141	383
Commodity related contracts	107	2	2
Total derivative contracts	50,338	244	651

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

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

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

Nominal values per time period	2014	2013
	£m	£m
0 to 6 months	14,305	2,370
6 to 12 months	1,133	925
1 to 2 years	6,165	14,930
2 to 5 years	8,003	2,825
	29,606	21,050

14. Derivative financial instruments (continued)

The Group has hedged the following forecast future cash flows, which primarily vary with interest rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows 2014 £m	Forecast payable cash flows 2014 £m	Forecast receivable cash flows 2013 £m	Forecast payable cash flows 2013 £m
within one year	56	68	31	25
between one and two years	71	95	59	19
between two and three years	67	242	29	8
between three and four years	15	23	22	12
between four and five years	2	10	14	15
	211	438	155	79

	2014 £m	2013 £m
Gain/(loss) arising from fair value hedges (note 6)		
Hedging instrument	14	21
Hedged item attributable to the hedged risk	(7)	(29)
	7	(8)

	2014 £m	2013 £m
Gain/(loss) from cash flow hedges recognised in income statement due to hedge ineffectiveness (note 6)	2	(3)

15. Loans and advances to customers

Group	2014 £m	2013 £m
Overdrafts	1,767	2,024
Credit cards	364	396
Lease finance	417	482
Mortgages	18,444	16,148
Other term lending – business	4,272	4,427
Other term lending – retail	824	756
Other lending	33	32
Gross loans and advances to customers	26,121	24,265
Accrued interest receivable	79	65
Unearned income	(27)	(44)
Deferred and unamortised fee income	(27)	(37)
Impairment provisions on credit exposures (note 16)	(245)	(289)
	25,901	23,960

The Group has transferred £4,763m (2013: £4,834m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 17). The mortgages do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements the Group continues to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £2,780m (2013: £2,471m).

Included within Group loans and advances to customers are £2,007m (2013: £2,751m) of mortgages assigned to a bankruptcy remote structured entity, Clydesdale Covered Bonds No. 2 LLP (note 17). These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2014 there were £1,063m (2013: £1,041m) of covered bonds in issue under the covered bond programmes.

The Group also has a portfolio of fair valued business loans and advances (note 13). Combined with the above this is equivalent to total loans and advances of £27,484m (2013: £26,131m).

15. Loans and advances to customers (continued)

Lease finance

The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The costs of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £2m (2013: £3m) and £269m (2013: £210m) respectively. The total receivables from finance leases and hire purchase contracts were £8m (2013: £12m) and £384m (2013: £437m) respectively.

Finance lease and hire purchase receivables	Group	
	2014	2013
	£m	£m
Gross investment in finance lease and hire purchase receivables		
Due within one year	187	216
Due within one to five years	220	247
Due after more than five years	10	19
	417	482
Unearned income	(25)	(33)
Net investment in finance lease and hire purchase receivables	392	449

There are specific provisions of £2m (2013: £3m) in relation to finance lease receivables, with a collective provision of £Nil (2013: £Nil) as at 30 September 2014.

Maximum exposure to credit risk

The maximum exposure to credit risk is disclosed in note 39.

Distribution of loans and advances by credit quality

Group As at 30 September 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	84	349	405	18,045	5,662	713	25,258
Past due but not impaired	10	15	6	335	161	17	544
Impaired	-	-	6	64	249	-	319
	94	364	417	18,444	6,072	730	26,121

Group As at 30 September 2013	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	110	377	467	15,806	5,987	615	23,362
Past due but not impaired	12	19	6	266	218	19	540
Impaired	-	-	9	76	278	-	363
	122	396	482	16,148	6,483	634	24,265

[1] Business lending includes business overdrafts.

15. Loans and advances to customers (continued)

Credit quality of loans and advances

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

Distribution of loans and advances neither past due nor impaired

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

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

Group	2014 £m	2013 £m
Senior investment grade	1,244	1,402
Investment grade	1,740	1,529
Sub-investment grade	3,083	3,523
	6,067	6,454

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

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

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

Group	2014 %	2013 %
Less than 50%	27	24
50% to 75%	49	45
76% to 80%	6	8
81% to 85%	5	6
86% to 90%	4	5
91% to 95%	1	4
96% to 100%	1	2
Greater than 100%	1	2
Unknown	6	4
	100	100

15. Loans and advances to customers (continued)

Loans and advances which were past due but not impaired

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

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

Group 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	7	6	113	93	7	234
30 to 59 days past due	1	2	-	76	4	3	86
60 to 89 days past due	-	2	-	37	1	2	42
Past due over 90 days	1	4	-	109	63	5	182
	10	15	6	335	161	17	544

Group 2013	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	9	4	93	131	8	253
30 to 59 days past due	1	3	1	74	8	3	90
60 to 89 days past due	1	2	-	33	2	2	40
Past due over 90 days	2	5	1	66	77	6	157
	12	19	6	266	218	19	540

(1) Business lending includes business overdrafts.

During the year, the Group has refined the methodology behind the reporting of 90+ days past due mortgage assets to reflect a number of changes in how the Group assesses the population that should be reported. This includes a redefinition of those accounts that are reported within this category and now includes deceased customer accounts, all expired interest only mortgages which continue to make scheduled interest payments and a broader definition of accounts where revised repayment arrangements are in place. These changes have been applied prospectively by the Group in the above tables and they result in no change to the overall reported mortgage balance within loans and advances to customers. The effect on previous periods, had this refined methodology been in place, would have been to report 90+ days past due mortgage assets of £131m as at 30 September 2013 (originally £66m).

16. Impairment provisions on credit exposures

Group 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	10	12	3	31	218	15	289
Charge for the year	1	8	2	2	43	18	74
Amounts written off	(8)	(14)	(3)	(10)	(82)	(17)	(134)
Recoveries of amounts written off in previous years	4	3	-	-	5	4	16
Closing balance	7	9	2	23	184	20	245
Specific	-	-	2	16	92	-	110
Collective	7	9	-	7	92	20	135
	7	9	2	23	184	20	245

Group 2013	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	11	14	7	27	221	15	295
Charge for the year	4	12	3	14	99	12	144
Amounts written off	(9)	(18)	(7)	(10)	(110)	(16)	(170)
Recoveries of amounts written off in previous years	4	4	-	-	8	4	20
Closing balance	10	12	3	31	218	15	289
Specific	-	-	3	18	113	-	134
Collective	10	12	-	13	105	15	155
	10	12	3	31	218	15	289

[1] Business lending includes business overdrafts.

Group	2014 £m	2013 £m
Amounts included in		
Loans and advances to customers (note 15)	245	289
Non-accrual loans		
Loans and advances to customers	319	363
Specific provisions	(110)	(134)
	209	229

17. Securitisations and covered bonds

Securitisations

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

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

Covered bonds

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

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

The balances of assets and liabilities in relation to securitisation notes and covered bonds in issue at 30 September 2014 within the Group balance sheet are as follows:

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

2013		Group	
	Securitised Notes £m	Covered Bonds £m	Total £m
At 1 October 2012	2,079	1,084	3,163
Issuance of debt	541	-	541
Repayments	(613)	-	(613)
Other movements	23	(43)	(20)
At 30 September 2013	2,030	1,041	3,071
Securitised assets	4,834	2,751	7,585

17. Securitisation and covered bonds (continued)

Further information on bonds and notes can be found in note 28.

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

In addition to the securitisation notes disclosed above, there are £410m (2013: £441m) of Lannraig debt securities which are held by NAB and disclosed as a related party transaction (note 11). Assets which support the Lannraig debt are disclosed in the table above.

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

Group	2014		2013	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Carrying amount of transferred assets	4,763	2,007	4,834	2,751
Carrying amount of associated liabilities	2,780	1,063	2,471	1,041

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

Group	2014		2013	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Fair value of transferred assets	4,763	-	4,834	-
Fair value of associated liabilities	2,780	-	2,471	-
	1,983	-	2,363	-

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

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

Securitisation vehicles

The Group provides credit support to the structured entities via reserve funds through subordinated loan arrangements, exposures totalled £17m at the reporting date (2013: £1m). The Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities as at the reporting date of £690m (2013: £1,067m).

The Group has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Group has made no such repurchases in the current year.

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

17. Securitisation and covered bonds (continued)

Covered bonds

The Group has a regulated covered bond programme. A Limited Liability Partnership was established and a ring fenced mortgage portfolio assigned to provide a guarantee under the terms of the covered bonds. At the reporting date the nominal level of over-collateralisation was £1,249m (2013: £1,100m) of the outstanding covered bonds. From time-to-time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

The Bank has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Bank has made no such repurchases in the current year.

18. Property, plant and equipment

Group	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2012	20	3	144	147	314
Additions	-	-	26	11	37
Disposals	(1)	-	(14)	(23)	(38)
At 30 September 2013	19	3	156	135	313
Additions	-	-	11	12	23
Disposals	(8)	-	(6)	(33)	(47)
At 30 September 2014	11	3	161	114	289
Accumulated depreciation					
At 1 October 2012	1	-	78	95	174
Charge for the year	-	-	13	11	24
Disposals	-	-	(8)	(10)	(18)
At 30 September 2013	1	-	83	96	180
Charge for the year	-	-	13	11	24
Disposals	-	-	(4)	(32)	(36)
At 30 September 2014	1	-	92	75	168
Net book value					
At 30 September 2014	10	3	69	39	121
At 30 September 2013	18	3	73	39	133

18. Property, plant and equipment (continued)

Valuations

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

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

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

Group	2014 £m	2013 £m
Carrying value as included under the revaluation basis	13	21
Carrying value if the historical cost basis had been used	11	19

19. Investment properties

Group	2014 £m	2013 £m
At 1 October	63	77
Disposals	(19)	(14)
	44	63

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

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

During the year 99% (2013: 99%) of the investment properties generated total rental income of £2m (2013: £3m) and incurred operating and administrative expenses of £2m (2013: £2m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2013: £Nil).

20. Property inventory

Group	2014 £m	2013 £m
At 1 October	6	9
Disposals	(4)	(3)
	2	6

All properties within property inventory are complete and available for sale. No properties are under construction (2013: £Nil).

21. Investments in controlled entities and associates

	Group		Company	
	2014	2013	2014	2013
	£m	£m	£m	£m
At 30 September	2	3	2,577	2,654

As a part of a Group rationalisation programme, a number of the Company's subsidiaries were placed into voluntary liquidation with capital returned to the parent.

On 11 December 2013 the Company redeemed £100m of preference shares issued by Clydesdale Bank PLC. On 20 December 2013 the Company redeemed £200m of preference shares issued by Clydesdale Bank PLC and subscribed to £300m ordinary shares issued by Clydesdale Bank PLC. On 27 March 2014 the Company subscribed to £300m ordinary shares issued by Clydesdale Bank PLC.

Impairment review for subsidiary undertakings

As highlighted in note 3, an impairment test on the carrying value of the Company's investment in Clydesdale Bank PLC has been undertaken during the year, resulting in an impairment charge of £377m as at 30 September 2014 (2013: charge of £123m). For the purposes of the impairment test, Clydesdale Bank PLC is regarded as the cash generating unit with the value in use calculation compared to the current carrying value of the investment in Clydesdale Bank PLC in the Company balance sheet.

The key assumptions involved in these calculations are set out below.

Key assumptions used in impairment testing

The recoverable amount of the cash generating unit has been derived from a value in use calculation using discounted cash flow techniques and a forecasted performance approved by the Board. Cash flows beyond the forecasted period have been extrapolated using similar forecasted assumptions as in the forecast period. The following rates are used by the Company:

	2014	2013
	%	%
Post tax discount rate	9.9	10.0
Projected terminal growth rate	3.9	3.9

The calculation of the value in use is based on a Board approved five year forecast projection and is then extrapolated forward with a terminal growth rate applied. The five year forecast projections encompass a range of economic indications such as GDP growth, unemployment statistics as well as a range of other business assumptions specific to Clydesdale Bank PLC such as asset volumes, product volumes and margins which are commercially sensitive. The Board is satisfied that the assumptions used both within and beyond the forecasted period are appropriate and reasonable at the balance sheet date.

Discount rate

The discount rate applied reflects the current market assessment of the risk specific to Clydesdale Bank PLC. The discount rate was calculated by reference to a series of internal indicators combined with certain identifiable and available sector specific information. The impairment model used is based on post-tax cash flows and utilises a post-tax discount rate. A comparable pre-tax discount rate for the year would be 12% (2013: 12%).

Projected terminal growth rate

The projected terminal growth rate is based on management's expectation of the long term average growth prospects for UK GDP after taking into account the broader historic UK economic outlook and trends.

21. Investments in controlled entities and associates (continued)

Sensitivity to changes in assumptions

Changes in the post-tax discount rate or projected terminal growth rate will impact the Company's assessment of the value in use of Clydesdale Bank PLC. If adjusted independently of all other variables, a 10 basis point increase in the post-tax discount rate would result in an additional impairment charge of £34m and a 10 basis point decrease in the projected terminal growth rate would result in an additional impairment charge of £55m.

The principal controlled entities are as follows:

Wholly owned subsidiary undertakings as at 30 September 2014	Nature of business	Country of incorporation
Clydesdale Bank PLC	Banking	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	England
National Australia Group Europe Services Limited	IT and group services	Scotland

Structured entities

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

In the current and prior period all structured entities which the Group sponsors, or in which the Group holds an interest, are consolidated. Detail of the Group's interests in consolidated structured entities are set out in note 17.

The following companies are consolidated structured entities:

Other controlled entities as at 30 September 2014	Nature of business	Country of incorporation
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England
Clydesdale Covered Bonds LLP (in liquidation)	Acquisition of mortgage loans	England

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

Associates

Associates are undertakings over which the Company exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2014. The associated undertaking is The Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is the provision of finance and the Group's interest of 33.33% in the issued equity capital of £2m is held by Clydesdale Bank PLC. The associated undertaking has a 31 March year end.

21. Investments in controlled entities and associates (continued)

Significant restrictions

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

Contractual requirements - asset encumbrance

The Group uses its financial assets to raise finance in the form of securitisations and through the liquidity schemes of central banks. Once encumbered, the assets are not available for transfer around the Group. The assets affected are disclosed in the Strategic Report and note 17.

22. Intangible assets

Group

	2014	2013
Capitalised software costs	£m	£m
Cost		
At 1 October	421	352
Additions	75	69
Disposals	(103)	-
Impairment (note 7)	(39)	-
At 30 September	354	421
Accumulated amortisation		
At 1 October	206	154
Disposals	(103)	-
Charge for the year (note 7)	54	52
Impairment (note 7)	(16)	-
At 30 September	141	206
Net book value at 30 September	213	215

Additions of £75m (2013: £69m) relate predominantly to the Group's continuing investment in new systems to meet the requirements of the business. To the extent that the systems are in use within the business amortisation has been charged at the rates set out in note 2.

Management perform impairment testing of capitalised software assets in accordance with International Accounting Standards. The impairment charge follows a detailed review of the recoverable amount of the various assets. Where the benefits associated with the software were substantially reduced from what had originally been anticipated, the software has been written down to its recoverable amount. An impairment of £23m has been recognised in the year to 30 September 2014 (2013: £Nil).

23. Deferred tax

Movement in net deferred tax asset

Group	2014 £m	2013 £m As restated
At 1 October	266	266
Recognised in the income statement (note 8)	64	10
Recognised directly in equity	3	(10)
Other	6	-
	339	266

The Group recognises deferred tax attributable to the following items:

Group	2014 £m	2013 £m
Deferred tax assets		
Defined benefit pension liability	-	37
Impairment provision on credit exposures	8	9
Employee equity based compensation	1	1
Tax losses carried forward	223	103
Provisions	25	47
Accelerated capital allowances	87	66
Cash flow hedge reserve	4	-
Other	1	10
	349	273
Deferred tax liabilities		
Defined benefit pension liability	10	-
Net gain on revaluation of properties	-	1
Cash flow hedge reserve	-	6
	10	7
Net deferred tax asset	339	266

The Group considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The largest deferred tax asset held within the Group relates to tax losses carried forward. The tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses. The group expects that the recognised deferred tax asset of £223m in respect of tax losses will be recovered within four to six years. A twenty percent reduction in forecast profits would extend the recovery period by one year.

The statutory rate of UK corporation tax reduced from 24% to 23% on 1 April 2013 and to 21% on 1 April 2014. The enactment of Finance Act 2013 in July 2013 further reduced the corporation tax rate to 20% from 1 April 2015. Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Accordingly, as the future reductions of the corporation tax rate to 21% and 20% were enacted on 17 July 2013, the deferred tax balances at 30 September 2014 have been reflected at the tax rates they are expected to be realised or settled.

24. Other assets

Group	2014 £m	2013 £m As restated
Prepayments and accrued income	31	42
Other	218	362
	249	404

Other includes items in the course of collection.

25. Due to other banks

Group	2014 £m	2013 £m
Transaction balances with other banks	4	6
Securities sold under agreements to repurchase *	644	-
Deposits from other banks	266	515
	914	521

* Securities sold under agreements to repurchase have a fair value of £646m.

26. Due to customers

Group	2014 £m	2013 £m
Non-interest bearing demand deposits	1,849	1,687
Interest bearing demand deposits	16,346	15,278
Term deposits	5,587	6,801
Other wholesale deposits	119	380
	23,901	24,146
Accrued interest payable	172	209
	24,073	24,355

27. Provisions

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Payment Protection Insurance redress provision				
Opening balance	152	108	-	-
Charge to the income statement (note 7)	420	130	-	-
Provision utilised	(57)	(86)	-	-
Closing balance	515	152	-	-
Customer redress and other provisions				
Opening balance	118	58	-	-
Charge to the income statement [(1)]	376	108	-	-
Provision utilised	(81)	(48)	-	-
Closing balance	413	118	-	-
Restructuring provision				
Opening balance	33	126	-	-
Provision utilised	(8)	(73)	-	-
Transfer to surplus lease space provision	(7)	(20)	-	-
Closing balance	18	33	-	-
Surplus lease space provision				
Opening balance	12	-	-	-
Charge to the income statement	-	2	-	-
Provision utilised	(13)	(10)	-	-
Transfer from restructuring provision	7	20	-	-
Closing balance	6	12	-	-
Total provisions	952	315	-	-

(1) The income statement effect of the interest rate hedging products provisioning is nil as it is offset by a receivable from NAB.

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

The Group has provided its best estimate of conduct risk related liabilities at 30 September 2014 which have arisen as a result of its historical products and past sales practices.

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

Payment Protection Insurance ("PPI") redress

The Group has reassessed the level of provision that is considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and has concluded that additional provisions of £420m should be recognised for the year ended 30 September 2014.

The total provision raised to date in respect of PPI is £806m (September 2013: £386m); with £515m of this remaining as at 30 September 2014 (September 2013: £152m).

27. Provisions (continued)

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. The Group remains in regular dialogue with the Financial Conduct Authority ("FCA") regarding its approach to dealing with these issues and is subject to an enforcement process with the FCA in relation to its previous complaints handling process, the outcome of which is not yet known. Additionally, the Group is making modifications to its approach to PPI complaint handling, where appropriate, to reflect operational experience and ongoing discussions with the FCA, the FOS and third party professional advisers.

The increase in provisions includes amounts required for PPI redress in relation to the implementation of a revised complaints handling process, which has resulted in increased operational and administrative costs; higher than expected levels of new complaints; increased redress payments in respect of new complaints, costs associated with the ongoing enforcement process and additional operational and redress costs likely to be incurred as a result of reviewing previously handled complaints. The level of complaints received has declined compared to the prior year albeit the actual rate of decline is lower than previously anticipated and the month on month volatility has increased. The number of complaints received is monitored against past experience and future expectations.

The provision is based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies), the number of those claims that ultimately will be upheld, the amount that will be paid in respect of those claims, any additional amounts that may need to be paid in respect to previously handled claims, any requirements to undertake further proactive customer contact and the outcome of the FCA enforcement process including the possibility of fines. These factors mean that the eventual costs of PPI redress and complaint handling may therefore differ materially from that estimated and further provision could be required. Accordingly, the final amount required to settle the Group's potential PPI liabilities remains uncertain.

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

Assumptions	Change in assumption %	Sensitivity [(1)] £m
Number of expected future customer initiated complaints	+/-10%	£13m
Uphold rates		
Future complaints yet to be received	+/-10%	£21m
Existing complaints to be reviewed	+/-10%	£50m
Customer contact response rate [(2)]	-10%	£(24)m
Average redress costs	+/-10%	£59m

(1) There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged.

(2) Existing complaints review.

The Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop.

27. Provisions (continued)

The requirement for further proactive customer contact will be determined by the Group undertaking a past business review. Where systemic sales failings are identified and there was a risk of mis-sale, proactive mailing to customers will be undertaken. At this stage the extent to which proactive mailings will be required as a result of the past business review and the outcome of the FCA enforcement process in relation to the Group's previous complaints handling processes, are, as yet, unknown. It has therefore not been possible to reliably estimate the extent of additional liabilities, if any, which may result and these matters are considered to be contingent liabilities.

Customer redress and other provisions

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

On 29 June 2012 the Financial Services Authority ("FSA") announced that it had reached agreement with a number of UK banks in relation to a review and redress exercise on sales of certain interest rate hedging products to small and medium businesses. The Group agreed to participate in this exercise, as announced by the FSA on 23 July 2012, and has embarked on a formal programme to identify small and medium sized customers that may have been affected and where due, pay financial redress. The exercise incorporates certain of the Group's tailored business loan products as well as the standalone hedging products identified in the FSA's notice. The Group is also dealing with a number of claims by customers in relation to tailored business loans not currently in the scope of the review.

During the year the Group has continued to review the cases originally identified and to respond and react to further guidance provided by the FCA and the FOS. It has also commenced settlement payments.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for these matters and concluded that a further provision of £364m (30 September 2013: £49m) is appropriate at this time. This brings the total provisions raised in respect of interest rate hedging products to £431m (September 2013: £67m); with £362m of this remaining as at 30 September 2014 (September 2013: £49m).

The increase in provision is driven by a number of factors relating to offers of redress, compensation, offers of alternative products and costs. These factors could result in the total cost of the review and redress exercise and associated costs varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in this matter is therefore uncertain and further provision could be required. The income statement effect of these provisions is nil due to the recognition of an offsetting receivable from NAB.

Other provisions include amounts provided in respect of legal proceedings, a number of individually less significant conduct related matters, and claims arising in the ordinary course of the Group's business. A net charge of £12m was recognised in the period to 30 September 2014. They include our contribution to the banking industry response to the CPP Scheme of Arrangement as well as a number of other matters.

Restructuring provision

Following the announcement of the results of the UK Banking strategic review on 30 April 2012, a restructuring provision of £139m was raised in May 2012. The provision covers redundancy payments, property vacation costs and associated enablement costs. In the period to 30 September 2014, £8m was utilised (2013: £73m).

Surplus lease space provision

The Group provides for committed rental expense on surplus lease space in line with the expected years' exposure on individual leases where the property is unoccupied. The level of surplus lease space increased as a result of the UK Banking strategic review as highlighted above. The provision will be utilised over the remaining life of the leases or until the leases are assigned. The provision is measured at present values by discounting anticipated future cash flows.

28. Bonds and notes

Group	2014 £m	2013 £m
Residential mortgage backed securities	2,421	2,039
Covered bonds	1,097	1,096
	3,518	3,135
Fair value hedge adjustments	(85)	(64)
Total securitised notes and covered bonds (note 17)	3,433	3,071
Accrued interest payable	20	14
	3,453	3,085

On 19 March 2014, €300m and £350m of residential mortgage backed securities were issued through Lanark 2014-1.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC to parties outside of the NAB Group as at 30 September 2014 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Maturity date
Class A residential mortgage backed securities				
28 February 2012	EUR	351	3M EURIBOR + 1.95%	22 May 2015
27 July 2012	USD	401	3M USD LIBOR + 1.40%	22 May 2016
27 July 2012	GBP	523	3M GBP LIBOR + 1.63%	22 November 2017
13 July 2013	USD	178	3M USD LIBOR + 0.50%	22 August 2016
13 July 2013	GBP	337	3M GBP LIBOR + 0.45%	22 August 2016
19 March 2014	EUR	232	3M EURIBOR + 0.40%	22 August 2017
19 March 2014	GBP	348	3M GBP LIBOR + 0.50%	22 November 2018
		2,370		
Covered Bonds				
31 May 2012	GBP	664	4.63%	08 June 2026
31 May 2012	GBP	399	3M GBP LIBOR + 1.70%	08 June 2015
		1,063		
		3,433		

29. Retirement benefit obligations

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

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

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.3m (2013: £0.3m) and would have no material impact upon service costs and interest costs.

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

	2014 £m	2013 £m
Active members defined benefit obligation	(775)	(1,004)
Deferred members defined benefit obligation	(1,160)	(889)
Pensioner and dependent members defined benefit obligation	(1,285)	(1,022)
Total defined benefit obligation	(3,220)	(2,915)
Fair value of scheme assets	3,269	2,718
Net defined benefit pension asset/(obligation)	49	(197)
Post-retirement medical benefits obligations	(4)	(5)
Retirement benefits obligation	(4)	(202)

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

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

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

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

29. Retirement benefit obligations (continued)

Reconciliation of the net defined benefit pension asset/(liability)	2014 £m	2013 £m As restated
Opening net defined benefit pension scheme liability	(197)	(301)
Service cost	(23)	(38)
Interest on net defined benefit asset/(liability)	(3)	(8)
Remeasurement effects recognised in SOCI	24	21
Employer contributions	252	134
Administrative expenses	(4)	(5)
Closing fair value of net defined benefit pension scheme asset/(liability)	49	(197)

Reconciliation of the defined benefit pension scheme assets	2014 £m	2013 £m As restated
Opening fair value of defined benefit pension scheme assets	2,718	2,485
Interest income on scheme assets at discount rate	129	110
Return on scheme assets greater than discount rate	254	80
Employer contributions (note 11)	252	134
Benefits paid	(77)	(83)
Transfer payments	(3)	(3)
Administrative costs paid	(4)	(5)
Closing fair value of defined benefit pension scheme assets	3,269	2,718

Reconciliation of the defined benefit pension scheme obligations	2014 £m	2013 £m As restated
Opening defined benefit pension scheme obligations	(2,915)	(2,786)
Current service cost	(21)	(25)
Past service cost	(2)	(13)
Interest expense on the defined benefit obligation	(132)	(118)
Actuarial gain- experience adjustments	31	4
Actuarial (loss) – demographic assumptions	(23)	-
Actuarial (loss) – financial assumptions	(238)	(63)
Benefits paid from scheme assets	77	83
Transfer payments	3	3
Closing defined benefit pension scheme obligations	(3,220)	(2,915)

29. Retirement benefit obligations (continued)

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

	2014 £m	2013 £m
Quoted		
Equities	853	725
Government bonds	1,346	924
Global sovereign bonds	102	103
Corporate bonds	699	717
Other [(1)]	70	64
Cash	27	92
Secure income alternatives	62	-
Unquoted		
Property	110	93
Fair value of defined benefit pension scheme assets	3,269	2,718

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

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

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

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

Amounts recognised in the income statement	2014 £m	2013 £m As restated
Current service cost	21	25
Past service cost	2	13
Net interest on net defined benefit liability/(asset)	3	8
Defined benefit expense for the year	26	46
Administration costs incurred	4	5
Cost recognised in the income statement	30	51

In the current and prior period the past service cost relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements and in both periods these were fully offset in the income statement by a corresponding release from the restructure provision.

29. Retirement benefit obligations (continued)

Amounts recognised in the statement of comprehensive income	2014 £m	2013 £m As restated
Opening cumulative actuarial losses	(674)	(695)
Actuarial gain due to liability experience adjustments	31	4
Actuarial loss due to liability assumption changes	(261)	(63)
Return on scheme assets greater than discount rate	254	80
Cumulative actuarial losses recognised in the statement of comprehensive income	(650)	(674)

Actuarial assumptions	2014 % p.a.	2013 % p.a.
Financial assumptions		
Discount rate	4.10	4.60
Inflation (RPI)	3.15	3.25
Inflation (CPI)	2.15	2.25
Career average revalued earnings ('CARE') revaluations:		
Pre 31 March 2012 benefits (RPI)	3.15	3.25
Post 31 March 2012 benefits (CPI capped at 5% per annum)	2.15	2.25
Pension increases (capped at 2.5% per annum)	2.10	2.25
Pension increases (capped at 5% per annum)	3.00	3.10
Rate of increase for pensions in deferment	2.15	2.25

Demographic assumptions

Post retirement mortality:	2014 years	2013 years
Current pensioners at 60 – male	27.5	28.0
Current pensioners at 60 – female	29.4	28.5
Future pensioners at 60 – male	29.0	29.5
Future pensioners at 60 – female	30.9	30.0

29. Retirement benefit obligations (continued)

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

Assumption change	Impact on defined benefit obligation £m	Impact on pension cost £m
Discount rate		
+0.25%	(157)	(9)
-0.25%	169	9
Inflation		
+0.25%	142	7
-0.25%	(133)	(7)
Life expectancy		
+0.25%	98	5
-0.25%	(99)	(5)

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

The discounted mean term of the defined benefit obligation at 30 September 2014 is 22 years. The expected contributions for the year ended 30 September 2015 are £38m and expected benefit payments for the year ended 30 September 2015 are £81m.

30. Other liabilities

Group	2014 £m	2013 £m As restated
Accruals and deferred income	78	80
Notes in circulation	1,831	1,709
Other	186	211
	2,095	2,000

31. Called up share capital

Allotted, called up and fully paid	2014 £m	2013 £m
Ordinary shares of £1 each		
Opening ordinary share capital	1,582	1,582
Issued during the year	300	-
Closing ordinary share capital	1,882	1,582
Preference shares of £1 each		
Opening preference share capital	100	100
Redeemed during the year	(100)	-
Closing preference share capital	-	100
Closing called up and fully paid share capital	1,882	1,682

In accordance with the Articles of Association ("Articles") of the Company, and with the non-objection of the Prudential Regulation Authority, the Company obtained the consent of National Australia Bank Limited, London Branch ("the Holder") to redeem:

- 100,000,000 non-cumulative preference shares of £1 issued by the Company on 17 December 2008 and held by the Holder

The aforementioned preference shares were redeemed on 19 December 2013.

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

On 27 March 2014 300,000,000 ordinary shares of £1 were issued. All ordinary shares issued in the period were at par and fully paid up.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Company. All shares in issue at 30 September 2014 rank equally with regard to the Company's residual assets.

There is also one non-voting income share of £1 in issue (2013: £1).

32. Total equity

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Share capital (note 31)	1,882	1,682	1,882	1,682
Other equity instruments	300	-	300	-
Capital redemption reserve	100	-	100	-
Share option reserve	2	2	-	-
Asset revaluation reserve	2	2	-	-
Available for sale investments reserve	8	5	-	-
Cash flow hedge reserve	(16)	23	-	-
Total other reserves	96	32	100	-
Retained earnings	260	535	3	489
Total parent entity interest	2,538	2,249	2,285	2,171
Non-controlling interest	-	200	-	-
Total equity	2,538	2,449	2,285	2,171

Other equity instruments

Other equity instruments represent Additional Tier 1 (AT1) notes. On 20 December 2013, Perpetual Capital Notes were issued with a principal amount of £300m to the Company's ultimate parent. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV.

Share option reserve

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

Asset revaluation reserve

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

Available for sale investments reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale ("AFS") investments.

Cash flow hedge reserve

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

As at 30 September 2014 the cash flow hedge reserve comprises the remaining crystallised fair value gains arising from the de-designated cash flow hedge in 2013 (£27m) offset by deferred losses on interest rate swaps in ongoing cash flow hedges (£47m). The balance on the cash flow hedge reserve is net of tax.

£48m was recycled into the income statement in relation to the de-designated hedge in the period. £2m was transferred to the income statement due to ineffectiveness arising from cash flow hedges.

32. Total equity (continued)

Non-controlling interests

During the year the Group redeemed at par a £200 million limited partnership interest in Rmond LP, a limited partnership controlled by NAGE, representing a capital contribution by National HK Investments Limited ("NHKI"), a Hong Kong incorporated holding company, indirectly owned by NAB. The redemption reduces equity interests attributable to a non-controlling party to nil at 30 September 2014.

Rmond LP was dissolved on 20 December 2013. At 30 September 2013, NHKI held 40% of the ownership interest in Rmond LP, but had no voting rights.

Distributions of £8m were paid to the non-controlling interests of Rmond LP in the current year (2013: £Nil). Before intercompany eliminations Rmond LP recorded revenue, profit and total comprehensive income for the year of £5m (2013: £26m); net cash flows for the year of £nil (2013: £nil); total assets at 30 September 2014 of £nil (2013: £507m); and Members' interests at 30 September 2014 of £nil (2013: £507m).

33. Contingent liabilities and commitments

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

Group

	2014	2013
Contingent liabilities	£m	£m
Guarantees and assets pledged as collateral security:		
At call	-	1
Due in less than 3 months	32	34
Due between 3 months and 1 year	25	63
Due between 1 year and 3 years	9	12
Due between 3 years and 5 years	3	4
Due after 5 years	61	90
No specified maturity	6	9
	136	213
Other credit commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	8,422	8,696

The Company has issued a letter of support to the value of £10m (2013: £10m) in respect of one of its subsidiaries.

Capital commitments

The Group had future capital expenditure which had been contracted for but not provided for in the financial statements at 30 September 2014 of £3.6m (2013: £4.5m).

33. Contingent liabilities and commitments (continued)

Operating lease commitments

Group

	2014	2013
Leases as lessor	£m	£m
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	2	2
between 1 year and 5 years	6	3
over 5 years	2	2
	10	7
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	30	31
between 1 year and 5 years	94	91
over 5 years	121	115
	245	237

Other contingent liabilities

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme ("FSCS") provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be largely repaid from the realisation of the assets of the institutions. During the last year, the FSCS has also invoiced institutions for the first of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings which remains after the three annual levies have been paid is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2015 and an accrual of £7m (2013: £7m) is held for the Group's calculated liability to that date, with £6m of the current year charge having already been paid. The ultimate FSCS levy is uncertain.

Conduct risk related matters

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 27 to the annual report and consolidated financial statements reflecting the Group's current position in relation to redress for the PPI and interest rate hedging products. The final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

Legal claims

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

34. Notes to the statements of cash flows

	Group 2014 £m	Group 2013 £m As restated	Company 2014 £m	Company 2013 £m
Adjustments included in the loss before tax				
Interest receivable	(1,135)	(1,209)	(11)	(13)
Interest payable	363	453	16	55
Depreciation and amortisation (note 7)	78	75	-	-
Profit on sale of tangible fixed assets [1]	(7)	(1)	-	-
Transfer from cash flow hedge reserve	(2)	3	-	-
Derivative financial instruments fair value movements	(9)	11	-	-
Impairment losses on credit exposures (note 16)	74	144	-	-
Impairment losses on software (note 7)	23	-	-	-
Dividends received from subsidiaries	-	-	(14)	(77)
Adjustment to carrying value of investments	-	-	377	123
Movement in share option reserve	-	(3)	-	-
	(615)	(527)	368	88
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	1	(12)	-	-
Due from other banks	171	(170)	-	-
Derivative financial instruments	(26)	247	-	-
Financial assets at fair value through profit or loss	585	636	-	-
Loans and advances to customers	(2,001)	307	-	-
Due from customers on acceptances	(1)	3	-	-
Other assets	94	(114)	-	-
Assets held for sale	-	5,225	-	-
	(1,177)	6,122	-	-
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	395	(55)	-	-
Derivative financial instruments	(135)	(289)	-	-
Financial liabilities at fair value through profit or loss	(31)	(27)	-	-
Due to customers	(245)	(2,235)	-	-
Liabilities on acceptances	1	(3)	-	-
Provisions (note 27)	637	23	-	-
Defined benefit pension obligations	(223)	(83)	-	-
Other liabilities	163	177	-	-
Liabilities associated with assets held for sale	-	(142)	-	-
	562	(2,634)	-	-

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

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

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Cash and balances with central banks (note 10)	5,944	6,677	15	5
Other assets	143	178	-	-
Due to other banks	(26)	(28)	-	-
Due to related entities	(108)	(182)	-	-
Other liabilities	(58)	(95)	-	-
	5,895	6,550	15	5

35. Employees

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

	2014 Number	2013 Number
Managers	2,165	1,963
Clerical staff	4,978	4,863
	7,143	6,826

36. Equity based compensation

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

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

Short term incentive ("STI")

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

Recognition and retention shares

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

Commencement shares

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

36. Equity based compensation (continued)

UK Share Incentive Plan

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

General employee shares

Up to a target value of A$1,000 of NAB shares are offered to each eligible employee when the NAB Group's performance is on target, measured against a scorecard of objectives for the financial year. These shares are held in trust, restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Long-term incentives ("LTI")

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

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

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

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

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

Performance options	2014		2013	
	Number	Weighted average exercise price A$	Number	Weighted average exercise price A$
Outstanding at 1 October	85,715	19.89	278,946	26.12
Granted during the year	-	-	-	-
Forfeited and lapsed during the year	(4,947)	19.89	(55,527)	30.65
Exercised during the year	(80,768)	19.89	(41,177)	19.89
Expired during the year	-	-	(96,527)	31.70
Outstanding at 30 September	-	-	85,715	19.89
Exercisable at 30 September	-		-	

36. Equity based compensation (continued)

The number of performance options exercised during the year was 80,768 (2013: 41,177). There are no performance options outstanding at 30 September 2014, the weighted average remaining contractual life of those outstanding at 30 September 2013 was 0.79 years. The exercise price for performance options outstanding at 30 September 2013 was A$19.89.

Performance rights	2014 Number	2013 Number
Outstanding at 1 October	186,119	145,729
Granted during the year	197,835	61,258
Forfeited and lapsed during the year	(124,861)	(20,868)
Exercised during the year	-	-
Outstanding at 30 September	259,093	186,119
Exercisable at 30 September	-	-

No performance rights were exercised during the year (2013: Nil). For performance rights outstanding at 30 September 2014, the weighted average remaining contractual life is 4.04 years (2013: 2.87 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

No performance options were granted during the year ended 30 September 2014 (2013: Nil). 197,835 performance rights were granted during the year ended 30 September 2014 (2013: 61,258). Included within personnel expenses (note 7) is a fair value of goods or services to the value of £2.1m, which was measured indirectly by reference to the fair value on the performance rights granted during the year (2013: £0.8m).

37. Directors' emoluments

2014 £'000			Performance related pay							
			Short term incentive schemes (3)			Long term incentive schemes(5)				
	Salary and fees (1)	Benefits and allowances (2)	Upfront (cash)	Deferred (shares)	Total short term	Deferred (cash)	Deferred (performance rights)	Deferred (shares)	Total long term	Total emoluments
Executive Directors										
Cameron Clyne (4) (8)	-	-	-	-	-	-	-	-	-	-
Debbie Crosbie (6)	127	28	15	46	61	-	38	1	39	255
John Hooper	400	63	100	100	200	-	-	-	-	663
Mark Joiner (4) (8)	-	-	-	-	-	-	-	-	-	-
Richard Sawers (4)	-	-	-	-	-	-	-	-	-	-
David Thorburn	450	99	45	135	180	-	225	1	226	955
Total Executive	977	190	160	281	441	-	263	2	265	1,873
Non-executive										
David Allvey	82	-	-	-	-	-	-	-	-	82
David Browne	80	-	-	-	-	-	-	-	-	80
Richard Gregory OBE	140	-	-	-	-	-	-	-	-	140
Barbara Ridpath	70	-	-	-	-	-	-	-	-	70
James Pettigrew (7)	119	-	-	-	-	-	-	-	-	119
Alexander Shapland	70	-	-	-	-	-	-	-	-	70
Total Non-executive	561	-	-	-	-	-	-	-	-	561
Total Directors	1,538	190	160	281	441	-	263	2	265	2,434

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for Directors amounting to £305,000 (2013: £405,000) and in respect of emoluments for the highest paid Director of £130,118 (2013: £175,000).

37. Directors' emoluments (continued)

2013 £'000	Salary and fees [1]	Benefits and allowances [2]	Performance related pay: Short term incentive schemes [3]: Upfront (cash)	Deferred (shares)	Total short term	Long term incentive schemes[5]: Deferred (cash)	Deferred (performance rights)	Deferred (shares)	Total long term	Total emoluments
Executive Directors										
Cameron Clyne [4] [8]	-	-	-	-	-	-	-	-	-	-
John Hooper	591	242	70	211	281	267	267	1	535	1,649
Mark Joiner (4)	-	-	-	-	-	-	-	-	-	-
Richard Sawers [4]	-	-	-	-	-	-	-	-	-	-
David Thorburn	450	101	63	253	316	338	338	1	677	1,544
Total Executive	1,041	343	133	464	597	605	605	2	1,212	3,193
Non-executive Directors										
David Allvey	78	-	-	-	-	-	-	-	-	78
David Browne	78	-	-	-	-	-	-	-	-	78
Richard Gregory OBE	138	-	-	-	-	-	-	-	-	138
James Pettigrew [4] [7]	80	-	-	-	-	-	-	-	-	80
Barbara Ridpath	69	-	-	-	-	-	-	-	-	69
Alexander Shapland	69	-	-	-	-	-	-	-	-	69
Total Non-executive	512	-	-	-	-	-	-	-	-	512
Total Directors	1,553	343	133	464	597	605	605	2	1,212	3,705

The table above includes deferred cash and deferred performance rights awarded on 20 February 2013 in respect of the previous financial year.

37. Directors' emoluments (continued)

Notes

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

(2) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to two Directors (2013: one) under a defined benefit pension plan. Pension contributions amounting to £50,013 (2013: £16,730) were paid during the year. The highest paid director is a deferred member of the defined benefit pension plan.

(3) Performance related pay relates to the respective financial year. The short-term incentive scheme includes a cash element to be paid in the forthcoming year and the deferred amount represents rights and shares deferred for six months to two years. The highest paid Director received 5,656 shares (2013: 110,331) that vested during the year, with a fair value of £65,307 (2013: £422,940).

(4) Cameron Clyne, Mark Joiner and Richard Sawers were remunerated as employees of NAB and did not receive incremental remuneration in respect of their duties as Directors of the Company. The Directors believe it would be appropriate to apportion A$618,000 (2013: A$782,000) of their remuneration as being in respect of their duties to the Company.

(5) The long-term incentive scheme amounts principally represent deferred performance rights for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. The performance period is four years. The value attributed is the fair value of the shares at the date of granting. Two Directors (2013: two) received benefits under an executive long-term incentive scheme.

(6) Debbie Crosbie was appointed as an Executive Director on 12 May 2014 and accordingly the figures in the table above represent her emoluments from this date.

(7) James Pettigrew was appointed as Non-executive Chairman on 1 August 2014. He was a Non-executive Director for the full year.

(8) Mark Joiner resigned as a Director on 31 December 2013. Cameron Clyne resigned as a Director and as Chairman on 1 August 2014.

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

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

2013 Number	Performance options	Performance rights	Short term incentive shares	Long term incentive shares	Other employee share plans
Outstanding at 1 October	245,716	21,146	17,802	29,790	8,219
Granted during the year	-	12,060	-	-	36
Exercised/disposed during the year	(33,802)	-	(5,728)	(4,774)	-
Expired during the year	(90,216)	-	-	-	-
Forfeited and lapsed during the year	(51,334)	-	-	(8,314)	-
Restrictions ceased	-	-	(6,347)	-	-
Outstanding at 30 September	70,364	33,206	5,727	16,702	8,255

38. Fair value of financial instruments

(a) Fair value of financial instruments carried at amortised cost

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

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

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

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

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

Group	30 September 2014					30 September 2013	
			Fair value measurement using:				
	Carrying value	Fair value	Quoted market prices (Level 1)	Valuation techniques (observable inputs) (Level 2)	Valuation techniques (significant non-observable inputs) (Level 3)	Carrying value	Fair value
	£m	£m	£m	£m	£m	£m	£m
Financial assets							
Loans and advances to customers	25,901	25,734	-	1,293	24,441	23,960	24,004
Financial liabilities							
Due to customers	24,073	24,083	-	24,083	-	24,355	24,402
Due to related entities	2,677	2,633	-	2,633	-	3,036	3,036
Bonds and notes	3,453	3,534	-	3,534	-	3,085	3,088

38. Fair value of financial instruments (continued)

Company	30 September 2014					30 September 2013	
			Fair value measurement using:				
	Carrying value	Fair value	Quoted market prices (Level 1)	Valuation techniques (observable inputs) (Level 2)	Valuation techniques (significant non-observable inputs) (Level 3)	Carrying value	Fair value
	£m	£m	£m	£m	£m	£m	£m
Financial liabilities							
Due to related entities	1,082	1,002	-	1,002	-	1,263	1,263

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

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

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

(c) *Loans and advances to customers* – The fair value of loans and advances is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity and incorporating behavioural adjustments where appropriate.

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

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

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

(b) Fair value measurements recognised on the balance sheet

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

38. Fair value of financial instruments (continued)

Group	Fair value measurement as at 30 September 2014				Fair value measurement as at 30 September 2013			
	Quoted market prices (Level 1) £m	Valuation techniques (observable inputs) (Level 2) £m	Valuation techniques (significant non-observable inputs) (Level 3) £m	Total £m	Quoted market prices (Level 1) £m	Valuation techniques (observable inputs) (Level 2) £m	Valuation techniques (significant non-observable inputs) (Level 3) £m	Total £m
Financial assets								
Derivative financial assets	-	220	-	220	-	244	-	244
Investments – available for sale – listed	1,161	-	-	1,161	968	-	-	968
Investments – available for sale – unlisted	-	-	7	7	-	-	7	7
Other financial assets at fair value	-	-	1,583	1,583	-	-	2,171	2,171
Total financial assets measured at fair value	1,161	220	1,590	2,971	968	244	2,178	3,390
Financial liabilities								
Derivative financial liabilities	-	548	-	548	-	651	-	651
Other financial liabilities at fair value	-	-	91	91	-	-	123	123
Total financial liabilities measured at fair value	-	548	91	639	-	651	123	774

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

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

(b) *Other financial assets and liabilities at fair value* – Fair values are based on quoted market prices and data or valuation techniques based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument. Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 14).

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

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

38. Fair value of financial instruments (continued)

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

Level 3 movements analysis: Group 2014

	Investments – available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the period	7	2,171	123
Total gains/(losses)			
In profit or loss[1]	-	(44)	(4)
Settlements	-	(544)	(28)
Balance at the end of the period	7	1,583	91

Level 3 movements analysis: Group 2013

	Investments – available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the period	7	4,266	147
Total gains/(losses)			-
In profit or loss [1]	-	(176)	(6)
Sales	-	(1,452)	-
Settlements	-	(467)	(18)
Balance at the end of the period	7	2,171	123

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

There were no transfers out of Level 3 in the year ended 30 September 2014 (2013: Nil).

The total gains or losses for the year ended 30 September 2014 includes an unrealised loss of £44m (2013: £176m) relating to financial assets that are measured at fair value at the end of each reporting period. Such fair value gains or losses are included in non-interest income (note 6).

38. Fair value of financial instruments (continued)

Quantitative information about significant unobservable inputs in Level 3 valuations

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2014.

Group	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Financial assets					
Investments – available for sale					
Unlisted	7	Underlying/net asset value	Price	Nil	Market value on disposal
Other financial assets at fair value	1,583	Discounted cash-flow	Portfolio lifetime probability of default	5.0%	11.2%

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

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

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

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

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

The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected payment profile of the loans. If the loans were to be repaid six months earlier than currently predicted the loan carrying value would decline by £5m. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £15m and vice versa. There are inter-dependencies between a number of the key assumptions which add to the complexity of the judgements the Group has to make which mean that no single factor is likely to move independent of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged.

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

39. Financial risk management

Strategy in using financial instruments

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

Fair value hedges

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

Cash flow hedges

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

Credit risk

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

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

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

Derivatives

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

Master netting agreements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if a counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis.

39. Financial risk management (continued)

Credit risk (continued)

Credit-related commitments

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

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

Forbearance

Identification and classification

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

A concession refers to either of the following actions:

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

Typically, concessions will include the granting of more favourable terms and conditions than those provided either at drawdown of the facility or which would not ordinarily be available to others with a similar risk profile. Loans that have been renegotiated and/or restructured for solely commercial reasons, where there is no financial difficulty are not treated as forborne. In the current period, the Group has implemented revised forbearance policies and definitions in order to align the reporting of forbearance with the guidance established by the European Banking Authority ("EBA") for FINREP reporting which first applies on 30 September 2014. Comparative forbearance disclosures for the prior period which are presented in this note have not been restated following the policy change. In order to aid comparability with the prior year, the Group has chosen to present the current year forbearance tables for retail mortgage lending and non-retail on both a current policy and a historic policy basis. The revised policies and definitions include an extension to the minimum period after which loans can exit forborne status (to two years), resulting in a number of loans which would have previously been deemed to have exited forbearance being brought into scope for disclosure. Where there are significant variances in forborne exposures as a result of the changes in policy, further details are provided in the footnotes to the tables in this note.

39. Financial risk management (continued)

Forbearance (continued)

Identification and classification (continued)

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

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

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

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

Exit from forbearance

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

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

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

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

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

Retail forbearance

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

Forbearance is exercised on retail customers in a number of different ways and is specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action. The Group has implemented appropriate policies and procedures to ensure consistent application of forbearance. The operation, maintenance and governance surrounding these policies are regularly reviewed to confirm they remain relevant, appropriate and, most importantly, of value to our retail customers who have been identified as requiring forbearance.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

At an operational level, the majority of forbearance measures are granted by Mortgage Collections who seek to negotiate positive outcomes for customers who have fallen into arrears. Forbearance is also exercised from within a dedicated Financial Management and Customer Solutions Team (FMCST), part of whose remit is to assist retail customers in financial difficulty to manage their finances more effectively on a case by case basis. The support provided by FMCST is tailored specifically for individual customers and includes an income and expenditure assessment along with other relevant financial management support.

The Group classifies the forbearance measures offered to retail customers into the following categories:

Formal arrangements: A permanent change which could include capitalisation of arrears, or arrangement with the customer to repay arrears over a shorter period than capitalisation would involve;

Temporary arrangements: Short terms measures that allow a period of relief for customers in financial difficulty, these can include short-term payment holidays;

Interest only conversion: A permanent or temporary conversion to interest only repayments, allowing the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term;

Term extension: A permanent change to the loan term allowing the customer to make lower repayments whilst still repaying the outstanding balance in full, over a longer period;

Other: A segment of forbearance exposures specifically dealt with through FMCST, which includes product switches;

Legal: Court mandated forbearance exposures;

Where the Group has made a demand for repayment, the customers facilities have been withdrawn or where a debt repayment process has been initiated, the exposure is classified as forborne if the debt is subject to any of the forbearance concessions above.

Forbearance measures including formal arrangements and temporary arrangements, are exercised within Mortgage Collections, while other tools such as conversion to interest only payments, term extensions and other arrangements are part of the suite of forbearance available from FMCST.

Retail forbearance - Mortgage lending

The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. The Group reports retail forbearance at the exposure level. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

As at 30 September 2014 – Current policy basis (1) (2)

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	2,282	189	1.03	3.7	1.97
Temporary arrangements	581	49	0.27	1.1	2.24
Interest only conversion	40	7	0.04	-	0.02
Term extension	72	6	0.03	-	0.03
Other	6	1	-	-	0.61
Legal	221	25	0.14	2.0	7.90
	3,202	277	1.51	6.8	2.46

As at 30 September 2014 – Historic policy basis (3)

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	500	37	0.20	0.4	1.13
Temporary arrangements	175	18	0.10	0.1	0.57
Interest only conversion	28	6	0.03	-	0.01
Term extension	49	4	0.02	-	0.04
	752	65	0.35	0.5	0.80

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

As at 30 September 2013 [3][4]

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	585	41	0.26	1.0	2.44
Temporary arrangements	173	15	0.09	-	-
Interest only conversion	12	1	0.01	-	-
Term extension	26	2	0.01	-	-
Other	6	-	-	-	-
	802	59	0.37	1.0	1.69

(1) All forbearance is reported as at the balance sheet date.

(2) The revised exit criteria introduced as part of the EBA's FINREP reporting guidance and stated in the 'Exit from forbearance' section above has been applied retrospectively.

(3) Under the historic policy forborne loans dealt with by Mortgage Collections were deemed to exit forborne status immediately after forbearance measures ceased to apply, where formal arrangements have been broken by the customer, those loans continue to be reported as forbearance until they are removed from the arrangement classes. Forbearance provided by FMCST reflected only those exposures where forbearance was granted within that reporting period.

(4) Not restated.

The key change in the Group's forbearance policy for retail customers between current policy basis and historic policy basis is the exit criteria. The current policy basis retrospectively applies the minimum two year exit criteria stated in the 'Exit from Forbearance' section of this note. Under the historic policy basis, forborne loans dealt with by Mortgage Collections were deemed to exit forborne status immediately after forbearance measures ceased to apply and forbearance provided by FMCST reflected only those exposures where forbearance was granted within that reporting period.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

The change in forbearance policy is the significant factor in the increase in the value of forborne balances disclosed. Using the Bank's historic policy, the level of forborne retail mortgage assets increased by £6m or 10.17%.

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to pro-actively track and facilitate pre-maturity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2014, the Group had 162 (2013: 210) customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £20m (2013: £29m).

A further forbearance reserve of £4m (2013: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £11m and to increase overall coverage to 4.0%.

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the period to 30 September 2014 there were 155 repossessions of which 53 were voluntary (2013: 174 including 39 voluntary).

Retail forbearance – consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including money transmission accounts, unsecured loans and credit cards. Forbearance strategies implemented on consumer credit are of low financial significance in the context of the Group's overall lending operations. The Group reports consumer credit forbearance at the exposure level.

The Group has assessed the total loan balances subject to forbearance on other types of consumer credit to be £22m at 30 September 2014 (2013: £31m), representing 1.87% of the total portfolio (2013: 2.65%). Impairment provisions on forborne balances totalled £6m at 30 September 2014 (2013: £8m), providing overall coverage of 27.03% (2013: 25.33%).

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance

Forbearance may be extended to non-retail customers for reasons relating to the actual, or apparent, financial stress of the customer or when they have been identified as experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. Authority to grant forbearance measures for non-retail customers is held by the Group's Strategic Business Services unit and is exercised, where appropriate, on the basis of detailed consideration of a customer's financial position and prospects.

The Group reports non-retail forbearance at a customer level, with customers that have forbearance granted on one or more facilities recorded as a single customer, but at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Where a customer is part of a larger group, forbearance is exercised and reported across the group at the individual entity level. Forbearance is considered to exist where one or more of the following occurs, on a non-commercial basis, for reasons relating to the actual or apparent stress of a customer:

- *Term extension* - Extending of loan facility payment term or the term of an overdraft which is not fluctuating (e.g. where a Term Loan has matured and the balance passed to an overdraft which is then extended on a non-commercial basis, then forbearance is considered to exist).
- *Deferral of contracted capital repayments* – Includes capital repayment holiday, conversion to interest only for an extended period, or rescheduling, but still repaying within the remaining contracted term.
- *Reduction in the contracted interest rate* – Includes a reduction in the level of accrued interest or amendment to original fee structure.
- *Alternative forms of payment* - Including debt for equity, asset transfer and repayment made by taking possession of collateral;
- *Debt forgiveness* – Total or partial debt forgiveness by write-off of the debt.
- *Refinancing* - A complete or partial repayment of a loan with a new contract granted on or up to 3 months after the day when the original contract expires. In the case of partial repayment both the original and new loans shall be classified as forborne.

Where the Group has made a demand for repayment, where the customers facilities have been withdrawn or where a debt repayment process has been initiated this will be classified as forbearance if the debt is subject to any of the forbearance concessions above.

Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forborne.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance (continued)

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

As at 30 September 2014 – Current policy basis (1) (2) (4)

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	491	387	4.78	44.2	11.43
Deferral of contracted capital repayments	158	198	2.44	37.4	18.90
Reduction in contracted interest rate	22	16	0.20	3.4	20.97
Alternative forms of payment	11	27	0.33	12.7	47.07
Debt forgiveness	32	73	0.90	18.6	25.59
Refinancing	41	29	0.36	1.7	5.78
	755	730	9.01	118.0	16.17

As at 30 September 2014 – Historic Policy basis (1) (3)

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	296	292	3.61	35.3	12.08
Deferral of contracted capital repayments	71	130	1.61	28.1	21.53
Reduction in contracted interest rate	11	11	0.14	1.0	9.05
Alternative forms of payment	7	24	0.29	9.5	40.10
Debt forgiveness	18	64	0.80	16.6	25.74
	403	521	6.45	90.5	17.34

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance (continued)

As at 30 September 2013 (1) (3) (5)

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	281	220	2.41	21.9	10.00
Deferral of contracted capital repayments	112	144	1.58	28.6	20.14
Reduction in contracted interest rate	7	6	0.07	2.0	33.33
Alternative forms of payment	7	43	0.47	8.6	20.93
Debt forgiveness	16	34	0.37	6.8	20.59
	423	447	4.90	67.9	15.44

(1) All forbearance is reported at the balance sheet date.

(2) The revised 2 year exit criteria introduced as part of the EBA's FINREP reporting guidance and stated in the 'Exit from forbearance' section above in the note has been applied retrospectively.

(3) Forborne loans were deemed to exit forborne status immediately after forbearance measures ceased to apply.

(4) Where the Group has made a demand for repayment, where the customers facilities have been withdrawn or a debt repayment process initiated this will be classified as forbearance if the debt is subject to any of the forbearance concessions above. In 2013, amounts meeting these criteria were not classified as subject to forbearance but were included within defaulted assets.

(5) Not restated.

The key changes in forbearance policy for non-retail customers between the current policy basis and historic policy basis are shown below:

- The current policy basis exit criteria stated in this note have been applied retrospectively for the current period. Under the historic policy, forborne loans were deemed to exit forborne status immediately after forbearance measures ceased to apply.

- Under the current policy, where the Group has made a demand for repayment and where the customers facilities have been withdrawn and a debt repayment process initiated, this will be classified as forbearance if the debt is subject to any of the forbearance concessions above. Under the historic policy, exposures meeting these criteria were not classified as subject to forbearance, but solely as defaulted assets.

The change in forbearance policy is the significant factor in the increase in the value of forborne balances disclosed. Using the Bank's historic policy, the level of forborne non-retail assets increased by £74m or 16.6%.

Included in other financial assets at fair value is a portfolio of loans which are included in the above table. The value of fair value loans subject to forbearance at 30 September 2014 is £133m (2013: £55m), representing 1.65 % of the total non-retail portfolio (2013: 0.60%). Impairment allowances on these amounts totalled £28.9m (2013: £15m), a coverage of 21.69 % (2013: 26.34%).

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance (continued)

The Group has identified a number of situations that in isolation are not considered to be forbearance:

- The waiver of a financial covenant breach, or amendment to the terms of a financial covenant. Typically, financial covenants are set at levels where the ability to repay has yet to be adversely affected but permit rights of action at an earlier stage of credit deterioration. They are designed to allow the Group time to work with the customer to develop and agree solutions which are effective and appropriate to both the Group and the customer. Where financial covenant breaches have occurred which could imply that the customer is in financial difficulty, normal impaired asset review procedures are followed.
- Facilities that have been temporarily extended pending review and no concession has been granted for reasons relating to the actual or apparent financial stress of a customer.
- A reduction in asset quality to a level where actual, or apparent, financial stress is not evident.
- Where changes are made to the terms of a borrower's interest structure or repayment arrangement on a commercial basis.

Maximum exposure to credit risk

The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

	Group	
	2014	2013
	£m	£m
Cash and balances with central banks (note 10)	5,986	6,720
Due from related entities (note 11)	1,487	1,390
Due from other banks	13	184
Investments – available for sale (note 12)	1,168	975
Other financial assets at fair value (note 13)	1,583	2,171
Derivative financial assets (note 14)	220	244
Loans and advances to customers (note 15)	25,901	23,960
Due from customers on acceptances	5	4
	36,363	35,648
Contingent liabilities (note 33)	136	213
Other credit commitments (note 33)	8,422	8,696
Maximum credit risk exposure	44,921	44,557

39. Financial risk management (continued)

Credit risk (continued)

Offsetting of financial assets and liabilities

The table below illustrates the amounts for financial instruments that have been offset on the balance sheet and also those amounts that are covered by enforceable netting arrangements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. Loans and advances).

The "net amounts" presented in the table are not intended to represent the Group's exposure to credit risk, as the Group will use a wide range of strategies to mitigate credit risk in addition to netting and collateral.

The offsetting and collateral arrangements and other credit risk mitigation strategies are further explained in the preceding sections of this note

2014

	Amounts subject to enforceable netting arrangements						
	Effect of offsetting on balance sheet			Related amounts not offset			Amounts not subject to enforceable netting arrangements
Group	Gross amount £m	Amount offset £m	Net amount reported on balance sheet £m	Financial instruments [1] [2] [3] £m	Cash collateral [2] [3] £m	Net amount £m	£m
Assets							
Derivative financial instruments[4]	88	-	88	(88)	-	-	132
Total assets	88	-	88	(88)	-	-	132
Liabilities							
Derivative financial instruments[4]	522	-	522	(88)	(317)	117	26
Securities sold under repurchase agreements[5]	644	-	644	(644)	-	-	-
Total liabilities	1,166	-	1,166	(732)	(317)	117	26

39. Financial risk management (continued)

Offsetting of financial assets and liabilities (continued)

2013

	Amounts subject to enforceable netting arrangements						
	Effect of offsetting on balance sheet			Related amounts not offset			
Group	Gross amount £m	Amount offset £m	Net amount reported on balance sheet £m	Financial instruments [1] [2] [3] £m	Cash collateral [2] [3] £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m
Assets							
Derivative financial instruments [4]	103	-	103	(103)	-	-	141
Liabilities							
Derivative financial instruments[4]	615	-	615	(103)	(408)	104	36
Total liabilities	615	-	615	(103)	(408)	104	36

(1) Financial instruments include both recognised financial instruments and unrecognised financial instruments (i.e. non-cash collateral).

(2) Amounts relate to master netting and collateral agreements which have been determined to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.

(3) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order not to include any over-collateralisation.

(4) Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

(5) Securities sold under repurchase agreements are reported on the Group and Bank's Balance Sheet within Due to other banks.

Derivative assets and liabilities

Derivative financial instrument contracts are typically subject to International Swaps and Derivatives Association ("ISDA") master netting agreements, as well as Credit Support Annexes ("CSA"), where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house. The amounts included in Financial Instruments column refers to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement.

Repurchase agreements

Repurchase agreements will typically be subject to Global Master Repurchase Agreements (GMRAs) or similar agreements whereby all outstanding transactions with the same counterparty can be offset and closed out upon a default or insolvency event (i.e. close out netting).

Where the Group has a right of offset on default or insolvency only, the related financial instruments comprise of highly liquid securities pledged, which can be realised in the event of a default or insolvency by the counterparty.

Credit quality of financial assets

An assessment of the credit quality of loans and advances to customers can be found in note 15 with an assessment of the credit quality of investments contained in note 12.

39. Financial risk management (continued)

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to business rules and confidence levels. The loan to value ratio of our mortgage portfolio is disclosed in note 15.

Commercial property

Commercial property is the Group's main source of collateral on commercial lending and means of mitigating loss in the event of default credit risk inherent in its commercial portfolios. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

Non-property related collateral

Apart from Residential and Commercial Property based security, the Group also takes other forms of collateral when lending and this can involve obtaining security against the underlying loan through the use of cash collateral and/or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

39. Financial risk management (continued)

Collateral held as security and other credit enhancements (continued)

The following table shows the total non-property collateral held at 30 September 2014 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high quality) and netting. The exposure amount shown below is the total gross exposure (before any Credit Risk Mitigation and Credit Conversion Factors have been applied where applicable) for arrangements which have some form of associated collateral held against it and is not the total exposure for each asset class, as disclosed in the Strategic Report.

	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	49	-	-	49	51
Corporates	88	-	66	154	197
Institutions	910	68	-	978	1,034
Past due items	1	-	1	2	13
Public sector entities	-	-	-	-	0
Regional Government or local authorities	-	-	138	138	144
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	35	-	34	69	165
Secured by mortgages on residential property	5	-	7	12	33
	1,088	68	246	1,402	1,637

Corporates is the largest sector for other risk mitigation techniques, with all three methods utilised dependent on credit quality. The extent to which these will be used will be dependent on the specific circumstances of the customer.

39. Financial risk management (continued)

Risk concentration

Concentration of risk is managed by client/counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to limit exposure to a single entity/counterparty.

Eurozone risk

The Group and Bank have no material operations outside the UK and have no direct sovereign exposure to any Eurozone countries (2013: Nil). The Group has an exposure to the European Investment Bank of £100m at 30 September 2014 (2013: £100m).

Industry concentration of assets

The following tables show the levels of industry concentration of credit risk as at 30 September:

Gross loans and advances to customers including loans designated at fair value through profit or loss	Group 2014 £m	2013 £m
Government and public authorities	55	35
Agriculture, forestry, fishing and mining	1,677	1,758
Financial, investment and insurance	421	553
Property – construction	394	516
Manufacturing	733	723
Instalment loans to individuals and other personal lending (including credit cards)	1,712	1,902
Property – mortgage	18,444	16,148
Asset and lease financing	417	482
Other commercial and industrial	3,851	4,319
	27,704	26,436

Contingent liabilities and credit related commitments	Group 2014 £m	2013 £m
Government and public authorities	8	-
Agriculture, forestry, fishing and mining	1,022	1,006
Financial, investment and insurance	43	56
Property – construction	75	98
Manufacturing	188	228
Instalment loans to individuals and other personal lending (including credit cards)	3,742	3,939
Property – mortgage	2,107	2,010
Other commercial and industrial	1,373	1,572
	8,558	8,909

Available for sale and held to maturity investments	Group 2014 £m	2013 £m
Government and public authorities	1,161	968
Financial, investment and insurance	7	7
	1,168	975

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

39. Financial risk management (continued)

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Group's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

Interest rate risk in the banking book ("IRRBB")

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with NAB IRRBB policy. Risk measurement techniques include: Value at Risk ("VaR"), Earnings at Risk ("EaR"), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- Historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a statistical basis: 99% confidence level; three month holding period.
- Economic capital is allocated for IRRBB based on a higher confidence interval and a longer holding period.
- EaR utilises a twelve month forecast period.
- Eight years of business day historical data.
- VaR methodology is based on proportional rather than absolute changes in historical interest rates.
- Investment term for capital is modelled with an established benchmark term of between one and five years.
- Investment term for core "non-interest" bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between one and five years.

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of the UK Asset & Liability Committee ("UK ALCO").

Interest rate risk	Value at risk		Earnings at risk	
	2014	2013	2014	2013
	£m	£m	£m	£m
As at 30 September	36	30	2	7
Average value during the year	37	32	3	9
Minimum value during the year	32	29	2	3
Maximum value during the year	48	35	8	20

39. Financial risk management (continued)

Market risk (continued)

The following table shows the Group's principal financial assets and liabilities and the main non traded market risk types they are exposed to:

	2014 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	5,986				✔
Available for sale investments	1,168	✔	✔		✔
Loans and advances to customers	25,901	✔	✔	✔	✔
Derivative financial instruments	220	✔	✔	✔	✔
Other financial assets at fair value	1,583	✔	✔		✔
Liabilities					
Due to customers	24,073	✔	✔	✔	
Due to other banks	914	✔	✔	✔	
Derivative financial instruments	548	✔	✔	✔	
Other financial liabilities at fair value	91	✔	✔		
Bonds and notes	3,453	✔	✔	✔	

Prepayment risk

Customers may prepay certain loans and advances ahead of the contractual repayment schedule. This form of optionality gives rise to prepayment risk for the Bank whereby the expected timing of cashflows from loan repayments differs from the actual experience. The impact on the Bank would differ according to changes in the level of interest rates.

The Group assesses the risks arising from prepayment behaviour in order to show the potential impact on future cashflows. The impact is also managed through terms and conditions within loans and advances.

39. Financial risk management (continued)

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Group 2014	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,670	-	-	-	-	1,316	5,986
Due from related entities	1,487	-	-	-	-	-	1,487
Due from other banks	13	-	-	-	-	-	13
Investments – available for sale	-	2	1	101	1,058	6	1,168
Other financial assets at fair value	3	33	105	589	853	-	1,583
Derivative financial assets	2	29	59	47	83	-	220
Loans and advances to customers	2,519	293	769	4,063	17,893	364	25,901
Due from customers on acceptances	-	5	-	-	-	-	5
All other assets	143	71	45	-	-	770	1,029
Total assets	8,837	433	979	4,800	19,887	2,456	37,392
Liabilities							
Due to other banks	-	664	250	-	-	-	914
Other financial liabilities at fair value	-	2	6	65	18	-	91
Derivative financial liabilities	2	36	60	170	280	-	548
Due to customers	17,872	2,039	2,464	1,698	-	-	24,073
Liabilities on acceptances	-	5	-	-	-	-	5
Due to related entities	359	8	346	838	1,126	-	2,677
Bonds and notes	-	20	730	2,039	664	-	3,453
All other liabilities	1,938	107	65	-	-	983	3,093
Total liabilities	20,171	2,881	3,921	4,810	2,088	983	34,854
Off balance sheet items							
Contingent liabilities	-	32	25	12	61	6	136
Other credit commitments	8,422	-	-	-	-	-	8,422
Total off balance sheet items	8,422	32	25	12	61	6	8,558

39. Financial risk management (continued)

Market risk (continued)

Maturity analysis of assets and liabilities (continued)

Group 2013 As restated	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,508	-	-	-	-	1,212	6,720
Due from related entities	1,381	-	-	9	-	-	1,390
Due from other banks	19	100	65	-	-	-	184
Investments – available for sale	-	2	-	101	866	6	975
Other financial assets at fair value	11	87	242	530	1,301	-	2,171
Derivative financial assets	-	23	24	106	91	-	244
Loans and advances to customers	2,880	346	722	4,089	15,527	396	23,960
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	178	173	58	-	-	691	1,100
Total assets	9,977	735	1,111	4,835	17,785	2,305	36,748
Liabilities							
Due to other banks	-	484	37	-	-	-	521
Other financial liabilities at fair value	-	3	9	52	59	-	123
Derivative financial liabilities	1	54	53	184	359	-	651
Due to customers	16,659	2,656	2,515	2,525	-	-	24,355
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	623	61	-	1,227	1,125	-	3,036
Bonds and notes	-	14	-	2,429	642	-	3,085
All other liabilities	1,803	100	74	-	-	547	2,524
Total liabilities	19,086	3,376	2,688	6,417	2,185	547	34,299
Off balance sheet items							
Contingent liabilities	1	34	63	16	90	9	213
Other credit commitments	8,696	-	-	-	-	-	8,696
Total off balance sheet items	8,697	34	63	16	90	9	8,909

39. Financial risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

Group 2014	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	665	250	-	-	-	915
Other financial liabilities at fair value	-	3	9	79	20	-	111
Derivative financial liabilities	2	36	24	74	275	-	411
Due to customers	17,873	2,050	2,487	1,721	-	-	24,131
Liabilities on acceptances	-	5	-	-	-	-	5
Bonds and notes	-	40	782	2,214	880	-	3,916
All other financial liabilities	1,504	-	-	-	-	-	1,504
Hedging derivatives							
Contractual amounts payable	-	85	481	840	34	-	1,440
Contractual amounts receivable	-	(55)	(429)	(705)	-	-	(1,189)
Total liabilities	19,379	2,829	3,604	4,223	1,209	-	31,244

Group 2013	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	484	37	-	-	-	521
Other financial liabilities at fair value	-	4	14	71	65	-	154
Derivative financial liabilities	1	54	53	107	340	-	555
Due to customers	16,659	2,667	2,553	2,559	-	-	24,438
Liabilities on acceptances	-	4	-	-	-	-	4
Bonds and notes	-	34	57	2,627	751	-	3,469
All other financial liabilities	1,344	-	-	-	-	-	1,344
Hedging derivatives							
Contractual amounts payable	-	66	172	1,109	78	-	1,425
Contractual amounts receivable	-	(59)	(173)	(1,002)	-	-	(1,234)
Total liabilities	18,004	3,254	2,713	5,471	1,234	-	30,676

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

40. Management of risk

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy, as well as that of its parent entity NAB. The key components of the Group's risk management strategy are detailed below:

Risk control and management

Risk culture

Establishing and maintaining an appropriate risk culture within the Group is a key objective. The culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite which aligns to, and supports, the strategic objectives of the Group. The Group's strategic priorities refer to embedding a "strong risk culture in our people" and the Group has also established a conduct strategy in which an explicit objective is to develop a "customer centric culture". Together, these provide guidance and support to staff on what is expected of them.

Further initiatives that support the appropriate risk culture include: messaging from the CEO and Executive Committee members; the Group's performance management framework which incorporates a balanced assessment of factors (including risk management, behaviour and a transparent compliance gateway assessment); training; and escalation procedures (both through the management hierarchy or anonymously through the Group's whistle-blower facility) allowing staff to raise concerns quickly and appropriately.

Underpinning the risk management operating model, and at the heart of the Group's risk culture, is the notion of personal accountability for risk management at source. This is enabled through a risk management accountability model (which articulates specific accountabilities for core elements of risk management across the Group) and a formal delegation framework through which staff are able to make risk based decisions.

Strategic planning and risk appetite

The Board have established a formal Risk Appetite Statement ("RAS"). This places an overall limit on the total amount and types of risk that the Group is prepared to take. This is set with respect to the returns that the Group is seeking to provide to its shareholder, the credit rating that the Bank is seeking to maintain and the Group's capital position and desired capital ratios.

This informs the Group's risk, capital and business limits and policies. It is regularly reviewed by the Board as a part of the strategic planning process, or otherwise as the commercial circumstances of the Group change.

Risk Management Framework

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the businesses' front-line teams to be effective. This overriding principle embodies the following concepts:

- all business decisions proactively consider risk and the impact on the Group's customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components; and
- all employees are responsible for risk management in their day-to-day activities.

Within this context, the Group manages risk within a "three lines of defence" framework. Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are accountable for establishing risk policy, standards and the oversight of risk management effectiveness within the business. The third line of defence is Internal Audit who are responsible for independently reviewing, monitoring, and testing business unit compliance and regularly assessing the overall effectiveness of the Risk Management Framework.

40. Management of risk (continued)

Risk control and management (continued)

Risk Governance

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

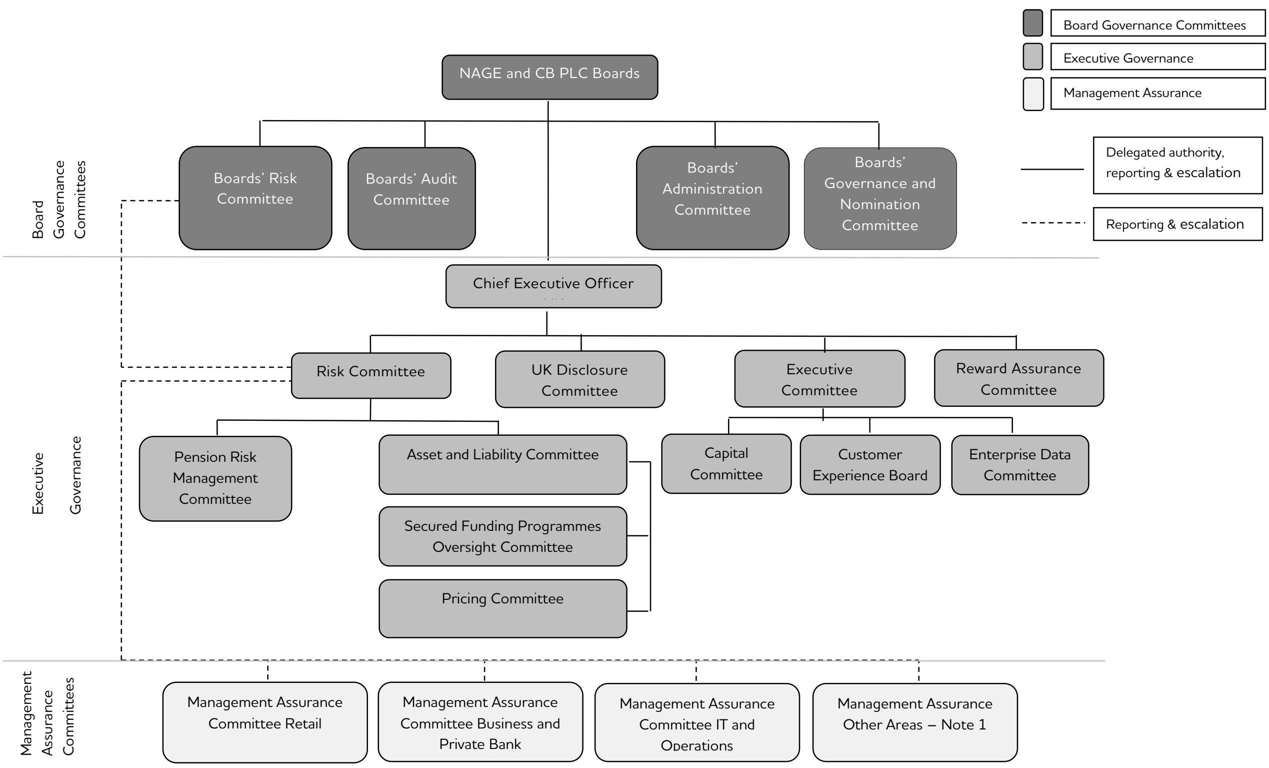
The NAB Group Risk and Reward Management Committee, chaired by the NAB Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance on the performance of the overall Risk Management Framework. This Committee is supported by three sub-committees - the NAB Group Credit Risk Committee, the NAB Group Asset and Liability Committee, and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated by the Boards' Risk and Audit Committees, the Boards approve the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Group's Corporate Governance statement on the Group's website (www.cbonline.co.uk) for further information on Board committees. The table below details the Bank's Executive and Management Assurance Commitees and their risk focus.

The following Executive Governance Committees have been established under the authority of the Chief Executive Officer UK (CEO)	
Committees	Risk Focus
Risk Committee	The UK Risk Committee (UKRC) supports the CEO in respect of his risk and control accountabilities and serves to provide leadership focus on key risk issues including: • Devising the Risk Appetite Statement for approval by the Boards; • Overseeing and challenging the enterprise wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools; • Monitoring the status of regulatory relationships, the reputation of the Group in relation to its regulators and the changing state of the regulatory landscape including the impacts for and readiness of the Group; • Monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and • Reviewing and endorsing risk policies, frameworks and tools for use across the Group.
UK Disclosure Committee	The UK Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations as a subsidiary of National Australia Bank Limited ("NAB") under the rules of the Australian Securities Exchange in relation to NAB securities and in relation to debt securities listed on the London, Luxembourg and Channel Islands stock exchanges.
Executive Committee	The UK Executive Committee supports the CEO UK to lead the Group to be a strong, customer focused bank for our communities by focusing on four business priorities; Customer, Risk and Control, Sustainable Returns and People.
Reward Assurance Committee	The Reward Assurance Committee provides oversight of the application of NAB Group remuneration policies and frameworks in the Group.
The Risk Committee is supported by	
Pension Risk Management Committee	The Pension Risk Management Committee is responsible for overseeing pension risk management and strategy. This committee also oversees and governs interaction with UK pension scheme trustees.
Asset and Liability Committee	Responsible for monitoring the performance of the Group against the Boards' approved Capital and Funding Plans. The committee focuses on the Group's non-traded market risks including capital, funding, liquidity, interest rate risk and pension risk to ensure that the Group's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives.
Pricing Committee	The Pricing Committee is responsible for managing pricing decisions in relation to business lending, retail lending and deposits.
The Executive Committee is supported by	
Capital Committee	The Capital Committee is responsible for ensuring effective governance of UK capital usage and performance. This includes monitoring key capital and related performance metrics; development of infrastructure to deliver key capital measures out to business functions; and optimising capital efficiencies.
Customer Experience Board	The Customer Experience Board is responsible for championing the end to end customer experience ensuring appropriate and consistent execution, whilst ensuring Treating Customers Fairly principles are adhered to.
Enterprise Data Committee	The Enterprise Data Committee is responsible for providing direction and oversight of information and data practices, including oversight of management's resolution of data issues.
First line responsibility for risk management resides with Management Assurance Committees which provide reports to the UKRC and Boards Risk committees	
Management Assurance Committee (Retail; Business and Private Bank; IT & Operations; Other Areas)	Each major business unit has established a Management Assurance Committee, which supports the business unit Director to lead the business unit in respect of risk matters and provides advice, guidance, challenge and recommendations. This includes recommending the business unit Risk Appetite Statement to the UKRC; monitoring performance against risk settings and tolerances; reviewing the strength of the control environment and risk capability; and monitoring the effectiveness of risk culture and on-going compliance with regulatory requirements.

40. Management of risk (continued)

The Group's risk management structure is diagrammatically represented below:



Note 1: for other business areas the responsibilities of the Management Assurance Committee will be discharged through either existing Leadership Team or Management Fora focussing on risk.

The UK Risk Management team independently monitors and systematically assesses the risk profile within the Group against established risk appetite parameters. They also assist the front line business units in the design and implementation of appropriate risk management policies and strategies and work with the business units to promote awareness of the need to manage risk.

Stress testing within the Group's risk governance and capital framework

Stress testing within the Group has been developed to inform future business and risk planning initiatives, strategic risk management (including Risk Appetite setting) and capital management. Specifically, stress testing is used or considered in informing the following management decisions:

Risk appetite and strategic business planning - As part of an annual assessment of future opportunities for, and threats to, the Group, stress testing outputs are used to inform the strategic planning process and to develop risk posture and risk appetite settings.

Capital planning ("ICAAP") - Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP process.

Liquidity management ("ILAA") - Scenarios provide insight into potential vulnerabilities in the Group's funding strategies and leverage profile. Regular stress tests are undertaken to understand and monitor exposure to liquidity risk with their regularity being aligned to the nature of, and exposure to, the risk type.

40. Management of risk (continued)

Risk control and management (continued)

Stress testing within the Group's risk governance and capital framework (continued)

Recovery & resolution plan ("RRP") –the RRP helps inform both stress testing and reverse stress testing scenario development. Reverse stress testing explores circumstances, or a set of circumstances, that render the Group's business model unviable, moving the Group into a resolution by the authorities. As a result, these stresses are recognised as a required risk management tool in the form of an early warning indicator of potential stress events.

Strategic risk management - Stress testing informs the nature and level of risk carried by the Group arising from opportunistic assessments such as investments, divestments and acquisitions through emerging material risks posed by trends in, or changes to, the business environment.

Stress Testing Oversight and Governance

Capital Committee - The UK Capital Committee ensures, through its remit as the primary capital stress testing review forum, that results are sufficiently debated and discussed. Outputs are challenged as appropriate before being endorsed and presented to the UK Executive Committee and the Board.

Asset and Liability Committee ("ALCO") - The UK ALCO reviews the scenarios, assumptions and results of liquidity stress testing. These are reported monthly using the liquidity stress scenarios approved by the Board as part of the ILAA.

Executive Committee - UK Executive Committee members are engaged in stress testing to provide an appropriate level of review, discussion and debate into the scenario selection process, utilising their business knowledge as Heads of each business unit. The committee also consider and assess results in the context of future strategic decision making, contingency planning, capital and business planning.

Board of Directors - The Board comprises Non-executive and Executive Directors of the Group with members engaged at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to scenario selection and development. In addition, the Board considers how the results are integrated into the future strategic decision making, contingency planning, capital and business planning and risk appetite.

40. Management of risk (continued)

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality.

The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities within the Group are clearly defined.

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Group Credit and Market Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the NAB Group Chief Credit Officer (and associated teams) provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management within the UK, with appropriate oversight through the UK executive governance committees.

The Group's credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

Single large exposure policies are in place within the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

40. Management of risk (continued)

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems or from external events. This includes legal risks as well as operational risk components associated with other risks categories (e.g. credit, traded market, non-traded market).

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events. These risk categories are defined as follows:

- Customer, products and sales practices ("conduct risk") – the treatment of customers and the management of customers impacts on all the Group's core activities. This is a principal focus of the Board, Senior Management and the regulators and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, that customer expectations are met and complaints are dealt with effectively and fairly. Consideration of customer outcomes is embedded within the Group's operating processes and metrics are regularly monitored to ensure outcomes are appropriate.
- Regulatory environment and market practices – the Group is required to comply with a large volume of laws and regulations and the regulatory environment has also been subject to substantial change in recent years. This is likely to continue and represents an on-going focus of the Group's management in ensuring the Group continues to operate within prudential parameters and that the conduct of the Group's activities meets the expectations of the Group's customers, shareholders and regulators. The Group operates a zero tolerance for regulatory breaches and organises its activities to ensure controls over regulatory risk are maintained in addition to maintaining a strong, open and trusted relationship with its regulators.
- Monitoring, reporting and oversight – effective controls over business operations are essential for the protection of the Group's customers and shareholders and is a key responsibility of all employees and managers. The Group continues to reinforce frameworks, standards and oversight arrangements to enhance the quality of risk management in the organisation. Each business unit maintains a risk profile with embedded controls and actions to manage inherent risks.
- Payments and process management – the Group processes a large volume of transactions for customers every day and manages the risks in this and other operations to ensure these activities are conducted safely and efficiently. However, in all operational activity there is a potential risk of established procedures not being followed, a failure to detect errors or that inadequate controls are in place.
- External fraud and criminal activities – the Group takes seriously its responsibilities to protect customers against financial crime. This includes preventing fraud activities in all channels through which customers transact; the prevention of money laundering; and compliance with legal sanctions requirements. Fraud management is an ongoing challenge for the financial services industry and presents a constant risk to the Group as criminal activities evolve on a national and global basis. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Cyber attack – the Group recognises the risk of cyber attack against its services and data. Dealing with cyber attacks is an ongoing challenge for the financial services industry and presents a constant risk to the Group as the motivations constantly change, the techniques become more sophisticated and the resources used in the attacks become more readily available as a commodity service. The Group has implemented industry standard tools and internal controls to help prevent external intrusions of the Bank's systems and loss of sensitive information; these controls ensure compliance with regulation. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Internal fraud and criminal activities – The Group recognises the risk of internal fraud associated with internal acts intended to defraud, misappropriate funds, information and physical assets, and circumvent policy. The Group has zero tolerance for internal fraud and has a strong control framework in place to mitigate this risk.

  Workplace practices and environment – providing a safe environment for customers and colleagues is important for the success of the business and the Group seeks to ensure adequate safeguards are in place and are operating effectively.

40. Management of risk (continued)

Operational risk (continued)

- Systems and infrastructure – There is a risk of service interruption due to failure of the Group's systems leading to a period of service disruption. The Group has a strong framework of controls over the continuity of service provision for all critical processes including recovery procedures in the event of unplanned service interruption.
- Third party providers - Failure to manage third party providers effectively may also impact on the level of service available to customers. The Group's controls to mitigate this risk include regular oversight of third party processes and assurance testing of the effectiveness of relationship management.

Responsibility for the management of operational risk rests with the business managers with oversight from the risk management function and independent assurance activities undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. It is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes and includes:

- an established governance structure that is used to ensure consistent application, control and reporting of the Operational Risk Management process. This element also includes the establishment and communication of the Group's operational risk appetite; and
- a structured process to facilitate the identification, quantification and management of risks underpinned by clear policies and guidelines. Material risks are reported monthly to the Management Assurance Committees and the UK Risk Committee, and to each Boards' Risk Committee to provide visibility and understanding of the Group's overall risk profile.

Non-traded market risk

Non-traded market risks include liquidity and funding risk, structural interest rate risk, foreign exchange risk and risks associated with the Group's defined benefit pension scheme. The primary objective for the management and oversight of non-traded market risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

Policies relating to non-traded market risks are approved by the Board of the NAB Group. The consistent application of NAB Group polices across the Group is the responsibility of the Group's Board with the support of executive management governance committees. In relation to non-traded market risks, the primary management committee is the UK ALCO.

Risk appetite and limits are approved for non-traded market risk by the Group's Board, with authority delegated to the UK ALCO for their subsequent implementation and monitoring.

The UK ALCO meets monthly and reports to the UK Risk Committee. The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from UK Risk.

Liquidity and funding risk

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

Liquidity within the Group is managed in accordance with the ILAA that is approved by the Board. The ILAA includes the manner in which the Group meets all regulatory requirements of the PRA and includes the Group's policy for the management of liquidity risk, including the Group's Overall Liquidity Adequacy Rule. Oversight of liquidity risk is undertaken by the UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group is

40. Management of risk (continued)

Non-traded market risk (continued)

Liquidity and funding risk (continued)

also monitored by the NAB Group ALCO in accordance with the NAB Group Non-Traded Market Risk Policy. To meet the requirements of local regulatory authorities the liquidity of the Group is managed on a daily basis as a stand-alone undertaking using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. The UK ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances. The Group has a Contingency Funding Plan which is used to detail actions to be taken in the event of an escalated liquidity requirement.

A contingency plan has also been established for management of an escalated liquidity requirement if the Group or the NAB Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, currency, counterparty, term structure and market.

The Group's main sources of funding include the following:

- Retail, SME, corporate deposits;
- Commercial paper programme;
- Access to sterling money markets through cash deposits and certificates of deposit;
- Medium Term Note programme;
- "Lanark" residential mortgage securitisation programme (owner occupied);
- "Lannraig" buy-to-let mortgage securitisation programme;
- Regulated Covered Bond programme; and
- Access to the facilities within the Bank of England Sterling Monetary Framework.

These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet. The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage backed debt.

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and NAB Group ALCO.

There are three major contributors to interest rate risk:

- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities; and
- the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets i.e. basis risk.

40. Management of risk (continued)

Non-traded market risk (continued)

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk management across the Group is directed by UK ALCO with delegation for day-to-day management to the Group's Treasury division. The UK Risk Committee, through UK ALCO oversight, monitors risk to ensure it remains within approved policy, limits and Board requirements.

Basis risk is managed through a combination of wholesale market basis risk products, pricing strategies and product innovation.

A key feature of the risk management and oversight framework is the use of VaR as a measure of interest rate risk, along with EaR to measure the impact on future net interest income. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group's Balance Sheet & Liquidity Risk Oversight team that is independent of the Treasury division.

Foreign exchange risk

Exposures arise if future cash flows can only be converted to Sterling at rates that are different than at the time of the original transaction. The Group's policy is to fully hedge these exposures at the time of commitment for all exposures that are considered to be of a marketable size.

The transactional currency exposures principally arise from dealings with customers and the Group maintains a matched position through transactions with a range of counterparties including the NAB Group in order to comply with the Group's Trading Policy Statement.

Pension risk

Pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. The operation of a pension scheme gives rise to a number of risks, e.g. movements in equity valuations, changes in bond yields and life expectancy of scheme members. The Scheme is managed by independent Trustees. However, the impact of the Scheme on the Group is subject to management by the Group and corresponding risk oversight. The Group's Pension Risk Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

The Group is governed by NAB Group's Capital Management Policy. The objectives of the NAB Group's Capital Management Policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators' requirements and managing the ratings agencies assessment of the Group. The UK Capital Plan is approved by the UK Boards on an annual basis. The UK Assets and Liabilities Committee ("UK ALCO") monitors the capital plan and forecast positions on a monthly basis. This ensures that in the event that further capital is deemed necessary to meet regulatory requirements or support future strategy, the issue is proactively escalated to Senior Management and the UK Boards, as well as the NAB Group Treasury, to determine the most appropriate strategy for the Group to achieve the desired capital outcome.

The Group implemented Basel II requirements from 1 January 2008 in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Group calculates its minimum capital requirements based on 8% of RWAs. The PRA then adjusts this requirement to cover risks under Pillar II of Basel II and generates an Individual Capital Guidance ("ICG") and a Capital Planning Buffer ("CPB"). The CPB is designed to be available to absorb losses and / or to cover increased capital requirements in adverse circumstances that are outside the Group's normal and direct control.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The UK ALCO, which consists of the Chief Executive Officer, Chief Operating Officer, the Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Group actively manages its capital position and reports this on a regular basis to senior management through the UK ALCO and other governance committees, including the Capital Committee which is responsible for ensuring effective governance of UK capital usage and performance. Capital requirements are included within an annual capital management plan which is presented to and approved by the Board of Directors.

The Financial Services (Banking Reform) Act 2013 received Royal Assent in December 2013. The Act seeks to protect deposit holders and ensure the PRA can hold banks to account. The reforms may affect the structure of banks and the amount of capital held. The key aspect of the Act is to establish the concept of ring fenced bodies ("RFB"). A RFB is defined by reference to its core retail deposits which fall within the ring fence and which cannot be allowed to leak outside the ring fence. One of the thresholds for inclusion as a RFB is minimum core customer deposits of £25bn. The PRA has since released a Consultation Paper (The Implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities). A working group has been established to consider the impacts on the Group.

The PRA issued a Policy Statement, known as PS7/13 which has implemented CRD IV in the UK from 1 January 2014. This included the need to make certain deductions from CET1 capital in full from 1 January 2014 with no transitional relief, including certain Deferred Tax Assets and the IAS19 Defined Benefit Pension Deficit. This approach has resulted in the injection of £300m of ordinary shares into the Group on 27 March 2014 to offset the impact of these deductions (note 31).

CRD IV also provides for new regulatory capital buffers including a Capital Conservation Buffer (CCB) and Counter-Cyclical Buffer (CCyB) to replace the existing Capital Planning Buffer (CPB). With effect from May 2014, the Financial Policy Committee (FPC) at the Bank of England assumed formal responsibility for setting the CCyB each quarter. At its June 2014 meeting, the FPC discussed the appropriate setting for the first time and decided to set the first quarterly CCyB rate for UK exposures to 0%. Under CRD IV the CCB will, when fully adopted in 2019, equate to 2.5% of RWAs. Further detail on the Group's regulatory capital is included on pages 10 to 14 of the Strategic Report.

42. Pillar 3 disclosures

Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation (CRR). Article 13(3) of the CRR allows for the application of disclosure requirements on a consolidated basis, where equivalent disclosures are made by a parent undertaking.

The Group relies on the following references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations. It has already included additional capital resources disclosure on pages 10 to 14 of these financial statements.

National Australia Bank Limited 2014 Pillar 3 Report: http://www.nab.com.au/about-us/shareholder-centre/financial-disclosuresandreporting.

In addition disclosures on the Risk Management and Risk Profile of the Group are contained within the Strategic Report on pages 17-19 of these financial statements.

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

PRA remuneration Pillar 3 disclosures

Remuneration Pillar 3 disclosure requirements are set out in Article 450 of the Capital Requirements Regulation (CRR). The Group relies on the following references to equivalent National Australia Bank Limited consolidated disclosures plus additional aggregate disclosures for UK Code Staff to satisfy the Pillar 3 disclosure obligations.

UK Code Staff disclosures are available at: http://www.nab.com.au/about-us/shareholder-centre/financial-disclosuresandreporting/regulatory-disclosures

National Australia Bank Limited 2014 Pillar 3 Report: http://www.nab.com.au/about-us/shareholder-centre/financial-disclosuresandreporting.

The remuneration report is held within the Report of the Directors of the National Australia Bank Limited 2014 Annual Financial Report.

National Australia Bank Limited 2014 Annual Financial Report: http://www.nab.com.au/about-us/shareholder-centre/financial-disclosuresandreporting.

43. Events after the balance sheet date

There have been no subsequent events which have occurred since 30 September 2014 that would require disclosure in the annual report and financial statements of National Australia Group Europe Limited.

Enhanced disclosure task force recommendations

Below is a tabular overview of how the Group has responded to the EDTF recommendations as referred to on page 19 of the annual report and consolidated financial statements. The Group already provides risk disclosures in accordance with International Financial Reporting Standards which can predominantly be found in notes 39, 40 and 41 to the financial statements and the appropriate cross reference between these and the relevant EDTF recommendation is provided as necessary to avoid duplicating information.

EDTF recommendation	Description	The Group's approach
1	Amalgamate all risk related information and if not possible provide an aid to help users locate risk disclosures	Risk disclosures are included within the Strategic Report and notes 39, 40 and 41 of the annual report and consolidated financial statements.
2	Define the Group's risk terminology and risk measures	Relevant definitions are included within the glossary to the annual report and consolidated financial statements.
3	Describe and discuss top and emerging risks	Commentary on the Group's top and emerging risks can be found within the Strategic Report starting on page 2.
4	Outline plans to meet each new key regulatory ratio once the applicable rules are finalised. These include: • net stable funding ratio ("NSFR"); • liquidity coverage ratio ("LCR"); and • leverage ratio	The ratios which will be introduced under the Basel III regime, including LCR, NSFR and the Leverage ratio, are being actively monitored and managed by the Group. They are reported at key governance committees and are disclosed within 'Key Measures' in the strategic report.
5	Summarise the Group's risk management organisation	The Group's risk management organisation is described and diagrammatically represented in note 40.
6	Describe the Group's risk culture and how procedures and strategies are applied to support the culture	Commentary on the Group's risk culture can be found in note 40.
7	Describe the Group's key risks from the business model and activities along with the Group's risk appetite and how these risks are managed	Commentary on the Group's business model risks can be found within the Strategic Report starting on page 2.
8	Describe the use of stress testing within the Group's risk governance and capital frameworks	Commentary on the use of stress testing within the Group's risk governance and capital frameworks is provided in note 40

Enhanced disclosure task force recommendations (continued)

9	Provide minimum Pillar 1 capital requirements, including any capital surcharges or capital conversion buffers, or the minimum internal ratio	The Group's Pillar 1 requirements can be found in the capital position section within the Strategic Report starting on page 2.
10	Summarise composition of capital and provide a reconciliation of the accounting balance sheet to the regulatory balance sheet	The Group provides a summary of its Tier 1 capital position along with a reconciliation of regulatory capital to statutory equity in the capital position section within the Strategic Report starting on page 2.
11	Present a flow statement of movements in regulatory capital for the year, including changes in common equity tier 1, tier 1 and tier 2 capital	The Group's regulatory capital flow statement can be found in the capital position section within the Strategic Report starting on page 2.
12	Capital planning within a more general discussion of management's strategic planning	An overview of the Group's capital management approach can be found in note 41 to the annual report and consolidated financial statements which highlights that it is governed by NAB Group's Capital Management Policy. The Group is a wholly owned subsidiary with a significant Global parent. The Group operates a UK Risk Appetite Framework to support the Group's strategic planning and capital planning processes. The framework identifies material risks to which the business is exposed to and for which capital needs to be held. The UK Risk Appetite Statement is the formal articulation of the risk bearing capacity of the Group, it is approved annually by the Board and supports the strategic planning process.
13	How do RWAs relate to business activities and related risks	The Group provides an analysis of RWAs in the capital position section within the Strategic Report starting on page 2. This breaks down the RWA figure into our key business activities with the risks calculated on a standardised basis.
14	Capital requirements for calculating RWAs for credit risk for each Basel asset class including the major portfolios within those classes	The Group's capital requirements for calculating RWAs for credit risk for each Basel asset class can be found in the capital position section within the Strategic Report starting on page 2.
15	Tabulate credit risk in the banking book for Basel asset classes and major portfolios within the Basel asset classes	A table analysing the credit risk in the banking book for Basel asset classes can be found in the capital position section within the Strategic Report starting on page 2. The table discloses our exposure consistent with the standardised approach.

Enhanced disclosure task force recommendations (continued)

16	RWA flow statement	An RWA flow analysis is presented within the Strategic Report starting on page 2.
17	Contextualising Basel Pillar 3 back-testing requirements	As detailed in note 42, the Group will rely on comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations.
18	Potential liquidity needs management and the components of the liquidity reserve held to meet these needs	Notes 39 and 40 to the annual report and consolidated financial statements contain information in relation to liquidity risk and non-traded market risk (specifically liquidity and funding risk) respectively. The funding and liquidity section within the Strategic Report starting on page 2 also describes the Group's year end liquidity position.
19	Encumbered and unencumbered assets by balance sheet categories including collateral	The Group's encumbered and unencumbered assets position is shown within the funding and liquidity section within the Strategic Report starting on page 2.
20	Consolidated total assets, liabilities and off-balance sheet commitments by remaining contractual maturity	A table with the Group's consolidated assets, liabilities and off balance sheet commitments by remaining contractual maturity can be found within note 39 of the annual report and consolidated financial statements.
21	The Group's funding strategy including key sources and any funding concentrations	Commentary on the Group's funding strategy can be found in the liquidity and funding section within note 40.
22	Linking balance sheet and balance sheet line items with positions included in the trading market and non-trading market disclosures	A table showing the balance sheet with values combined with the principal non-traded risk types that affect each significant balance sheet line item can be found within note 39 of the annual report and consolidated financial statements.

Enhanced disclosure task force recommendations (continued)

23	Significant trading and non-market trading risk factors	The Group does not operate a trading portfolio. There is no appetite for traded market risk other than de minimus positions arising from the timing of hedging transactions. Market risk is defined as positions in financial instruments, including derivative products and other off-balance sheet instruments, held with trading intent. Interest rate risk is the most significant non-traded market risk the Group faces. Further comment on interest risk and prepayment risk can be found in note 39 to the annual report and consolidated financial statements with additional non-traded market risk factors contained in note 40.
24	Significant market risk measurement model limitations	Note 39 to the annual report and consolidated financial statements provides a summary of key features of the internal interest rate risk management model that is used for non-traded portfolios. The Group does not operate traded portfolios.
25	Primary risk management techniques employed to measure and assess the risk of loss beyond reported risk measures and parameters	Note 39 to the annual report and consolidated financial statements provides detail on the value at risk and earnings at risk methods and also on a series of supporting measures for interest rate risk. As explained above the Group does not operate a trading portfolio.
26	Credit risk profile including any significant credit risk concentrations	Tables showing the levels of industry concentrations (including both on and off-balance sheet commitments) can be found in note 39 to the annual report and consolidated financial statements.
27	Policies for identifying impaired or non-performing loans including forbearance	The Group discusses its approach to identifying impaired or non-performing loans in note 15 to the annual report and consolidated financial statements. The Group has aligned its forbearance definitions and policy forbearance with FINREP reporting as of 30 September 2014. Current levels and types of forbearance are included in the relevant section within note 39 along with discussion of the changes to forbearance policy.
28	Reconciliation of non-performing or impaired loans including the allowance for loan losses	The Group's distribution of non-performing (past due but not impaired) and impaired loans and advances across product types can be found in note 15 to the financial statements with the associated impairment allowances in note 16 to the financial statements.
29	Counterparty credit risk that arises from derivative transactions	The Group's disclosures on derivative transactions can be found in note 14 of the annual report and consolidated financial statements. The Group's principal non customer derivative counterparty is NAB.

Enhanced disclosure task force recommendations (continued)

30	Credit risk mitigation, including collateral held for all sources of credit risk	A description of the Group's risk mitigation techniques; quantitative analysis on the non-property collateral held; disclosures on collateral held as security, and other credit enhancements can be found in note 39.
31	"Other risk" types including how these are identified, governed, measured and managed	The Group has not identified other risk types that are deemed to be material for disclosure purposes.
32	Publically known risk events related to other risks, including operational, regulatory compliance and legal risks, where material or potentially material loss events have occurred	The Group is exposed to a number of risks that are in the public domain, particularly around conduct related matters. These are discussed within note 27 to the annual report and consolidated financial statements and in the relevant sections of the Strategic Report starting on page 2.

Glossary

Term	Definition
Additional Tier (AT1) securities	Securities that are considered additional tier 1 (AT1) capital in the context of CRD IV.
APRA	Australian Prudential Regulatory Authority.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Bank Levy	This is applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the "International Convergence of Capital Measurement and Capital Standards".
Basel III	In December 2010, the Basel Committee issued final rules "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring". Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2014 with full implementation by 1 January 2019.
Business lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.
Cash earnings	A non-IFRS key performance measure that excludes certain items within the calculation of net profit attributable to owners of the Group. It is also a key performance measure used by the Australian peers of the ultimate parent with a similar business portfolio. These specified items are excluded in order to better reflect what is considered to be the underlying performance of the Group. Net profit attributable to owners of the Group adjusted for (where appropriate): • Distributions • Treasury shares • Fair value and hedge ineffectiveness • Restructure costs • Litigation expense • Property revaluation • Goodwill impairment • Software impairment
Collateral	The assets of a borrower that are used as security against a loan facility.

Glossary (continued)

Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Commercial paper	An unsecured promissory note issued to finance short term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.
Company	National Australia Group Europe Limited.
Conduct risk	The risk that the Group's behaviours (culture, governance, systems and controls) have led to inappropriate customer outcomes.
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
Common Equity Tier 1 capital ("CET1")	The highest quality form of regulatory capital that comprises total shareholders' equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
CRD IV	The European Union's ("EU") proposal to implement Basel III, the international agreement on bank capital standards agreed at G20 level. It replaces the EU's earlier capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. The CRD IV package raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision.
CRE	Commercial real estate.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty. Also known as a credit valuation adjustment ("CVA").
Customer deposits	Interest bearing, non-interest bearing and term deposits (including retail and corporate deposits).
Customer funding index ("CFI")	An internal NAB metric expressing customer deposits divided by core assets (gross loans and advances including acceptances, financial assets at fair value and held to maturity investments) as a percentage.
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Defined Liquidity Group	The defined liquidity group includes all material operating entities within the Group, excluding consolidated securitisation entities. It reflects the regulatory view with respect to oversight of the Group's liquidity position and resources.
Delinquency	See "Arrears".

Derivative	A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
Earnings at risk ("EaR")	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Effective interest rate method ("EIR")	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (Level 2 and Level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
FCA	Financial Conduct Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The FCA is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets.
Forbearance	The term generally applied to the facilities provided to assist borrowers, both retail and non-retail, who are experiencing, or are about to experience, a period of financial stress. Forbearance can take a variety of forms such as negotiating an arrangement or short term promise to pay, transfer to interest only terms, or term extensions. The granting of a forbearance measure to a borrower is as a consequence of concerns about the borrower's ability to meet their contractual payments when due and specifically relates to such instances where the changes to the existing arrangement have been made on terms that the Group would not ordinarily consider to be on a commercial basis.
FSA	Financial Services Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").
FSCS	Financial Services Compensation Scheme.
Forborne performing loans	Loans to which forbearance measures have been granted and which are less than or up to ninety days past due and do not otherwise meet the criteria of forborne non-performing loans.
Forborne non-performing loans	Forborne non-performing loans to which forbearance measures have been granted and which are more than ninety days past-due, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	National Australia Group Europe Limited and its controlled entities.
Hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value of hedging instruments not being fully offset by changes in fair value of hedged items.
Housing lending	Mortgages secured by residential properties as collateral.

Glossary (continued)

IFRS	International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB").
Impaired loans	Retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
Impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This may be assessed at either the individual level or collectively.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
Individual Liquidity Adequacy Assessment ("ILAA")	The ILAA documents the Group's assessment and management of balance sheet risks relating to funding and liquidity.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach ("IRB")	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investments - AFS	Investments - available for sale.
Investment grade	This is the highest possible range of credit ratings, from "AAA" to "BBB", as measured by external credit rating agencies.
IRRBB	Interest rate risk in the banking book.
Key management personnel	Directors of the Group, members of the UK Executive Committee and PRA approved persons with a controlled function 1 – 28 (as defined in SUP 10B.4.3 within the PRA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10B/4) and FCA approved persons with an FCA controlled function 1 – 29 (as defined in SUP 10A.4.4 within the FCA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10A/4#DES95
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio	This is a new regulatory standard ratio proposed by the Basel III reforms and is the Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee has proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

Glossary (continued)

LIBOR	London Interbank Offered Rate.
Liquidity coverage ratio ("LCR")	This is a new regulatory standard ratio proposed by the Basel III reforms and is the stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage. The Basel Committee intends to introduce the LCR on 1 January 2015 and phase in minimum requirements with full compliance due from 1 January 2019.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loan to value ("LTV")	A mathematical calculation that expresses the amount of a loan as a percentage of the value of security. A high LTV indicates that there is less of a cushion to protect the lender against asset price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
Medium Term Notes ("MTNs")	MTNs are issued by corporates, including financial institutions, across a range of maturities. MTNs are frequently issued by investment grade corporates in senior unsecured form under MTN Programmes whereby notes are offered on a regular and continuous basis to investors.
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of National Australia Group Europe Limited.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net interest margin	Net interest income as a percentage of average interest earning assets.
Net profit/(loss) attributable to owners of the Group	Represents the Group's statutory profit/(loss) after tax and reflects the amount of net profit that is attributable to owners.
Net promoter score	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Group, and a consumer.
Net stable funding ratio ("NSFR")	This is a new regulatory standard ratio proposed by the Basel III reforms and is the total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The NSFR is currently subject to an observation period, with the Basel Committee intending that it will become a minimum standard by 1 January 2018.
Non-impaired assets 90+ days past due	Consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Past due loans and advances	Loans and advances on which repayments are overdue.

Glossary (continued)

Pension risk	The risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations.
PPI	Payment Protection Insurance.
PRA	Prudential Regulation Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Probability of default ("PD")	The probability that an obligor will default (usually within a one-year time horizon).
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by APRA for the consolidated NAB Group and by local regulators (in the UK the PRA) for individual Group companies.
Residential mortgage-backed securities ("RMBSs")	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: • the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non-market extension of principal repayment period); • the Group has previously made a specific provision for the customer/obligor and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. See also forbearance.
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as residential mortgages, overdrafts and credit card balances.
Return on assets ("ROA")	Net profit/(loss) attributable to equity holders of the parent as a percentage of total assets.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed.

Glossary (continued)

Risk-weighted assets ("RWAs")	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Sale and repurchase agreement ("repo")	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counter-party (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically AAA rated securities secured by the underlying financial asset.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Structured entities ("SE")	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. These can also be known as Special Purpose Vehicles ("SPVs").
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Stable funding index ("SFI")	An internal NAB metric of the customer funding index ("CFI") plus the term funding index ("TFI") expressed as a percentage.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ("ECAI") ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Term funding index ("TFI")	An internal NAB metric expressing term wholesale funding (with a remaining maturity to first call date greater than 12 months) divided by core assets (gross loans and advances including acceptances, financial assets at fair value and held to maturity investments) as a percentage.

Glossary (continued)

Tier 1 capital	A component of regulatory capital which is able to absorb losses, is permanent and available when required, ranks for repayment upon winding up/administration or similar procedures after all other debts and liabilities, and has no fixed inescapable costs. It comprises core Tier 1 and other Tier 1 capital, which includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 2 capital	A component of regulatory capital which includes forms of capital that do not meet the requirements for permanency and absence of inescapable fixed servicing costs that apply to Tier 1 Capital. It comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.
Tier 1 ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 ratio	Tier 2 capital as a percentage of risk-weighted assets.
UK ALCO	UK Asset and Liability Committee.
Value at risk ("VaR")	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements.

Other information

Country by Country Reporting ("CBCR")

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's Capital Requirements Directive (CRD IV). The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations.

The vast majority of entities that are consolidated into the Group's financial statements are UK registered entities with the only substantive overseas element to the Group being a banking operation in Guernsey ("Clydesdale Bank International") that undertakes certain deposit activities. This branch was closed to new business on 14 January 2013 with the existing customer book now being run down.

The activities of National Australia Group Europe Limited ("NAGE") are as described on page 2.

NAGE does not hold a UK banking licence and undertakes limited economic activity outwith its principal activity, with all operations undertaken through UK registered entities, including Clydesdale Bank PLC, which are consolidated into the NAGE financial statements.

The total operating income and the average number of full time equivalent employees during the year to 30 September 2014 were:

Entity	Total operating income (£m)	Employees (Number)
National Australia Group Europe Limited	969	7,143
Clydesdale Bank PLC	963	4,521
Clydesdale Bank International	(2)	5

The only other non UK registered entities of the Group are two Trustee companies that are part of the Group's securitisation vehicles (Lanark and Lannraig). Both of these entities (Lanark Trustees Limited and Lannraig Trustees Limited) are registered in Jersey. These entities play a part in the overall securitisation process by having the beneficial interest in certain mortgage assets assigned to them. Both entities have no assets or liabilities recognised in their financial statements with the securitisation activity taking place in other UK registered entities of the structures. These entities do not undertake any external economic activity and have no employees. The results of these entities as well as those of the entire Lanark and Lannraig securitisation structures are consolidated in the financial statements of the Group.

Website	www.cbonline.co.uk
Media	Press office 0845 603 5447 press.office@nab.co.uk
National Australia Bank	NAB Group results are available from www.nab.com.au

Annual report & consolidated financial statements

National Australia Group Europe Limited

For the year ended 30 September 2013

Company Number: 2108635

National Australia Group Europe Limited

Annual report and consolidated financial statements

For the year ended 30 September 2013

Contents

Overview

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

Forward looking statements

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

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

National Australia Group Europe Limited

Officers and professional advisers

Directors	**Executive Chairman**	Cameron Clyne
	Non-executive	David Allvey * # David Browne * # Richard Gregory OBE, Senior Independent Director * # James Pettigrew * Barbara Ridpath # Alexander Shapland #
	Executive	David Thorburn, Chief Executive Officer # John Hooper Mark Joiner Richard Sawers #
		* Member of the Boards' Audit Committee # Member of the Boards' Risk Committee
UK Executive Committee		David Thorburn, Chief Executive Officer John Hooper, Executive Director and Chief Operating Officer Scott Butterworth, Chief Financial Officer Debbie Crosbie, Operations & IT Director Jennifer Darbyshire, General Counsel & Company Secretary Eric Gunn, Chief Risk Officer Lynn McManus, People & Communications Director Helen Page, Customer Experience & Marketing Officer (appointed 22 May 2013) Kevin Page, Strategy & Transformation Director Andrew Pearce, Retail Banking Director Paul Shephard, Business & Private Bank Director
Joint Company Secretary		Jennifer Darbyshire Lorna McMillan
Registered Office		88 Wood Street London, EC2V 7QQ
Bankers		National Australia Bank Limited
Auditor		Ernst & Young LLP 1 More London Place London, SE1 2AF

National Australia Group Europe Limited

Strategic report

The Directors of the Company with its subsidiary undertakings (which together comprise "the Group") present their Strategic Report for the year ended 30 September 2013.

The Strategic Report is a new statutory requirement under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, replacing the previous Business Review, and is intended to be fair and balanced, and to provide information that enables the Directors to be satisfied that they have complied with s172 of the Companies Act 2006 (which sets out the Directors' duty to promote the success of the company).

Our business model

The Group operates a full service UK-focused retail and commercial banking business under the brand names "Clydesdale Bank" and "Yorkshire Bank", in Scotland, the north of England and selected other sites. The Group delivers these services through a network of retail branches, Business Banking centres, direct banking and broker channels and currently has 323 retail branches, 43 Business Banking centres, and employs 7,033* staff. The Bank is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").

Our operating environment

The UK economic recovery is gaining momentum, albeit from a low base. The economy expanded by 0.7% in the June quarter and by 0.8% in the three months to September. The Q3 2013 GDP figures were enhanced by expansion in all four major sectors of the economy; services, industry, agriculture and construction. The Office for National Statistics (ONS) data also showed that export demand played a major role in driving growth, rising by 3.6% on the previous quarter, aided by the currency devaluation effects and the beginnings of some signs of improvement in the Eurozone economy. The UK unemployment rate as at September 2013 was 7.6%, with 2.47m people unemployed at that point, a reduction of 48,000 from the previous quarter.

Despite these positive impacts, however, the ONS cautions that the current rate of economic growth is still well below the rate experienced during previous recoveries from recessions, and that the short term outlook remains uncertain. The inflation rate (as measured by annualised growth in the Consumer Prices Index) slowed to 2.2% in October but remains above the Bank of England target of 2.0%. The Bank of England Base Rate has remained at 0.5% since March 2009, which is the longest period of rate stability in the post-war era, although the spread between base rate and 3 month LIBOR has narrowed which has an impact on the Group's funding. Under 'forward guidance', the Monetary Policy Committee has indicated that they do not intend to raise the Bank of England Base Rate until the unemployment rate has fallen to a threshold of 7%, subject to certain conditions.

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

- The formal separation of the previous Financial Services Authority into the PRA and the FCA, which took place with effect from 1 April 2013. This has led to a strengthening of regulatory scrutiny across matters relating to prudential and conduct risk. In particular, the PRA issued in August 2013 its consultation paper on how it proposes to implement in the UK the European Union's reforms to capital and risk management (Capital Requirements Directive IV) with effect from 1 January 2014. The FCA has also issued a number of changes and publications including new rules for packaged bank accounts and the publication of a Policy Statement setting out the new rules for the mortgage market, as well as conducting 'themed reviews' into areas such as PPI complaint handling.
- A range of political and governmental developments have occurred, including the publication of the Parliamentary Commission on Banking Standards' final report, 'Changing Banking For Good', which contained a range of recommendations and observations relating to the governance, accountability, competition and regulatory powers of UK banks. The UK Government is in the process of incorporating the results of this work, as well as the previous report from the Independent Commission on Banking, into its Banking Reform Bill ("BRB"), which is scheduled for passage into law in 2014.

* This is the NAGE Group full time equivalent ("FTE").

Our operating environment (continued)

- The UK Government has also put in place a range of mechanisms to improve consumer and business access to credit or other financial services. These include the 'New Buy' scheme (which provided an equity loan worth up to 20% of the value of a new build home, repayable at any time or once the home is sold). This has subsequently been extended into a 'Help to Buy' scheme which is a mortgage guarantee scheme for lenders who offer mortgages to households with a deposit between 5% and 20% on homes with a value up to £600,000. Support for business oriented lending has also been made available through mechanisms such as the 'Funding For Lending Scheme'.

Our goal and strategic priorities

The Group's business model and operating environment shape its overall strategic objective: to be a strong, customer-focused bank for the communities it serves.

To achieve this, the Group is pursuing four strategic priorities:

1. Putting the customer at the heart of our business

The customer is rightly at the heart of everything we do as an organisation.

During the course of the year, we have made improvements in the experience that we offer to our customers. This has ranged from specific initiatives to improve the offer to our customers around the introduction of mobile banking, the launch of an innovative 'low start' mortgage product to support first time home buyers, to participation in key industry wide projects such as the Current Account Switching Scheme. We have also addressed a range of legacy conduct issues during the year. A major part of strengthening our relationship with existing customers, as well as focussing on how we can make an attractive offering to new and potential customers, has centred on re-launching our presence with our "We Care About Here" branding, reflecting our belief that we can and do make a positive difference to communities, businesses and individuals around us.

2. Embedding strong management of risk and controls

The Group has strengthened its overall risk and control framework in recent years, and will continue to do so, to ensure that all of the material risks which it faces are appropriately managed in light of the increasing expectations of all stakeholders.

Central to this work has been to clearly embed the accountability for and ownership of risk management across each of our 'three lines of defence': the operating business units (the 'first line'), the risk function (the 'second line') and Internal Audit (the 'third line'). As part of this, our various risk and control functions have been restructured and strengthened across each of these three lines of defence.

In addition, the Group continues to build on the relationship it has with its primary UK Regulators; the PRA and the FCA.

Further information about the Group's approach to management of risk can be found in note 40.

Our goal and strategic priorities (continued)

3. Building sustainable returns

While there will continue to be challenges from an economic, regulatory and legacy conduct perspective, the Group aims to deliver appropriate returns through controlled and efficient growth of its Retail and Business & Private Banking franchises within agreed risk appetite parameters.

A range of strategic initiatives have been completed over the past year to give effect to this strategy. The vast majority of the Group's commercial real estate ("CRE") assets were transferred to our parent, NAB on 5 October 2012. The business has also been significantly simplified to focus on providing support to our customers in our heartland regions of Scotland and the North of England, as well as to selected groups of other customers that have been acquired through third party and direct channels. This refocusing of our business has resulted in 1,400 FTEs leaving our Group since September 2011. This restructuring and refocusing has been substantially completed a year ahead of schedule.

4. Engagement and enablement

The three strategic priorities outlined above can only be delivered if our people are motivated and equipped to give their best. Key to this is knowing and understanding what they think about the Group as an employer and as a place to work. To do this, the Group undertakes an annual "Speak Up Step Up" (SUSU) survey, which asks a range of questions to gauge how our employees are engaged with the Group and what the Group can do to enable them going forward.

The recent SUSU results were pleasing taking into consideration the context of significant change. 82% of employees responded to the voluntary survey. Whilst the measure of engagement changed in 2013, a like for like comparison using the previous measure showed an overall improvement from the previous year. In particular employee advocacy, pride, and motivation to go beyond what is expected had all improved, supported by positive results for questions relating to People Leaders' actions and behaviours. The results also indicated a very strong customer focus and a similar risk and compliance culture across our staff. The Group will continue to proactively work on the insights that come from SUSU so as to understand and act on the areas where improvements can be made.

National Australia Group Europe Limited

Strategic report (continued)

Our goal and strategic priorities (continued)

The following table highlights our progress to date (as at 30 September 2013) in relation to the key performance indicators ("KPI") that we have identified to measure progress against our strategic goals:

Priority	***Strategic goal***	***KPI***	***Comments***
The Customer	"We Care About Here" is how we put customers at the heart of our business. We listen to customers to learn how to become a better bank, act in a way that shows we are all accountable to them, and design every product and service to meet their expectations.	Net promoter score	The Group's brand has been successfully relaunched in 2013. New product development, particularly in the area of mortgages and current accounts, has met with an encouraging customer response.
Risk & Control Framework	Embed a strong risk culture in our staff that consistently delivers the right customer outcomes and take informed risk and reward decisions that maintain the financial strength of the Group while protecting our customers, staff, assets and earnings.	Adherence to risk appetite settings	The Group is broadly operating within its credit and operational risk tolerances. However, legacy conduct related matters and the regulatory (prudential and conduct) change agenda continue to impact this KPI.
Sustainable Returns	Meet capital, liquidity and funding ratios within risk appetite while returning the UK business to sustainable profit and return on equity measures. Through the execution of detailed strategic initiatives, targets for capital, funding, liquidity and cash earnings will be achieved and deliver sustainable and satisfactory returns to shareholders.	Capital, liquidity, and funding ratios, together with a sustainable profit and return on equity	Financial measures continue to demonstrate progress (see pages 6, 10 and 13), but are affected by legacy conduct issues and will also be impacted by the implementation of CRD IV in future years. Balance sheet settings remain under review as the regulatory and environmental conditions change.
People	Provide a compelling employee proposition that motivates, equips and rewards staff and encourages appropriate behaviours; demonstrated through increased employee satisfaction and our ability to develop/attract talent.	Employee engagement survey scores	The Group restructuring continued during 2013 and whilst this impacted on engagement, some progress was achieved. Recruiting, retaining and developing people is one of the Group's key priorities following this period of intense change.

Financial analysis

The statutory result improved over the previous year, from a loss of £635m in 2012, to a loss of £27m in 2013.

Underlying performance has improved significantly, with a £574m improvement in profit before tax, restructuring expenses, pension scheme reforms benefit, PPI redress expense, impairments of intangibles assets, FSCS levy and bank levy to £113m in 2013, from an equivalent loss of £461m in 2012. Completing the strategic re-focussing of our business and has resulted in a material decrease in impairment losses on credit exposures and a reduction in underlying expenses. At a statutory profit level, performance has been offset by the impact of dealing with legacy conduct matters.

The balance sheet reflects the results of our strategic refocus with an increase in the Tier 1 capital ratio to 11.1% (from 8.9% at 30 September 2012) primarily driven by the impact of the UK CRE transfer and subsequent reduction in credit risk weighted assets.

	2013 £m	2012 £m	2013 vs 2012 %
Net interest income	**756**	869	(13.0%)
Non-interest income	**60**	135	(55.5%)
Total operating income	**816**	1,004	(18.7%)
Total operating expenses	**(700)**	(1,054)	33.5%
Operating profit/(loss) before impairment losses	**116**	(50)	Large
Impairment losses on credit exposures (1)	**(144)**	(737)	80.4%
Loss on ordinary activities before tax	**(28)**	(787)	96.4%
Analysed as:			
Profit/(loss) before tax, restructuring expenses, pension scheme reforms benefit, Payment Protection Insurance redress expense, impairments of intangible assets, FSCS levy and bank levy	**113**	(461)	
Restructuring expenses	**-**	(149)	
Pension scheme reforms benefit	**-**	130	
Payment Protection Insurance redress expense	**(130)**	(120)	
Impairment of goodwill	**-**	(141)	
Impairment of software	**-**	(36)	
FSCS levy and bank levy	**(11)**	(10)	
Loss on ordinary activities before tax	**(28)**	(787)	
Tax credit	**1**	152	
Loss attributable to equity holders	**(27)**	(635)	

(1) Impairment provisions and impairment losses on credit exposures relate solely to loans and advances to customers (see notes 14 and 15 to the financial statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in fair value assets within non-interest income (see note 5 to the financial statements).

Key measures

	2013	2012	2013 vs 2012
Net interest margin	**2.14%**	2.05%	9 bps
Cost to income ratio (2)	**85.8%**	83.3%	(250 bps)
Gross loans and acceptances (3) (4) (£bn)	**27.1**	33.6	(19.4)%
Interest earning assets (3) (£bn)	**35.3**	42.4	(16.8)%
Total assets (3) (£bn)	**38.0**	45.5	(16.5)%
Customer deposits (3) (5) (£bn)	**24.2**	24.6	(1.9)%

(2) 30 September 2012 has been adjusted to exclude the impacts of one off items in the year.

(3) Average volume.

(4) Gross loans and acceptances include gross loans and advances to customers, loans designated at fair value through profit or loss and amounts due from customers on acceptances. In the year to 30 September 2012, they also include assets held for sale reclassified from these categorisations.

(5) Customer deposits include current accounts, savings accounts, term deposits and business deposits.

Financial analysis (continued)

September 2013 v September 2012

Net interest income decreased by £113m (13.0%). The key driver in this reduction was lower business lending income as a result of the NAB UK CRE transfer. Lower returns on non-interest bearing deposits and capital were also contributory factors. In addition, there was an increase in the Financial Services Compensation Scheme ("FSCS") levy in the year. These were partially offset by higher mortgage lending income, reflecting growth in this product.

Average gross loans and acceptances, which incorporate loans accounted for at fair value, decreased by £6.5bn (19.4%) to £27.1bn. There was a £7.1bn reduction in business lending balances primarily due to the NAB UK CRE transfer. Excluding this impact, business lending attrition continued, reflecting risk appetite and the impact of negative system growth. These impacts were partially offset by housing lending growth of 7.5% which was significantly higher than system growth of 1.0%*.

Average customer deposits decreased by £0.4bn or 1.9%. This reflected the managed rebalancing of the retail deposit book following the NAB UK CRE transfer.

The net interest margin increased by 9bps to 2.14% (2.05%). This was driven by higher lending margins, an improvement in the retail deposit mix and the impact of the NAB UK CRE transfer.

Non-interest income decreased by £75m (55.5%). The key drivers in this reduction were the impact on fees and commissions of subdued economic activity and lower insurance income resulting from the restructuring of the Wealth Management business. The prior year included £130m of pensions reforms benefit that did not recur in 2013. The Payment Protection Insurance redress expense of £130m (2012: £120m) was netted against non-interest income.

Operating expenses decreased by £354m (33.5%) over the prior year. The prior year included £149m of restructuring costs. Costs related to legacy conduct related matters continue to have an impact on expenses, with £50m (2012: £23m) of additional provisions charged in the year. Impairment losses on goodwill (£141m) and software (£36m) were also included in the prior year. Excluding these, underlying operating expenses decreased by £55m or 7.8%. Delivery of efficiency initiatives has reduced personnel costs, with planned FTE savings ahead of schedule. Occupancy costs were also lower due to the closure of Business Banking centres. This was partly offset by higher marketing costs relating to re-investment in the brand and normalisation of performance related remuneration.

Impairment losses on credit exposures have decreased by £593m (80.4%) over the prior year. The reduction was primarily driven by the transfer of NAB UK CRE assets. Excluding this, charges on the remaining business lending book amount to £102m, in line with the prior year. Housing lending loss rates are stable with unsecured retail lending losses continuing to fall as a result of improvements in delinquency rates.

Investment spend

The Group continues to maintain its investment in the business with the spend focused on regulatory and compliance, efficiency and simplification, and revenue generation categories.

Key achievements during the year included the successful implementation of the Current Account Switching Scheme that went live in September, improved fraud protection on Retail Internet Banking, the launch of our Mobile App in July and the refresh and upgrade of our Payments Infrastructure.

Significant progress was also made on projects that will upgrade the mortgage processing platform, refresh and upgrade the employee IT infrastructure and enhance our online channel.

* Source: Bank of England – September 2013.

Asset quality

Provisions on credit exposures (£m)	**2013**	2012
Specific provision for doubtful debts [1]	**134**	404
Collective provision for doubtful debts [1]	**155**	354

Credit risk adjustments on loans at fair value (£m)	**2013**	2012
Individually assessed credit risk adjustments on loans at fair value [1]	**23**	42
Collectively assessed credit risk adjustments on loans at fair value [1]	**54**	126

Past due and impaired assets (£m)	**2013**	2012
90+ Days Past Due ("DPD") assets [1]	**157**	322
Gross impaired assets [2] [5]	**426**	1,294

Asset quality measures (%)	**2013**	2012
90+ DPD plus gross impaired assets to gross loans and acceptances [2]	**2.20%**	4.86%
Specific provision to gross impaired assets [2]	**36.7%**	34.4%
Net write-offs to gross loans and acceptances	**0.57%**	1.05%
Total provision as a percentage of net write-offs [3]	**239%**	265%
Total provision to gross loans and acceptances [3]	**1.38%**	2.78%
Impairment losses on credit exposures to credit risk-weighted assets	**0.80%**	2.62%

Impairment provisions on credit exposures (£m) [4]	**2013**	2012
Business lending	**221**	691
Retail lending	**68**	67
	289	758

Impairment losses on credit exposures	**2013 £m**	2012 £m
Business lending	**102**	698
Retail lending	**42**	39
	144	737
Of which:		
Specific	**163**	627
Collective	**(19)**	110
	144	737

(1) Balances at 30 September 2012 include amounts associated with assets classified as held for sale.

(2) Gross impaired assets for September 2013 and September 2012 include £63m and £109m gross impaired fair value assets respectively.

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

(4) Impairment provisions on loans and advances include provisions in respect of assets held for sale at 30 September 2012.

(5) 30 September 2012 includes £842m in respect of assets held for sale.

Economic and market conditions have stabilised through the second half of the 2013 year with growth prospects in the UK improving, albeit from a low base.

Retail asset quality was stable with lower default rates observed across all unsecured lending. Housing lending impaired loan levels have remained subdued.

Asset quality (continued)

The total 90+ DPD balances continued to fall to £157m as at 30 September 2013, compared with £322m at 30 September 2012. There has been a stabilisation in the asset quality of the portfolio. The 90+DPD levels for housing lending and the unsecured portfolios have continued to improve through the 12 months to September 2013. However, the portfolio remains sensitive to economic conditions with the balance of non-retail 90+DPD falling, yet remaining higher than the long-term trend.

The level of gross impaired assets has fallen to £426m in the year to September 2013. This follows a period of stability in the non-retail portfolio resulting in a reduced level of impaired balances.

The overall collective provision for doubtful debts decreased, reflecting the reduction in the business lending portfolio and improvement in overall asset quality.

The personal lending collective provision has also decreased driven by the improved delinquency profile of these portfolios.

The ratio of total provisions to gross loans and acceptances has decreased to 1.38% at 30 September 2013. The movement in the ratio reflects the lower risk profile of the book, with a reduced business lending portfolio and growth in the housing lending portfolio which has a lower provisioning requirement.

Capital position

The National Australia Group Europe Limited Core Tier 1 ratio (on a UK Prudential Regulation Authority basis) increased from 7.7% in September 2012 to 9.6% in September 2013 and the Tier 1 ratio increased from 8.9% to 11.1%. This was predominantly due to the impact of the NAB UK CRE transfer and the subsequent reduction in risk-weighted assets (“RWAs”).

Regulatory capital

Tier 1 capital	**2013 £m**	2012 £m
Permanent share capital	**1,582**	1,582
Profit and loss and other reserves	**535**	(298)
Share premium account	**-**	893
Pension fund regulatory adjustments (1)	**2**	73
Hybrid Tier 1 capital	**200**	200
Perpetual non-cumulative preference shares	**100**	100
Deductions from Tier 1 capital	**(218)**	(200)
Total Tier 1 capital after deductions	**2,201**	2,350
Tier 2 capital		
Upper Tier 2 capital		
Revaluation reserves	**2**	1
General/collective provisions (2)	**155**	330
	157	331
Lower Tier 2 capital		
Undated subordinated debt	**1,125**	1,125
Excess Tier 2 capital	**(24)**	-
Deductions from Tier 2 capital	**(3)**	(2)
Total Tier 2 capital after deductions	**1,255**	1,454
Total capital after deductions (3)	**3,456**	3,804

Capital position (continued)

Risk-weighted assets [4]	**2013 £m**	2012 £m
Retail mortgages	**6,319**	6,139
Business lending	**9,694**	15,805
Other retail lending	**1,071**	1,104
Other lending	**878**	1,137
Credit risk	**17,962**	24,185
Operational risk	**1,684**	1,905
Counterparty risk	**170**	370
Market risk	**1**	1
	19,817	26,461

Capital ratios		
Core Tier 1 ratio [5]	**9.6%**	7.7%
Tier 1 ratio	**11.1%**	8.9%
Total capital ratio	**17.4%**	14.4%

(1) For regulatory capital purposes, the pension fund deficit is added back to regulatory capital and substituted with an estimate of additional pension fund contributions to be made over the next five years, adjusted for deferred tax.

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

(3) There is no Tier 3 capital.

(4) Risk weighted assets are calculated under the standardised approach.

(5) Core Tier 1 capital is Tier 1 capital excluding perpetual non-cumulative preference shares and hybrid Tier 1 capital.

Regulatory capital to statutory total equity reconciliation	**2013 £m**	2012 £m
Regulatory Tier 1 capital	**2,201**	2,350
Reverse pension regulatory adjustments	**(2)**	(73)
Reverse deductions from capital	**218**	200
Share option reserve	**2**	5
Asset revaluation reserve	**2**	1
Available for sale reserve	**5**	12
Cash flow hedge reserve	**23**	124
Statutory total equity	**2,449**	2,619

Minimum Pillar 1 capital requirements	**2013 £m**	2012 £m
Credit risk	**1,437**	1,935
Operational risk	**135**	152
Counterparty risk	**14**	30
Market risk	**-**	-
Tier 1 Regulatory Capital	**1,586**	2,117

National Australia Group Europe Limited
Strategic report (continued)

Capital position (continued)

Regulatory capital flow of funds	**2013 £m**	2012 £m
Tier 1		
Tier 1 capital at 1 October	**2,350**	2,707
Share capital issuance	**-**	500
Profit and loss and other reserves	**833**	(930)
Share premium	**(893)**	-
Pension deficit adjustment	**(71)**	(31)
Intangible assets	**(17)**	(37)
Goodwill written off	**-**	141
Tier 1 deductions	**(1)**	-
Total Tier 1 capital after deductions	**2,201**	2,350
Tier 2		
Tier 2 capital at 1 October	**1,454**	1,566
Subordinated debt redemption	**-**	(200)
Asset revaluation reserve	**1**	(1)
Collective provision	**(175)**	87
Excess Tier 2 capital	**(24)**	2
Tier 2 deductions	**(1)**	-
Total Tier 2 capital after deductions	**1,255**	1,454
Total capital after deductions	**3,456**	3,804

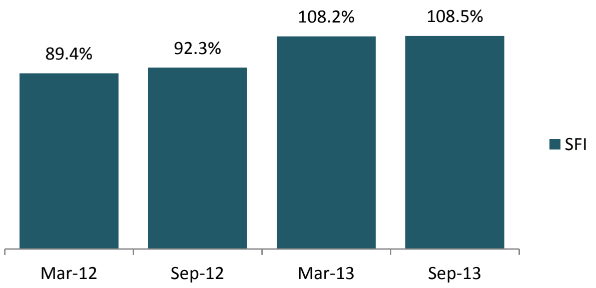
Capital position (continued)

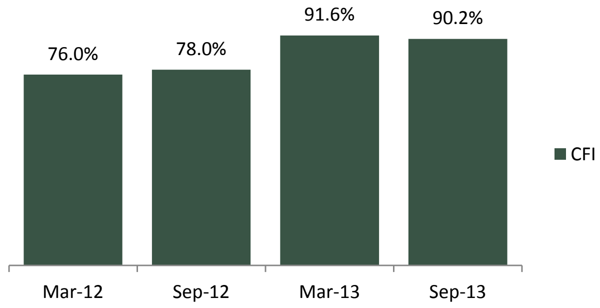
Capital requirements for calculating RWAs	**Capital required £m**	**RWA £m**	**Exposure £m**
Central Governments or Central Banks	-	-	6,344
Regional Governments or Local Authorities	2	25	106
Multilateral development banks	-	-	100
Institutions	6	72	241
Corporates			
Term lending - Business	157	1,957	2,008
Other lending	145	1,807	1,807
Overdrafts	34	431	431
Lease	34	428	428
	370	4,623	4,674
Retail			
Term lending - Retail	44	550	733
Credit cards	23	290	387
Other unsecured including overdrafts	15	189	252
	82	1,029	1,372
Secured by mortgages on residential property			
Mortgages	493	6,164	16,688
Term lending - Business	85	1,065	1,627
	578	7,229	18,315
Secured by mortgages on commercial real estate			
Term lending - Business	241	3,013	3,013
Overdrafts	62	777	777
	303	3,790	3,790
Past due items	32	396	336
Short term claims on institutions and corporates	2	21	105
Collective investments undertakings	-	3	3
Other	62	774	2,249
	1,437	**17,962**	**37,635**
Operational risk	135	1,684	
Counterparty risk	14	170	
Market risk	-	1	
	1,586	**19,817**	

The 'Exposure' amounts disclosed above are post Credit Risk Mitigation and Credit Conversion Factors having been applied where applicable.

Funding and liquidity

Stable funding and customer funding indices





The year on year improvement in the Group's funding indices was primarily due to the impact of the NAB UK CRE transfer, offset by the impact of reducing higher cost term deposits. The Customer Funding Index (CFI) increased from 78.0% to 90.2% and the Stable Funding Index (SFI) increased from 92.3% to 108.5%.

The Group has maintained its ability to raise term funding with the Covered Bond and Securitisation programmes, and remains diversified in terms of the type of instrument and product, currency, counterparty, term structure and market that make up its wholesale funding base.

At 30 September 2012 Clydesdale Bank PLC's long-term senior debt and short-term senior debt credit ratings were as follows: Moody's as A2 / P-1 (stable outlook); S&P BBB+ / A-2 (positive outlook) and Fitch A / F1 (stable outlook). On 30 July 2013 Standard & Poor's maintained Clydesdale Bank PLC's ratings but revised the outlook to negative in line with other UK banks. On 14 August 2013 Fitch affirmed Clydesdale Bank PLC's ratings and outlook at A / F1 (stable outlook). On 23 August 2013 Moody's downgraded Clydesdale Bank PLC's long-term rating to Baa2 and short-term rating to P-2 while maintaining a stable outlook

Clydesdale Bank PLC's long-term credit ratings are summarised below:

	Outlook as at 21 November 2013	**2013**	2012
Fitch	**Stable**	**A**	A
Moody's	**Stable**	**Baa2**	A2
Standard & Poor's	**Negative**	**BBB+**	BBB+

Liquid reserve	**2013 £m**
Cash and balances with central banks	**6,720**
Encumbered cash balances	**(2,161)**
	4,559
Investments – available for sale	**973**
Encumbered AFS investments	**(268)**
	705
Total unencumbered liquid assets	**5,264**

In addition to the above, as at 30 September 2013, the Group had £3.2bn gross of eligible collateral pre-positioned with the Bank of England for potential use in their liquidity facilities.

Funding and liquidity (continued)

	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,161	4,559	**6,720**
Investments – available for sale	268	705	**973**
Loans and advances to customers	7,585	16,310	**23,895**
	10,014	**21,574**	**31,588**
Encumbered cash and balances with central banks			
Note cover	2,118		
Cash ratio deposit	43		
	2,161		
Encumbered investments - available for sale			
Payment system collateral (1)	217		
Repurchase ("repo") transaction collateral (1)	51		
	268		
Encumbered loans and advances to customers			
Structured Programme collateral – Lanark Master Trust	3,091		
Structured Programme collateral – Structured Covered Bond (SLS)	747		
Structured Programme collateral – Regulated Covered Bond	2,004		
Structured Programme collateral – Lannraig Master Trust	1,743		
	7,585		

(1) Market value of securities posted as collateral.

	2013 £bn	2012 £bn
UK Government Treasury Bills and Gilts	**0.9**	0.9
Cash and cash at central bank	**4.6**	6.1
Note cover *	**2.1**	1.8
Interbank lending	**0.3**	0.1
Liquid assets	**7.9**	8.9

***** Note cover is excluded from PRA regulatory liquidity.

The Group has reduced its holding of highly liquid assets during the year due to reduced reliance on short-term wholesale funding.

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

Customers, employees and community

The Group continues to support its customers and the communities it serves.

The Yorkshire and Clydesdale Bank Foundation provides financial support to a large number of charities across the UK. In the last 12 months the Foundation has distributed over £825,000 to over 480 worthy causes, including £250,000 for the Spirit of the Community Awards. The Spirit of the Community Awards were launched in February 2013 with donations made to charities across England and Scotland in July and August 2013. This included a one-off donation of £175,000 in recognition of Clydesdale Bank's 175th anniversary. The charity partnership with Help the Hospices is now in its sixth year and over £3m has been raised in this time, including matching donations from the Group. In addition, 20% of employees currently donate to their chosen charities through Payroll Giving and the Group's Employee Volunteering Policy offers all employees the opportunity to take two days paid leave to work in the local community.

During the year, the Group won two "Your Mortgage" Awards, with Yorkshire Bank named "Best Regional Mortgage Lender" for the fourteenth time overall and Clydesdale Bank named "Best Mortgage Lender in Scotland" for the ninth consecutive year. The Group also won a "Moneyfacts" award for "Best Personal Loan Provider".

Business model challenges and top emerging risks

The primary areas of risk to the Group's business model areas are outlined below. Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the Group's risk appetite statement ('RAS') process. The position against the various RAS settings is monitored and reported to the Group's various management and Board governance committees as set out in note 40 to the financial statements.

- *Credit risk*: this is the risk of financial loss if a customer or counterparty fails to meet their contractual payments. This risk applies to both customer facing segments of the business (Retail and Business & Private Bank) as well as our treasury operations and is continually assessed as the Group's business and key initiatives evolve. Bank lending activities account for most of the Group's credit risk, with a strategic focus on managing the acceptance of a range of potential credit risk exposures. Further detail on the Group's approach to the management of credit risk is included in note 39 to the financial statements;
- *Conduct risk*: this is the risk that the Group's behaviours (culture, governance, systems and controls) lead to inappropriate outcomes for customers, exposing the Group to customer redress costs and the potential for regulatory action. The Group, in common with the rest of the financial services industry, has faced a number of conduct risk challenges in relation to a range of industry wide issues including PPI and Interest Rate Hedging Products. The Group continues to review these challenges in light of on-going customer and regulatory feedback and action. The Group continues to address legacy conduct related matters and is also reviewing new product designs, sales practices, remuneration policies and other offerings to ensure the potential for future conduct related issues is mitigated. Further detail on the Group's approach and exposures to conduct risk related matters can be found in notes 3, 27, 33 and 40 to the financial statements;
- *Operational risk (excluding conduct risk):* this is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The Group regards operational risks as a core component of doing business as they arise from day-to-day operational activities as well as from organisational changes such as projects and business change initiatives. The Group has focused on improving these areas over recent years with an emphasis on control effectiveness and improvements in the control environment (processes), enhancing skills and appropriate resource allocation (people) and improvements in system resilience and availability. An important constituent part of operational risk is service interruption. The Group recognises the impact that any service interruption issues may cause to our customers and continues to assess and manage its current technical systems landscape and to develop contingency plans to manage and mitigate this risk;
- *Pension risk*: the Group is the sponsoring employer in one defined benefit pension scheme ("the Scheme") and is exposed to the risk that, at any point in time, the Scheme is in deficit (i.e. the Scheme's liabilities outweigh its assets). The Scheme's asset values and liabilities are affected by a number of factors including, but not limited to, the discount rate used to calculate the liability net present value, the long-term inflation assumption and other actuarial assumptions (including mortality rates). The Group has implemented a number of reforms in order to de-risk, as far as possible, the ultimate defined benefit pension obligation and liaises with the Scheme's independent Trustees and actuaries on a regular basis to assess the current liability estimate. Nevertheless, the Scheme exposes the Group to substantial future liabilities and is a significant absorber of capital. Further detail on the Scheme (including the actuarial assumptions) is included in note 29 to the financial statements; and

Business model challenges and top emerging risks (continued)

- *Financial management risk*: this falls into 3 broad categories:
  - *Capital risk:* this is the risk that the Group does not hold sufficient capital and reserves to meet regulatory requirements, achieve its strategic plans and objectives, or to cover the risks to which it is already exposed and to protect against unexpected losses. Changes in regulation have the potential to change the required level of capital that the Group is required to hold which may adversely impact the Group's financial performance and position;
  - *Funding and liquidity risk:* these are the risks that the Group is unable to raise short and long-term funding to support its strategic plans and objectives and is unable to meet its financial obligations as they fall due. The Group continues to improve its stable and customer funding indices, holds significant highly liquid assets and maintains the ability to access term funding through its Securitisation and Covered Bond programmes; and
  - *Interest rate risk:* this is the risk to the Group's financial performance and position caused by changes in interest rates. As interest rates and yield curves change over time, the Group may be exposed to a loss in earnings and economic value due to the interest rate profile of its balance sheet. The Group actively monitors and manages interest rate risk principally through the use of interest rate swaps.

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

The Group scans the environment in which it operates to identify those emerging risks that can have an impact on how it operates from a strategic, operational and financial perspective. The Group currently considers its top emerging risks to be:

- *The UK economy:* while the UK economic recovery is currently gaining momentum it remains fragile. The Group's future plans are linked to the UK economy achieving a current and prolonged period of economic growth and ultimately, in the medium term, to a resumption of more normalised interest rate conditions. Government initiatives such as the "Help to Buy" scheme may help to stimulate this economic growth.
- *The changing financial industry landscape:* the Group is subject to extensive regulation and changes to this may adversely impact the Group's financial performance and position. Regulations are designed to protect the interests of depositors and the banking and financial services system as a whole. Future changes in laws, regulations and other industry wide initiatives are unpredictable and beyond the Group's control and could adversely affect its business and operations. These changes are influenced by a number of different and competing drivers including evolving stakeholder expectations regarding transparency, competition, financial system stability and international harmonisation.
- *Competition:* there is substantial competition in the UK banking market. Increased competition for customers can have the effect of compressing profit margins, changing terms and conditions, increasing advertising and related expenses to attract and retain customers, increasing customer turnover, decreasing customer loyalty or driving loss of market share. As technology and customer attitudes are rapidly evolving, this increases the risk of competition from new business entrants and the cost of doing business.

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

The Strategic Report was approved by the Board of Directors on 21 November 2013 and was signed on its behalf by:

D Thorburn

David Thorburn
Chief Executive Officer

National Australia Group Europe Limited
Enhanced risk disclosure

In October 2012, the Enhanced Disclosures Task Force ("EDTF"), an industry-led initiative, reported to the Financial Stability Board on how the risk disclosures of banks could be improved to provide a greater level of transparency as well as improving comparability between banks. Their report included seven fundamental principles and 32 recommendations. The recommendations cover the following broad headings:

- general (recommendations 1 to 4);
- risk governance and risk management strategies/business model (recommendations 5 to 8);
- capital adequacy and risk-weighted assets (recommendations 9 to 17);
- liquidity and funding (recommendations 18 to 21);
- market risk (recommendations 22 to 25);
- credit risk (recommendations 26 to 30); and
- other risks (recommendations 31 to 32).

The EDTF noted that the fundamental principles are applicable to all banks but noted: "We have developed the recommendations for enhanced risk disclosures with large international banks in mind although they should be equally applicable to banks that actively access the major public equity or debt markets. We believe that many of the recommendations may be adopted in 2012 or 2013. However, some recommendations… will take longer to develop and implement… We would expect smaller banks and the subsidiaries of listed banks will adopt only those aspects of the recommendations that are relevant to them." In June this year the Financial Policy Committee (FPC) made a recommendation that all major UK banks and building societies should comply with the recommendations on a 'comply or explain' basis, under Section 9Q(3) of the Bank of England Act 1998 (as amended by the Financial Services Act 2012).

The Group agrees with and supports the primary objectives of the EDTF and is committed to ensuring compliance with the EDTF's principles and recommendations where possible against the backdrop of the Group's ownership, its position within the UK market and the globally systemic reach of the EDTF's objectives and aims noting the more recent pronouncement of the FPC.

The Group already provides risk disclosures in accordance with International Financial Reporting Standards which can be found in notes 39, 40 and 41 to the financial statements, with the appropriate cross references made between these notes and the relevant EDTF recommendation as necessary to avoid duplicating information.

In its full year Risk and Capital Report for the year ended 30 September 2012, our ultimate Parent, National Australia Bank Limited, described the Group's principal subsidiary, Clydesdale Bank PLC, as its subsidiary in the United Kingdom, who at that time was regulated by the Financial Services Authority (FSA) and had been accredited to apply the standardised approach to operational and credit risk management in accordance with the regulatory requirements. Additionally, the Group has a waiver direction as described in note 42 to the financial statements and as such is not required to prepare any separate Pillar 3 disclosures. All such disclosures are made within our ultimate Parent's Risk and Capital Report as noted above. The PRA has indicated to the Group that this waiver will expire on 1 January 2014. The options for satisfying future disclosure obligations are being reviewed by the Group.

Accordingly, in assessing the EDTF's recommendations, the Group has taken all of these factors into consideration and applied a measured and proportionate approach with the recommended disclosures. We have applied those recommendations we believe are of more direct relevance to our stated position as a wholly owned subsidiary applying a standardised approach to operational and credit risk management. The additional disclosures included are designed to increase the reader's understanding of our financial position and risk governance and management.

The table and disclosures from pages 111 to 118 provide a brief description of the EDTF recommendations with the accompanying narrative cross referring to other disclosures provided in the financial statements (where relevant) and/or the additional detail (both quantitative and qualitative where necessary) we believe satisfy the EDTF requirements.

National Australia Group Europe Limited
Report of the Directors

The Directors of the Company with its subsidiary undertakings (which together comprise "the Group") submit their report and consolidated financial statements for the year ended 30 September 2013.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2013 amounted to £28m (2012: loss of £787m). The loss attributable to the shareholders for the year ended 30 September 2013 amounted to £27m (2012: loss of £644m). No dividends were paid on the ordinary shares during the year ended 30 September 2013 (2012: £Nil). The Directors do not recommend the payment of a final dividend in respect of this financial year (2012: £Nil). Preference share dividends of £Nil (2012: £6m) were paid during the year.

The Group's strategic highlights and business developments are set out in the Strategic Report on pages 2 to 16.

Financial instruments

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

Directors and Directors' interests

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

Directors' interests

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

Directors' liabilities

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

Employee involvement

The Group carries out an information programme to keep staff informed of business objectives and results. This is achieved through regular meetings, conference calls, circulars, bulletins and specially commissioned communications as well as training courses for staff.

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on the market or issue shares which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

During the year, under the UK National Share Incentive Plan, NAB gifted ordinary shares of A$900 in total to each eligible employee based on Group performance in respect of the 2012 financial year. A similar offer for the 2013 financial year has been announced and is based on Group performance.

Directors and Directors' interests (continued)

Equality of employment opportunities

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

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

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

Political donations

No political donations were made during the year (2012: £Nil).

Corporate governance

It is the Group’s policy not to include all of the disclosures in respect of voluntary corporate governance Codes of Practice as it is a wholly owned subsidiary of NAB. The NAB Group's Annual Financial Report details the Corporate Governance framework applicable to the Company and its subsidiaries. These disclosures are made after consideration of authoritative pronouncements on Audit Committees and associated disclosures in Australia, the USA, and the UK. Remuneration policy is not the responsibility of the Board. The remuneration policy that applies to employees and Directors of the Company is decided at the NAB Group level.

Management of risk

The Group has a well-established Boards’ Risk Committee for the consideration of risks (note 40). The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals. The NAB Group publishes an annual and half-yearly "Risk and Capital Report" which provides extensive and rigorous coverage of all aspects of risk considered relevant including the position in the UK. Further disclosure on the Group’s risk management structure in the UK is included in note 40.

Going concern

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

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

Events after the balance sheet date

On 13 November 2013, the Directors approved a distribution payment of £8m (2012: £Nil) to the Non-controlling Interest (note 32).

Auditors

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

National Australia Group Europe Limited
Report of the Directors (continued)

Directors' statement as to disclosure of information to the auditor

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

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

By order of the Board

Jennifer Darbyshire
Joint Company Secretary
21 November 2013

National Australia Group Europe Limited
Statement of Directors' responsibilities

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

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

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

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

Jennifer Darbyshire
Joint Company Secretary
21 November 2013

Building a better
working world

Independent auditor's report to the members of National Australia Group Europe Limited

We have audited the financial statements of National Australia Group Europe Limited for the year ended 30 September 2013 which comprise the Consolidated Income Statement, the Group and Company Statements of Comprehensive Income, the Group and Company Balance Sheets, the Group and Company Statements of Changes in Equity, the Group and Company Statements of Cash Flow and the related notes 1 to 43. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of Directors and Auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 21, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group and Company's affairs as at 30 September 2013 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Ernst & Young LLP

Javier Faiz (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
21 November 2013

National Australia Group Europe Limited
Consolidated financial statements
Contents

National Australia Group Europe Limited
Consolidated income statement
for the year ended 30 September 2013

	Note	**2013 £m**	2012 £m
Interest income and similar income		**1,209**	1,461
Interest expense and similar charges		**(453)**	(592)
Net interest income	4	**756**	869
Gains less losses on financial instruments at fair value		**(14)**	(123)
Other operating income		**74**	258
Non-interest income	5	**60**	135
Total operating income		**816**	1,004
Personnel expenses		**(281)**	(313)
Depreciation expense		**(75)**	(75)
Other operating expenses		**(344)**	(517)
Restructuring expenses		**-**	(149)
Total operating expenses before impairment losses	6	**(700)**	(1,054)
Operating profit/(loss) before impairment losses		**116**	(50)
Impairment losses on credit exposures	15	**(144)**	(737)
Loss on ordinary activities before tax		**(28)**	(787)
Analysed as:			
Profit/(loss) before tax, pension scheme reforms benefit, PPI redress expense, FSCS levy and Bank levy		**113**	(787)
Pension scheme reforms benefit	29	**-**	130
Payment Protection Insurance redress expense	27	**(130)**	(120)
Financial Services Compensation Scheme levy and bank levy		**(11)**	(10)
Loss on ordinary activities before tax		**(28)**	(787)
Tax credit	7	**1**	152
Loss for the year		**(27)**	(635)
Attributable to			
Equity holders of the parent		**(27)**	(644)
Non-controlling interest		**-**	9
		(27)	(635)

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

The notes on pages 31 to 110 form an integral part of these financial statements.

National Australia Group Europe Limited
Statements of comprehensive income
for the year ended 30 September 2013

		Group		Company	
		2013	2012	**2013**	2012
	Notes	**£m**	£m	**£m**	£m
Loss for the year		**(27)**	(635)	**(89)**	(1,191)
Items that may be reclassified to the income statement					
Change in cash flow hedge reserve					
(Losses)/gains during the year		**(81)**	2	**-**	-
Transfers to the income statement		**(51)**	(1)	**-**	-
Tax thereon		**31**	3	**-**	-
		(101)	4	**-**	-
Change in available for sale investments reserve					
(Losses)/gains during the year		**(13)**	2	**-**	-
Transfers to the income statement		**-**	(4)	**-**	-
Taxation thereon		**6**	-	**-**	-
		(7)	(2)	**-**	-
Total items that may be reclassified to the income statement		**(108)**	2	**-**	-
Items that will not be reclassified to the income statement					
Actuarial gains/(losses) on defined benefit pension plans	29	**-**	(344)	**-**	-
Restatement in respect of rate change / tax thereon		**(33)**	64	**-**	-
		(33)	(280)	**-**	-
Change in asset revaluation reserve					
Decrement on revaluation		**-**	(1)	**-**	-
Restatement in respect of rate change / tax thereon		**1**	-	**-**	-
		1	(1)	**-**	-
Total items that will not be reclassified to the income statement		**(32)**	(281)	**-**	-
Other comprehensive losses		**(140)**	(279)	**-**	-
Total comprehensive losses for the year net of tax		**(167)**	(914)	**(89)**	(1,191)
Attributable to:					
Equity holders of the parent		**(167)**	(923)	**(89)**	(1,191)
Non-controlling interest		**-**	9	**-**	-
		(167)	(914)	**(89)**	(1,191)

The notes on pages 31 to 110 form an integral part of these financial statements.

National Australia Group Europe Limited
Balance sheets
as at 30 September 2013

	Note	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Assets					
Cash and balances with central banks	9	**6,720**	7,927	**5**	3
Due from related entities	10	**1,381**	1,256	**769**	748
Due from other banks		**184**	14	**-**	-
Investments – available for sale	11	**973**	1,039	**-**	-
Other financial assets at fair value	12	**2,155**	2,791	**-**	-
Derivative financial instruments	13	**240**	600	**-**	-
Loans and advances to customers	14	**23,895**	24,346	**-**	-
Due from customers on acceptances		**4**	7	**-**	-
Current tax assets		**3**	30	**6**	10
Property, plant and equipment	17	**133**	140	**-**	-
Investment properties	18	**63**	77	**-**	-
Property inventory	19	**6**	9	**-**	-
Investments in controlled entities and associates	20	**3**	3	**2,654**	6,953
Intangible assets	21	**215**	198	**-**	-
Deferred tax assets	22	**273**	287	**-**	-
Other assets	23	**639**	515	**-**	-
Assets held for sale	24	**-**	5,225	**-**	-
Total assets		**36,887**	44,464	**3,434**	7,714
Liabilities					
Due to other banks	25	**521**	557	**-**	-
Other financial liabilities at fair value	12	**120**	147	**-**	-
Derivative financial instruments	13	**663**	952	**-**	-
Due to customers	26	**24,146**	26,381	**-**	-
Liabilities on acceptances		**4**	7	**-**	-
Provisions	27	**315**	292	**-**	-
Due to related entities	10	**3,026**	7,716	**1,263**	5,454
Bonds, notes and subordinated debt	28	**3,071**	3,163	**-**	-
Retirement benefit obligations	29	**202**	306	**-**	-
Deferred tax liabilities	22	**7**	21	**-**	-
Other liabilities	30	**2,363**	2,161	**-**	-
Liabilities associated with assets held for sale	24	**-**	142	**-**	-
Total liabilities		**34,438**	41,845	**1,263**	5,454
Equity					
Share capital and share premium	31,32	**1,682**	2,575	**1,682**	2,575
Other reserves	32	**32**	142	**-**	-
Retained earnings	32	**535**	(298)	**489**	(315)
Total parent entity interest		**2,249**	2,419	**2,171**	2,260
Non-controlling interest	32	**200**	200	**-**	-
Total equity		**2,449**	2,619	**2,171**	2,260
Total liabilities and equity		**36,887**	44,464	**3,434**	7,714

The notes on pages 31 to 110 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 21 November 2013 and were signed on its behalf by:

D Thorburn.

David Thorburn
Chief Executive Officer

National Australia Group Europe Limited
Statements of changes in equity
for the year ended 30 September 2013

Group	Note	Share capital £m	Share premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total parent entity interest £m	Non-controlling interest £m	Total equity £m
As at 1 October 2011		1,182	893	14	2	14	120	632	2,857	200	3,057
(Loss)/profit for the year		-	-	-	-	-	-	(644)	(644)	9	(635)
Other comprehensive (losses)/income		-	-	-	(1)	(2)	4	(280)	(279)	-	(279)
Total comprehensive (losses)/income for the year		-	-	-	(1)	(2)	4	(924)	(923)	9	(914)
Dividends paid	8	-	-	-	-	-	-	(6)	(6)	-	(6)
Distribution		-	-	-	-	-	-	-	-	(9)	(9)
Shares issued – ordinary	31	500	-	-	-	-	-	-	500	-	500
Share options expensed		-	-	11	-	-	-	-	11	-	11
Share options settled		-	-	(20)	-	-	-	-	(20)	-	(20)
As at 30 September 2012	31,32	**1,682**	**893**	**5**	**1**	**12**	**124**	**(298)**	**2,419**	**200**	**2,619**
Loss for the year		-	-	-	-	-	-	(27)	(27)	-	(27)
Other comprehensive losses		-	-	-	1	(7)	(101)	(33)	(140)	-	(140)
Total comprehensive losses for the year		-	-	-	1	(7)	(101)	(60)	(167)	-	(167)
Share premium cancellation		-	(893)	-	-	-	-	893	-	-	-
Share options expensed		-	-	3	-	-	-	-	3	-	3
Share options settled		-	-	(6)	-	-	-	-	(6)	-	(6)
As at 30 September 2013	31,32	**1,682**	**-**	**2**	**2**	**5**	**23**	**535**	**2,249**	**200**	**2,449**

The notes on pages 31 to 110 form an integral part of these financial statements.

National Australia Group Europe Limited
Statements of changes in equity (continued)
for the year ended 30 September 2013

Company	Note	Share capital £m	Share premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total parent entity interest £m	Non-controlling interest £m	Total equity £m
As at 1 October 2011		1,182	893	-	-	-	-	882	2,957	-	2,957
Loss for the year		-	-	-	-	-	-	(1,191)	(1,191)	-	(1,191)
Other comprehensive income		-	-	-	-	-	-	-	-	-	-
Total Comprehensive losses for the year		-	-	-	-	-	-	(1,191)	(1,191)	-	(1,191)
Dividends paid		-	-	-	-	-	-	(6)	(6)	-	(6)
Shares issued – ordinary	31	500	-	-	-	-	-	-	500	-	500
As at 30 September 2012	31,32	**1,682**	**893**	**-**	**-**	**-**	**-**	**(315)**	**2,260**	**-**	**2,260**
Loss for the year		-	-	-	-	-	-	(89)	(89)	-	(89)
Other comprehensive income		-	-	-	-	-	-	-	-	-	-
Total Comprehensive income for the year		-	-	-	-	-	-	(89)	(89)	-	(89)
Share premium cancellation		-	(893)	-	-	-	-	893	-	-	-
As at 30 September 2013	31,32	**1,682**	**-**	**-**	**-**	**-**	**-**	**489**	**2,171**	**-**	**2,171**

The notes on pages 31 to 110 form an integral part of these financial statements.

National Australia Group Europe Limited
Statements of cash flows
for the year ended 30 September 2013

		Group		Company	
		2013	2012	**2013**	2012
Operating activities	Note	**£m**	£m	**£m**	£m
Loss on ordinary activities before tax		**(28)**	(787)	**(103)**	(1,218)
Adjustments for:					
Non-cash or non-operating items included in loss before tax	34	**(527)**	100	**88**	1,184
Changes in operating assets	34	**6,122**	457	**-**	-
Changes in operating liabilities	34	**(2,655)**	(2,185)	**-**	(2)
Interest received		**1,213**	1,563	**-**	-
Interest paid		**(317)**	(451)	**-**	-
Tax received		**30**	3	**17**	21
Net cash provided by/(used in) operating activities		**3,838**	(1,300)	**2**	(15)
Cash flows from investing activities					
Dividends received		**-**	-	**77**	60
Interest received		**8**	12	**-**	-
Proceeds from sale or maturity of investments		**50**	79	**-**	-
Proceeds from sale of tangible fixed assets *		**39**	39	**-**	-
Purchase of tangible fixed assets *		**(37)**	(16)	**-**	-
Purchases of investments		**(50)**	-	**-**	-
Purchase of intangible assets		**(69)**	(62)	**-**	-
Investment in controlled entities		**-**	-	**4,176**	(500)
Net cash (used in)/provided by investing activities		**(59)**	52	**4,253**	(440)
Cash flows from financing activities					
Interest received		**5**	13	**13**	15
Interest paid		**(131)**	(229)	**(54)**	(78)
Proceeds from ordinary shares issued	31	**-**	500	**-**	500
Redemption of subordinated debt		**-**	(200)	**-**	-
Maturity of medium term notes		**-**	(1,898)	**-**	-
Redemption, principal repayment and other movements on residential mortgage backed securities and covered bonds	16	**(613)**	(936)	**-**	-
Issuance of residential mortgage backed securities and covered bonds	16	**541**	2,644	**-**	-
Net (increase)/decrease in amounts due from related entities		**(125)**	3,696	**(21)**	-
Net (decrease)/increase in amounts due to related entities		**(4,859)**	(248)	**(4,191)**	(8)
Amounts paid to non-controlling interest		**-**	(9)	**-**	-
Dividends paid	8	**-**	(6)	**-**	(6)
Net cash (used in)/provided by financing activities		**(5,182)**	3,327	**(4,253)**	423
Net (decrease)/increase in cash and cash equivalents		**(1,403)**	2,079	**2**	(32)
Cash and cash equivalents at the beginning of the year		**7,953**	5,874	**3**	35
Cash and cash equivalents at the end of the year	34	**6,550**	7,953	**5**	3

The notes on pages 31 to 110 form an integral part of these financial statements.

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

1. Basis of preparation

Reporting entity

The Company is incorporated in the UK and registered in England and Wales. The consolidated financial statements comprise the Company and its controlled entities (together the "Group"). The Group's principal controlled entities are listed in note 20.

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

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with IFRS as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. As permitted by section 408 of the Companies Act 2006, no Income Statement is presented for the Company.

The consolidated financial statements of the Group for the year ended 30 September 2013 were authorised for issue by the Board of Directors on 21 November 2013.

Basis of measurement

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

Going concern

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

The Group's ultimate parent, NAB, provides funding to the Group in the ordinary course of business. As a consequence the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including special purpose entities ("SPEs")) over which the Group has the power to govern the financial and operating policies so as to obtain economic benefits from their activities. The Group sponsors the formation of SPEs, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well defined objectives. SPEs require consolidation in circumstances such as those where the Group in substance has control over them through access to the majority of the residual income or is exposed to the majority of the residual risk associated with the SPE.

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

Accounting developments

The Group has not elected to early adopt any new or amended accounting standard or interpretation in the current year.

The following amendments have been adopted in the current financial year. These amendments have not had a material impact on the Group's financial statements.

- *Amendments to IAS 1*, issued 16 June 2011 and effective for financial years beginning on or after 1 July 2012. The amendment sets out enhanced presentation requirements of items of other comprehensive income.
- *Amendments to IAS 12 Income Taxes,* issued 20 December 2010 and effective for financial years beginning on or after 1 January 2012. This amendment enhances the methodology for measuring the effect of deferred tax relating to the recovery of an entity's investment property assets. The impact of this amendment is not considered to be material to the Group.

The following standards and amendments are relevant to the Group and were available for adoption in the European Union, but are not mandatory and have not been applied by the Group in the 30 September 2013 reporting year:

- *Amendments to IAS 19*, issued 16 June 2011 and effective for financial years beginning on or after 1 January 2013. The amendment sets out enhanced disclosures around post-employment benefit plans and removes the option to defer the recognition of gains and losses on these. The Group currently recognises all gains and losses on post-employment benefit plans as they arise. The amendment also introduces a single net interest income/cost on the net asset or liability recognised in the balance sheet, which will replace the interest cost and the expected return on assets, and is measured based on the plan's discount rate. For the Group, this will result in a change to the income statement with a compensating change to other comprehensive income with no overall impact on the Group's reserves.
- *Amendments to IFRS 7 Financial Instruments: Disclosures,* issued 16 December 2011 and effective for financial years beginning on or after 1 January 2013. This amendment places further disclosure requirements on netting arrangements of financial assets and liabilities. The impact of this Amendment is not considered to be material to the Group.

2. Accounting policies (continued)

Accounting developments (continued)

- *IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities,* issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013 (with the application date for EU entities being financial years beginning on or after 1 January 2014). The Group will look to early adopt these standards from 1 October 2013 to align with the ultimate parent company as the standards have been adopted by the EU. These are part of a suite of standards covering the amended accounting requirements for consolidations and joint arrangements and their related disclosures. IFRS 10 introduces a single control model to determine which investees should be consolidated. It defines control as consisting of three elements: power, exposure to variable returns and an investor's ability to use power to affect its amount of variable returns. This requires an analysis of all facts and circumstances and the application of judgement in making the control assessment. IFRS 11 introduces a revised model for accounting for joint arrangements. IFRS 12 will not affect any of the amounts recognised in the financial statements, but will require new disclosures about the judgements made by management to determine whether control exists and to require summarised information about these entities. The impact of these standards on initial application is not considered to be material to the Group.
- *IFRS 13 Fair Value Measurement,* issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013. The standard brings together the measurement and disclosures for fair values under the one standard. The standard does not alter the requirements for what should be fair valued but does require some enhanced disclosures around the inputs and valuation techniques to develop fair value measurement. The impact of this standard on initial application is not considered to be material to the Group.
- *Amendments to IAS 32 Financial Instruments: Presentation,* issued 16 December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment provides clarification on the criteria that already exist for offsetting. The impact of this amendment is not considered to be material to the Group.
- *Improvements to IFRSs 2009 – 2011 cycle, issued 17 May 2012 and effective for financial years beginning on or* after 1 January 2013. As part of the IASB's annual improvement process, this makes numerous non-essential changes to accounting standards which are necessary to maintain the overall integrity of financial statements. The impact of these improvements is not considered to be material to the Group.

The following standards, revisions and amendments are relevant to the Group but were not available for adoption in the European Union and have not been applied by the Group in the 30 September 2013 reporting year:

- *IFRS 9 Financial Instruments* contains new requirements for the classification and measurement of financial assets and liabilities along with new impairment criteria, which will mean calculating the impairment of financial assets on an expected loss basis in contrast to the current incurred loss basis as required by IAS 39. The final phase of IFRS 9 relates to hedge accounting and macro hedge accounting. The hedge accounting section is near finalisation but the macro hedge accounting section will not be finalised until after IFRS 9 is published. The IASB have already agreed that entities will have a policy choice to make in relation to hedge accounting until both sections of hedge accounting under IFRS 9 are finalised. IFRS 9 will introduce significant changes in the way the Group accounts for financial instruments with the full impact on the Group's results still uncertain. The overall impact of IFRS 9 on the Group will become clear when the classification and measurement and impairment requirements are finalised by the IASB. There is currently no definitive effective date for the implementation of IFRS 9 and the Group will continue to monitor the IASB's developments in finalising IFRS 9 and the accompanying EU endorsement process thereafter.
- *IFRIC Interpretation 21 Levies* issued May 2013 and effective for financial years beginning on or after 1 January 2014. The IFRIC addresses the accounting for a liability to pay a levy recognised in accordance with IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets', and the liability to pay a levy whose timing and amount is certain. The Group are assessing the implications of when to adopt the Interpretation. The impact of this interpretation is not considered to be material to the Group.
- *IAS 39 Novation of Derivatives and Continuation of Hedge accounting – Narrow Scope Amendment,* issued June 2013 and effective for financial years beginning on or after 1 January 2014. This narrow scope amendment addresses the question around whether hedge accounting can be continued if an entity novates its hedging derivative from one counterparty to a central clearing counterparty as a result of regulatory changes if specific conditions are met. The impact of this narrow scope amendment is not considered to be material to the Group.

2. Accounting policies (continued)

Foreign currency

Functional and presentation currency

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

Transactions and balances

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

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

Revenue recognition

Net interest income

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

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

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

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

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

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

Fees and commissions

Fees and commissions not integral to the effective interest rate arising from services provided to customers and third parties are recognised once the service has been provided.

2. Accounting policies (continued)

Revenue recognition (continued)

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

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

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

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

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

Financial assets and liabilities designated at fair value through profit or loss recognise fair value movements (excluding interest) on those items designated as fair value through profit or loss.

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

Income tax

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

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

Current tax

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

Deferred tax

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

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

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

2. Accounting policies (continued)

Income tax (continued)

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

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

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. This includes cash and liquid assets, amounts due from other banks (to the extent less than 90 days) and short-term government securities (which have the same characteristics as cash).

Repurchase and reverse repurchase agreements

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

Securities purchased under agreements to resell ("reverse repos") are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the financial statements. Securities borrowed are not recognised in the financial statements unless they are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Financial instruments

Recognition and derecognition of financial instruments

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

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

The Group classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and amortised cost.

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

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

Offsetting financial instruments

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

2. Accounting policies (continued)

Financial instruments (continued)

Financial instruments designated at fair value through profit or loss

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

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

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

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

Financial assets held for trading

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

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of (i) fair value through profit or loss (ii) loans and receivables or (iii) held to maturity.

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

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

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the period in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities and an immaterial investment in equity securities.

Held to maturity financial assets

Held to maturity investments are non-derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

2. Accounting policies (continued)

Financial instruments (continued)

Financial liabilities

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

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

Fair value measurement

Fair value is defined as the amount for which an asset could be exchanged or a liability settled, between willing parties in an arm's length transaction.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm’s length basis. Assets are measured at a bid price; liabilities are measured at an asking price.

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

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

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

Derivative financial instruments and hedge accounting

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

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

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

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

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

Fair value hedge

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

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the period in which the hedged item will affect profit or loss.

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

Derivatives that do not qualify for hedge accounting

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

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

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

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

2. Accounting policies (continued)

Loans and advances

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

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

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value and not within loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Impairment of financial assets other than fair value loans

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

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

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

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

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

2. Accounting policies (continued)

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

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

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

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

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

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

If the originally contracted terms of loans and advances are amended, the amounts are classified as restructured and would be disclosed as forbearance. Such accounts accrue interest as long as the loan performs in accordance with the restructured terms.

Equity and debt instruments – classed as available for sale

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

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

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

Leases

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

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

As lessee

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

2. Accounting policies (continued)

Leases (continued)

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

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

As lessor

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

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within depreciation expense in the income statement consistent with the nature of the asset (refer to note 17, property plant and equipment).

Property, plant and equipment

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

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

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

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

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

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

Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

2. Accounting policies (continued)

Property, plant and equipment (continued)

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale, are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Intangibles assets

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

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

Investments in controlled entities and associates

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

Investment properties

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

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

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

Property inventory

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

2. Accounting policies (continued)

Assets and liabilities classified as held for sale

The Group transferred the vast majority of its commercial real estate assets to NAB on 5 October 2012.

In accordance with IFRS 5 (non-current assets held for sale and discontinued operations) the Group classifies assets and liabilities as held for sale where they will be recovered principally through sale rather than their continued use.

The Group reclassified certain assets and liabilities on this basis in its financial statements for the year ended 30 September 2012 (note 24).

Income earned and expenses incurred on assets and liabilities classified as held for sale continued to be recognised in the appropriate line items in the income statement until the transaction was completed.

Provisions

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

Pension and post retirement costs

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

Defined contribution pension scheme

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

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings. A liability or asset in respect of the defined benefit scheme is recognised in the balance sheet. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the Group's defined benefit obligation.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, interest cost, expected return on plan assets, curtailment gains and past service cost. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly in retained earnings through the statement of comprehensive income.

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

Subordinated liability and related entity balances

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

2. Accounting policies (continued)

Debt issues

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

Financial guarantees

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

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

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

Contingent liabilities

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

Equity

Share option reserve

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

Cash flow hedge reserve

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

2. Accounting policies (continued)

Preference shares

Preference shares are classified as an equity instrument if and only if both of the following conditions are met:

- The instrument includes no contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- If the instrument will or may be settled in the issuer's own equity instruments and it is:
  - a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

Where preference shares do not satisfy the above conditions, then they are classified as a financial liability. The Company's preference shares currently issued meet the criteria for classification as equity.

Dividends on ordinary and preference shares

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

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

Equity based compensation

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

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

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

2. Accounting policies (continued)

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

3. Critical accounting estimates and judgements

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

Fair value of financial instruments

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

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected repayment profile of the loans. If the loans were to be repaid six months earlier than currently predicted the value would decline by £7m. If the level of early repayment is less than expected the loan value would increase by up to £36m. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £15m, and vice versa. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The valuation of these financial instruments is described in more detail in note 12.

Impairment losses on loans and advances

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

3. Critical accounting estimates and judgements (continued)

Impairment losses on loans and advances (continued)

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). To the extent that the probabilities of default improves from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £5m. Alternatively, if probabilities of default deteriorate by 5%, the impairment provision on loans and advances would increase by £5m. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £15m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The impairment loss on loans and advances is disclosed in more detail in note 15.

Payment Protection Insurance redress provision and other conduct related matters

Disclosures in relation to the Group’s payment protection insurance redress provision can be found in note 27 with the Group holding a provision of £152m at 30 September 2013 (2012: £108m). Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates (how many claims are, or may be, upheld in the customer’s favour) and redress costs (the average payment made to customers). The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated likely position at 30 September 2013. Consequently, the provision calculated may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used.

The most significant of the individual assumptions are the level of complaints, the uphold rate, the customer contact response rate and average pay-out per complaint. If the total number of complaints were to be 5% higher or lower than that estimated, the provision would increase / decrease by approximately £7m. If the uphold rate across the population of existing and future complaints was 5% higher or lower than that estimated, the provision would increase / decrease by approximately £18m. If the customer contact response rate was 5% higher or lower than that estimated, the provision would increase / decrease by approximately £8m. If the average redress cost was to be 5% higher or lower than that currently estimated, the provision would increase / decrease by approximately £7m, as average redress is a factor affecting both future and existing cases. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

There are similar uncertainties and judgements for other conduct risk related matters disclosed in note 27 however the level of liability for each matter is lower.

3. Critical accounting estimates and judgements (continued)

Equity based compensation

The Group's ultimate parent, NAB, grants shares and share options to the Group's employees as a part of employee remuneration which is recharged to the Group. IFRS 2 requires recognition of an expense for those shares and share options at the fair value on the grant date. For shares granted to employees, the fair value is measured directly at the market price of NAB Group's shares, adjusted to take into account the terms and conditions upon which the shares were granted. For share options granted to employees, the fair value of the equity instruments granted is estimated using a valuation technique consistent with generally accepted valuation methodologies. Further details are provided in note 36.

Retirement benefit obligations

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

Carrying value of investments

In accordance with the requirements of IAS 36, an impairment test was performed on the carrying value of Clydesdale Bank PLC in the Company at the Group's standard annual impairment test date in August 2013. The results of this test highlighted a reduction in the current carrying value of Clydesdale Bank PLC to £2,344m and a subsequent impairment charge of £123m (2012: charge of £1,181m) has been recognised in these financial statements.

The key assumptions and sensitivities involved in these calculations are discussed further in note 20.

4. Net interest income

	2013 £m	2012 £m
Interest income		
Loans and advances to other banks	**31**	27
Available for sale investments	**8**	13
Loans and advances to customers	**1,100**	1,271
Due from related entities (note 10)	**5**	14
Other interest income	**1**	7
	1,145	1,332
Financial assets at fair value through profit or loss	**64**	129
Total interest income	**1,209**	1,461
Less: Interest expense		
Due to other banks	**2**	6
Financial liabilities at fair value through profit or loss	**2**	2
Due to customers	**305**	347
Bonds and notes	**75**	53
Due to related entities (note 10)	**57**	176
Other interest expense	**12**	8
Total interest expense	**453**	592
Net interest income	**756**	869

Other interest expense includes the FSCS levy.

5. Non-interest income

	2013 £m	2012 £m
Gains less losses on financial instruments at fair value		
Movement in fair value of assets and liabilities	**(171)**	(121)
Interest rate derivatives	**147**	(12)
Foreign exchange derivatives	**21**	21
Ineffectiveness arising from fair value hedges (note 13)	**(8)**	(12)
Ineffectiveness arising from cash flow hedges (note 13)	**(3)**	1
	(14)	(123)
Other operating income		
Fees and commission	**63**	106
Net fair value movement on investment properties	**-**	(7)
Gain on disposal of tangible fixed assets *	**1**	10
Other income	**10**	149
	74	258
Total non-interest income	**60**	135

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

Fees and commission income is reported net of charges of £130m for Payment Protection Insurance redress (2012: £120m). Also included is £3m income in relation to financial instruments at fair value through profit or loss (2012: £5m).

Other income in 2012 included a contribution of £130m to the defined benefit pension scheme from NAB (note 29).

The movement in fair value of assets incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans. They are fair valued with the movements in fair value taken through the income statement as part of non-interest income. The fair value of the loan is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. As interest rates fall, the carrying value of the loan increases. Similarly, as interest rates increase, the carrying value of the loan decreases. This valuation technique is reflective of current market practice and is regularly reviewed to ensure it appropriately captures the continued economic uncertainty and volatility currently being experienced in the markets.

6. Operating expenses

	2013 £m	2012 £m
Personnel expenses		
Salaries, wages and non-cash benefits	**185**	203
Related personnel expenses	**21**	23
Defined contribution pension expense	**13**	15
Defined benefit pension expense	**19**	20
Equity based compensation	**4**	11
Other personnel expenses	**39**	41
	281	313
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (note 17)	**23**	23
Amortisation of intangible assets (note 21)	**52**	52
	75	75
Other operating expenses		
Operating lease rental	**32**	38
Other occupancy charges	**42**	42
Related entity recharges (note 10)	**1**	17
Impairment losses on goodwill	**-**	141
Impairment losses on software (note 21)	**-**	36
Other operating expenses	**269**	243
	344	517
Restructuring expenses		
Other personnel expenses	**-**	96
Other occupancy expenses	**-**	32
Other expenses	**-**	21
	-	149
Total operating expenses	**700**	1,054

Auditor's remuneration

Included within other operating expenses:	**2013 £'000**	2012 £'000
Audit of the financial statements	**242**	230
Other fees to the auditor:		
Audit of the Group pension scheme	**75**	75
Local statutory audits for subsidiaries	**1,635**	1,424
Other assurance including regulatory compliance based work	**141**	262
	2,093	1,991

7. Tax

	2013	2012
Current tax	**£m**	£m
UK corporation tax		
Current year	**10**	(32)
Adjustment in respect of prior years	**(5)**	1
Other overseas taxation	**-**	3
	5	(28)
Deferred tax (note 22)		
Current year	**(5)**	(120)
Adjustment in respect of prior years	**(1)**	(4)
	(6)	(124)
Tax credit	**(1)**	(152)

The tax assessed for the year differs from the standard rate of corporation tax in the UK (23.5%). A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	2013	2012
	£m	£m
Loss on ordinary activities before tax	**(28)**	(787)
Tax credit based on the standard rate of Corporation Tax in the UK of 23.5% (2012: 25%)	**(7)**	(197)
Effects of:		
Expenses not deductible for tax purposes	**4**	41
Bank levy	**-**	1
Amounts not subject to UK tax	**-**	(2)
Rate differences	**8**	6
Adjustments in respect of prior years	**(6)**	(3)
Other	**-**	2
Tax credit	**(1)**	(152)

8. Dividends paid

	2013	2012
	£m	£m
Preference dividends paid – 12% per annum payable semi-annually	**-**	6

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

9. Cash and balances with central banks

	Group		Company	
	2013	2012	**2012**	2012
	£m	£m	**£m**	£m
Cash assets	**1,212**	1,127	**5**	3
Balances with central banks	**5,508**	6,800	**-**	-
	6,720	7,927	**5**	3
Less mandatory deposits with central banks	**(43)**	(31)	**-**	-
Included in cash and cash equivalents (note 34)	**6,677**	7,896	**5**	3

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

10. Related party transactions

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

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

The Group receives a range of services from the parent and related parties, including loans and deposits, forward foreign exchange and interest rate cover and various administrative services. Fees may be charged for these services.

Amounts due from related entities	Group		Company	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Loans				
Ultimate parent	**1,278**	1,215	**-**	-
Controlled entities of the Company	**-**	-	**240**	219
	1,278	1,215	**240**	219
Subordinated loans				
Controlled entities of the Company	**-**	-	**526**	526
Other receivables				
Ultimate parent	**87**	34	**-**	-
Controlled entities of the ultimate parent	**16**	7	**-**	-
Controlled entities of the Company	**-**	-	**3**	3
	103	41	**3**	3
Total amounts due from related entities	**1,381**	1,256	**769**	748
Interest income on the above amounts was as follows:				
Ultimate parent (note 4)	**5**	14	**-**	-
Controlled entities of the Company	**-**	-	**12**	15
	5	14	**12**	15

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

10. Related party transactions (continued)

Amounts due to related entities	**Group**		**Company**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Deposits				
Ultimate parent	**1,776**	6,452	**-**	-
Controlled entities of the ultimate parent	**100**	100	**100**	100
Controlled entities of the Company		-	**582**	4,777
	1,876	6,552	**682**	4,877
Subordinated liabilities				
Ultimate parent	**782**	782	**232**	232
Immediate parent	**343**	343	**343**	343
	1,125	1,125	**575**	575
Other payables				
Ultimate parent	**12**	23	**-**	-
Immediate parent	**1**	2	**1**	2
Controlled entities of the ultimate parent	**12**	14	**5**	-
	25	39	**6**	2
Total amounts due to related entities	**3,026**	7,716	**1,263**	5,454
Interest expense on the above amounts was as follows (note 4):				
Ultimate parent	**50**	166	**2**	3
Immediate parent	**4**	6	**4**	6
Controlled entities of ultimate parent	**3**	4	**3**	4
Controlled entities of the Company	**-**	-	**46**	65
	57	176	**55**	78

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

The decrease in deposits due to the ultimate parent reflects funds repaid following the completion of the transfer of the CRE assets on 5 October 2012 (note 24).

Repurchase agreements

Included in amounts due from related entities is £51m (2012: £Nil) for securities sold subject to repurchase agreements. The fair value of the securities sold under these terms as at 30 September 2013 amounts to £51m (2012: £Nil).

Derivatives

The following derivative positions are held with the ultimate parent:

	2013	2012
	£m	£m
Derivative financial assets (note 13)	**95**	179
Derivative financial liabilities (note 13)	**412**	710

Subordinated liabilities

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

10. Related party transactions (continued)

Subordinated liabilities (continued)

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

The rates of interest stated below apply at 30 September 2013:	**2013 £m**	2012 £m
6.21250% (2012: 6.40438%) 10 year, non-call five years with a final maturity of 15 February 2019	**300**	300
4.92940% (2012: 5.17900%) 10 year, non-call with a final maturity of 25 January 2021	**250**	250
0.76738% (2012: 0.90313%) Undated subordinated notes	**285**	285
1.07125% (2012: 1.81344%) Undated subordinated notes	**258**	258
	1,093	1,093
Other subordinated notes	**32**	32
Total subordinated liabilities	**1,125**	1,125

Securitisation

The Group has securitised part of its residential mortgage portfolio and the cash raised from the issue of residential mortgage backed securities ("RMBS") through SPEs forms part of the Group's medium term funding. A portfolio of buy to let mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £441m (2012: £474m) of the securities issued are held by the Group's ultimate parent.

Other transactions with related entities	**Group**	
	2013 £m	2012 £m
Non-interest income received		
Ultimate parent	**6**	8
Controlled entities of the ultimate parent	**7**	10
	13	18
Administrative expenses (note 6)		
Ultimate parent	**(2)**	13
Controlled entities of the ultimate parent	**3**	4
	1	17

Administrative expenses paid to the ultimate parent are offset in the year to 30 September 2013 by payments received by the Group for the provision of services to NAB subsequent to the transfer of the Group's CRE portfolio.

Compensation of key management personnel ("KMP")

For the purposes of IAS 24 Related Party Disclosures KMPs comprise Directors of the Company, members of the UK Executive Committee and PRA approved persons with a control function of 1 to 29.

Group	**2013 £m**	2012 £m
Salaries and other short-term benefits	**10**	11
Share based payments	**-**	3
	10	14

Directors' emoluments are analysed in note 37.

10. Related party transactions (continued)

Transactions with key management personnel

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

Group	2013 £m	2012 £m
Loans and advances	**2**	5
Deposits	**1**	1

No provisions have been recognised in respect of loans provided to KMPs (2012: £Nil). There were no debts written off or forgiven during the year to 30 September 2013 (2012: £Nil). Included in the above are six (2012: seven) loans totalling £0.9m (2012: £1.6m) made to Directors.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2013 (2012: £0.3m) were charged to the Group sponsored Scheme. The Group has deposits of £4.5m (2012: £3.1m) at the year end placed by the Scheme at market rates.

Pension contributions of £134m (2012: £242m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (see note 29).

11. Investments

Group	2013 £m	2012 £m
Available for sale – listed	**966**	1,032
Available for sale – unlisted	**7**	7
	973	1,039

Included in the available for sale ("AFS") listed securities are £0.8bn (2012: £0.8bn) in UK Government Gilts and £0.1bn (2012: £0.1bn) in other banks' debt securities.

The listed AFS investments are classified as level 1 in the fair value hierarchy, with the unlisted AFS investments classified as level 3 (note 38).

Credit quality of investments

	2013 £m	2012 £m
Available for sale		
Senior investment grade	**966**	1,032
Other	**7**	7
	973	1,039

12. Other financial assets and liabilities at fair value

Group	2013 £m	2012 £m
Other financial assets at fair value through profit or loss		
Loans and advances	**2,155**	2,791
Other financial liabilities at fair value through profit or loss		
Due to customers – term deposits	**120**	147

Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as Held for Trading derivative financial instruments (note 13).

Loans and advances

Included in other financial assets at fair value is a portfolio of loans. Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £2,155m (2012: £2,791m). The cumulative movement in the fair value of the loans attributable to changes in credit risk amounts to £77m (2012: £82m) and the change for the current year is a reduction of £5m (2012: increase of £11m).

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

Due to customers - term deposits

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

The change in fair value attributable to changes in the Company credit risk is £Nil (2012: £Nil). The Company is contractually obligated to pay £10m (2012: £16m) less than the carrying amount at maturity to the deposit holder.

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

13. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, certain derivatives do not meet the hedging criteria within IAS 39 and are therefore accounted for as held for trading, though they are used for risk mitigation purposes. The tables below analyse derivatives between those held as hedging instruments and those that do not meet the hedging criteria within IAS 39.

Group	2013 £m	2012 £m
Fair value of derivative financial assets		
Designated as hedging instruments	**3**	160
Designated as held for trading	**142**	261
Designated as held for trading – related entities (note 10)	**95**	179
	240	600
Fair value of derivative financial liabilities		
Designated as hedging instruments	**216**	187
Designated as held for trading	**35**	55
Designated as held for trading – related entities (note 10)	**412**	710
	663	952

The derivative financial instruments held by the Group are classified as level 2 in the fair value hierarchy as their value is determined using directly observable inputs other than directly quoted prices.

13. Derivative financial instruments (continued)

In the following tables the contract amount is the amount from which the cash flows from the derivative contracts are derived and is not an indication of the amounts at risk relating to these contracts.

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

Derivative financial assets and liabilities include the hedges for the Group securitisation and covered bond programmes and cash flow hedges.

The carrying value of the currency liabilities issued through securitisation fluctuates as a result of foreign exchange movements. There is a corresponding (and off-setting) movement in the value of the hedging derivative.

In the year to 30 September 2013, the Group adjusted its cash flow hedging strategy but not the principal risks being hedged. As a result, the existing hedge relationship was de-designated and a new macro cash flow hedge designated as at 31 March 2013. The principal risk being hedged remains interest rate risk.

Group

Total derivative contracts as at 30 September 2013	**Contract amount**	**Fair value of assets**	**Fair value of liabilities**
Derivatives designated as hedging instruments	**£m**	**£m**	**£m**
Cash flow hedges			
Interest rate swaps	21,050	3	51
Fair value hedges			
Interest rate swaps	1,458	-	135
Cross currency swaps	1,194	-	30
	2,652	-	165
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,983	38	54
Cross currency swaps	460	50	2
Options	666	6	6
	5,109	94	62
Interest rate related contracts			
Swaps	20,506	130	357
Swaptions	176	2	2
Options	738	9	24
	21,420	141	383
Commodity related contracts	107	2	2
Total derivative contracts	**50,338**	**240**	**663**

13. Derivative financial instruments (continued)

Group Total derivative contracts as at 30 September 2012	Contract amount	Fair value of assets	Fair value of liabilities
Derivatives designated as hedging instruments	£m	£m	£m
Cash flow hedges			
Interest rate swaps	8,970	160	2
Fair value hedges			
Interest rate swaps	1,458	-	133
Cross currency swaps	1,023	-	52
	2,481	-	185
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,785	43	48
Cross currency swaps	504	78	6
Options	542	6	6
	4,831	127	60
Interest rate related contracts			
Swaps	41,476	280	638
Swaptions	398	11	11
Options	1,350	20	54
	43,224	311	703
Commodity related contracts	75	2	2
Total derivative contracts	59,581	600	952

The Group macro hedges its interest rate exposure using cash flow hedges. These are vanilla fixed rate interest rate swaps for which the Group has the following commitments in the time bands noted:

Nominal values per time period	**2013 £m**	2012 £m
0 to 6 months	**2,370**	2,810
6 to 12 months	**925**	995
1 to 2 years	**14,930**	2,145
2 to 5 years	**2,825**	3,020
	21,050	8,970

The Group has hedged the following forecast cash flows, which primarily vary with interest rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows 2013 £m	**Forecast payable cash flows 2013 £m**	Forecast receivable cash flows 2012 £m	Forecast payable cash flows 2012 £m
within one year	**31**	**25**	40	-
between one and two years	**59**	**19**	21	-
between two and three years	**29**	**8**	16	-
between three and four years	**22**	**12**	10	-
between four and five years	**14**	**15**	3	-
	155	**79**	90	-

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

13. Derivative financial instruments (continued)

	2013 £m	2012 £m
Loss arising from fair value hedges (note 5)		
Hedging instrument	**21**	(563)
Hedged item attributable to the hedged risk	**(29)**	551
	(8)	(12)

	2013 £m	2012 £m
(Loss)/gain from cash flow hedges recognised in income due to hedge ineffectiveness (note 5)	**(3)**	1

14. Loans and advances to customers

Group	**2013 £m**	2012 £m
Overdrafts	**2,024**	2,346
Credit cards	**396**	436
Lease finance	**482**	694
Mortgages	**16,148**	15,369
Other term lending – business	**4,427**	5,151
Other term lending – retail	**756**	730
Other lending	**32**	51
Gross loans and advances to customers	**24,265**	24,777
Unearned income	**(44)**	(78)
Deferred and unamortised fee income	**(37)**	(58)
Impairment provisions on credit exposures (note 15)	**(289)**	(295)
	23,895	24,346

The Group has transferred £4,834m (2012: £4,364m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 16). The mortgages do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements the Group continues to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £2,471m (2012: £2,553m).

Included within Group loans and advances to customers are £2,751m (2012: £2,498m) of mortgages assigned to two bankruptcy remote special purpose entities, Clydesdale Covered Bonds LLP and Clydesdale Covered Bonds No. 2 LLP (note 16). These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2013 there were £1,041m (2012: £1,084m) of covered bonds in issue under the covered bond programmes.

The Group also has a portfolio of fair valued business loans and advances (note 12). Combined with the above this is equivalent to total loans and advances of £26,050m (2012: £27,137m).

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14. Loans and advances to customers (continued)

Lease finance

The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The costs of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £3m (2012: £4m) and £210m (2012: £314m) respectively. The total closing balances of finance leases and hire purchase contracts were £12m (2012: £20m) and £437m (2012: £629m) respectively.

Finance lease receivables	Group	
	2013	2012
	£m	£m
Gross investment in finance lease receivables		
Due within one year	**216**	301
Due within one to five years	**247**	365
Due after more than five years	**19**	28
	482	694
Unearned income	**(33)**	(45)
Net investment in finance lease receivables	**449**	649

There are specific provisions of £3m (2012: £6m) in relation to finance lease receivables, with a collective provision of £Nil (2012: £1m) as at 30 September 2013.

Maximum exposure to credit risk

The maximum exposure to credit risk is disclosed in note 39.

Distribution of loans and advances by credit quality

Group As at 30 September 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Gross loans and advances:							
Neither past due nor impaired	110	377	467	15,806	5,987	615	**23,362**
Past due but not impaired	12	19	6	266	218	19	**540**
Impaired	-	-	9	76	278	-	**363**
	122	**396**	**482**	**16,148**	**6,483**	**634**	**24,265**

Group As at 30 September 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	132	415	661	14,994	7,016	529	23,747
Past due but not impaired	12	21	19	304	274	57	687
Impaired	-	-	14	71	258	-	343
	144	436	694	15,369	7,548	586	24,777

***** Business lending includes business overdrafts.

14. Loans and advances to customers (continued)

Credit quality of loans and advances

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

Distribution of loans and advances neither past due nor impaired

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

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

Group	**2013** **£m**	2012 £m
Senior investment grade	**1,402**	1,419
Investment grade	**1,529**	2,020
Sub-investment grade	**3,523**	4,238
	6,454	7,677

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

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

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

Group	**2013** **%**	2012 %
Less than 50%	**24**	21
50% to 75%	**45**	40
76% to 80%	**8**	9
81% to 85%	**6**	7
86% to 90%	**5**	6
91% to 95%	**4**	5
96% to 100%	**2**	4
Greater than 100%	**2**	4
Unknown	**4**	4
	100	100

14. Loans and advances to customers (continued)

Loans and advances which were past due but not impaired

Loans and advances that are past due but are not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility. The distribution of loans and advances that are past due but not impaired are analysed below:

Group 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
1 to 29 days past due	8	9	4	93	131	8	**253**
30 to 59 days past due	1	3	1	74	8	3	**90**
60 to 89 days past due	1	2	-	33	2	2	**40**
Past due over 90 days	2	5	1	66	77	6	**157**
	12	**19**	**6**	**266**	**218**	**19**	**540**

Group 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	8	18	111	173	44	362
30 to 59 days past due	2	3	1	79	9	4	98
60 to 89 days past due	1	3	-	36	6	3	49
Past due over 90 days	1	7	-	78	86	6	178
	12	21	19	304	274	57	687

***** Business lending includes business overdrafts.

15. Impairment provisions on credit exposures

Group 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Opening balance	11	14	7	27	221	15	**295**
Charge for the year	4	12	3	14	99	12	**144**
Amounts written off	(9)	(18)	(7)	(10)	(110)	(16)	**(170)**
Recoveries of amounts written off in previous years	4	4	-	-	8	4	**20**
Closing balance	**10**	**12**	**3**	**31**	**218**	**15**	**289**
Specific	-	-	3	18	113	-	**134**
Collective	10	12	**-**	13	105	15	**155**
	10	**12**	**3**	**31**	**218**	**15**	**289**

* Business lending includes business overdrafts.

15. Impairment provisions on credit exposures (continued)

Group 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Opening balance	11	18	6	31	287	21	374
Charge for the year	7	13	7	10	691	9	737
Amounts written off	(10)	(22)	(6)	(14)	(308)	(22)	(382)
Recoveries of amounts written off in previous years	3	5	-	-	14	7	29
Transfer to assets held for sale (note 24)	-	-	-	-	(463)	-	(463)
Closing balance	11	14	7	27	221	15	295
Specific	-	-	6	14	106	-	126
Collective	11	14	1	13	115	15	169
	11	14	7	27	221	15	295

* Business lending includes business overdrafts.

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

Group	**2013 £m**	2012 £m
Amounts included in		
Loans and advances to customers (note 14)	**289**	295
Non-accrual loans		
Loans and advances to customers	**363**	343
Specific provisions	**(134)**	(126)
	229	217

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

16. Securitisations and covered bonds

Securitised advances are subject to non-recourse finance arrangements. These loans have been transferred at principal value to SPEs and have been funded through the issue of amortising mortgage backed securities to investors. The transfers do not meet the criteria for derecognition in IAS 39 as the Group has retained the risks and rewards of the assets. The Group consolidated financial statements include the results, assets and liabilities of the securitisation SPEs, on a line by line basis.

The balances of assets and liabilities in relation to Securitisation Notes and Covered Bonds in issue at 30 September 2013 within the Group balance sheets are as follows:

2013

	Securitised Notes £m	Covered Bonds £m	Total £m
At 1 October 2012	2,079	1,084	**3,163**
Issuance of debt	541	-	**541**
Repayments	(613)	-	**(613)**
Other movements	23	(43)	**(20)**
At 30 September 2013	**2,030**	**1,041**	**3,071**
Securitised assets	**4,834**	**2,751**	**7,585**

2012

	Securitised Notes £m	Covered Bonds £m	Total £m
At 1 October 2011	1,439	-	1,439
Issuance of debt	1,556	1,096	2,652
Repayments	(869)	-	(869)
Other movements	(47)	(12)	(59)
At 30 September 2012	2,079	1,084	3,163
Securitised assets	4,364	2,498	6,862

Further information on bonds, notes and subordinated debt can be found in note 28.

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

In addition to the securitisation notes disclosed above, there are £441m (2012: £474m) of Lannraig debt securities which are held by NAB and disclosed as a related party transaction (note 10). Assets which support the Lannraig debt are disclosed in the table above.

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

Group	**2013**		2012	
	Securitisation £m	**Covered bonds £m**	Securitisation £m	Covered bonds £m
Carrying amount of transferred assets	**4,834**	**2,751**	4,364	2,498
Carrying amount of associated liabilities	**2,471**	**1,041**	2,553	1,084

16. Securitisation and covered bonds (continued)

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

Group	2013		2012	
	Securitisation £m	**Covered bonds £m**	Securitisation £m	Covered bonds £m
Fair value of transferred assets	**4,834**	**-**	4,364	-
Fair value of associated liabilities	**2,471**	**-**	2,553	-
	2,363	**-**	1,811	-

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

Securitisation

The loans do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an on-going basis. The Group continues to be exposed primarily to liquidity risk, interest rate risk and credit risk of the loans. The securitisation trusts are consolidated into the Group. The note holders only have recourse to the mortgage pool of assets.

Covered Bonds

The residential mortgages do not qualify for derecognition because the Group retain all of the risks and rewards associated with them and where derivatives have not been externalised, interest rate and foreign currency risks are held in the Group. The covered bonds SPEs are consolidated, the residual mortgages are retained on the Group's balance sheet and the covered bonds issued are included within debt securities in issue. The covered bond holders have dual recourse to Clydesdale Bank PLC or the covered bond pool assets.

17. Property, plant and equipment

Group	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Short-term leasehold land and buildings £m	Motor vehicles, fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2011	34	4	138	158	334
Additions	-	-	9	5	14
Disposals	(12)	-	(3)	(16)	(31)
On revaluation	(2)	(1)	-	-	(3)
At 30 September 2012	**20**	**3**	**144**	**147**	**314**
Additions	-	-	26	11	37
Disposals	(1)	-	(14)	(23)	(38)
At 30 September 2013	**19**	**3**	**156**	**135**	**313**
Accumulated depreciation					
At 1 October 2011	1	-	69	99	169
Charge for the year	-	-	11	12	23
Disposals	-	-	(2)	(16)	(18)
At 30 September 2012	**1**	**-**	**78**	**95**	**174**
Charge for the year	-	-	13	11	24
Disposals	-	-	(8)	(10)	(18)
At 30 September 2013	**1**	**-**	**83**	**96**	**180**
Net book value					
At 30 September 2013	**18**	**3**	**73**	**39**	**133**
At 30 September 2012	19	3	66	52	140

Valuations

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Company's own Director valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors. Valuations are performed annually in July. A comparison of the carrying value under the revaluation basis and if the historical cost basis had been used is shown below:

Group	**2013 £m**	2012 £m
Carrying value as included under the revaluation basis	**21**	22
Carrying value if the historical cost basis had been used	**19**	19

18. Investment properties

Group	2013 £m	2012 £m
At 1 October	**77**	81
Additions	**-**	1
Disposals	**(14)**	(2)
Deficit on revaluation	**-**	(3)
	63	77

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Company's own Director valuations. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards.

During the year 99% (2012: 99%) of the investment properties generated total rental income of £3m (2012: £3m) and incurred operating expenses of £2m (2012: £2m). The operating expenses of the investment properties that did not generate rental income were £Nil (2012: £Nil).

19. Property inventory

Group	2013 £m	2012 £m
At 1 October	**9**	27
Additions	**-**	1
Disposals	**(3)**	(14)
Write down of property inventory	**-**	(5)
	6	9

All properties within property inventory are complete and available for sale. No properties are under construction (2012: £2.0m)

20. Investments in controlled entities and associates

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
At 30 September	**3**	3	**2,654**	6,953

During the year, as a part of a Group rationalisation programme, a number of the Company's subsidiaries were placed into voluntary liquidation with capital returned to the parent.

As highlighted in note 3, an impairment test on the carrying value of the Company’s investment in Clydesdale Bank PLC has been undertaken during the year, resulting in an impairment charge of £123m as at 30 September 2013 (2012: charge of £1,181m). For the purposes of the impairment test, Clydesdale Bank PLC is regarded as the cash generating unit with the value in use calculation compared to the current carrying value of the investment in Clydesdale Bank PLC in the Company balance sheet.

The key assumptions involved in these calculations are set out below.

20. Investments in controlled entities and associates (continued)

Key assumptions used in impairment testing

The recoverable amount of the cash generating unit has been derived from a value in use calculation using discounted cash flow techniques and a forecasted performance approved by the Board. Cash flows beyond the forecasted period have been extrapolated using similar forecasted assumptions as in the forecast period. The following rates are used by the Company:

	2013	2012
	%	%
Post tax discount rate	**10**	10
Projected terminal growth rate	**3.9**	3.3

The calculation of the value in use is based on a Board approved three year forecast projection and is then extrapolated forward with a terminal growth rate applied. The three year forecast projections encompass a range of economic indications such as GDP growth, unemployment statistics as well as a range of other business assumptions specific to Clydesdale Bank PLC such as asset volumes, product volumes and margins which are commercially sensitive. The Board is satisfied that the assumptions used both within and beyond the forecasted period are appropriate and reasonable at the balance sheet date.

Discount rate

The discount rate applied reflects the current market assessment of the risk specific to Clydesdale Bank PLC. The discount rate was calculated by reference to a series of internal indicators combined with certain identifiable and available sector specific information. The impairment model used is based on post-tax cash flows and utilises a post-tax discount rate. A comparable pre-tax discount rate for the year would be 12% (2012: 12%).

Projected terminal growth rate

The projected terminal growth rate is based on management's expectation of the long term average growth prospects for UK GDP after taking into account the broader historic UK economic outlook and trends.

Sensitivity to changes in assumptions

Changes such as a 1% increase in the post-tax discount rate or a 1% decrease in the projected terminal growth rate in the Company's assessment of the carrying value of Clydesdale Bank PLC in the Company, if adjusted independently of all other variables, would result in a further impairment of £491m from a 1% increase in the post-tax discount rate and a further impairment of £282m from a 1% decrease in the projected terminal growth rate.

The principal controlled entities are as follows:

Wholly owned subsidiary undertakings as at 30 September 2013	**Nature of business**	**Country of incorporation**
Clydesdale Bank PLC	Banking	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	England
National Australia Group Europe Services Limited	IT and group services	Scotland

20. Investments in controlled entities and associates (continued)

The following companies are SPEs established in connection with the Group's securitisation and covered bond programmes (note 16). Although the Company has no direct or indirect ownership interest in these companies, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's financial statements.

Other controlled entities as at 30 September 2013	Nature of business	Country of incorporation
Clydesdale Covered Bonds LLP	Acquisition of mortgage loans	England
Clydesdale Covered Bonds No.2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

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

Associates

Associates are undertakings over which the Group exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2013. The associated undertaking is The Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is in the provision of finance and the Group's interest of 33.33% in the issued equity capital of £2m is held by Clydesdale Bank PLC. The associated undertaking has a 31 March year end.

21. Intangible assets

Group

Capitalised software costs	**2013 £m**	2012 £m
Cost		
At 1 October	**352**	404
Additions	**69**	62
Write down of software	**-**	(114)
At 30 September	**421**	352
Accumulated amortisation		
At 1 October	**154**	180
Write down of software	**-**	(78)
Charge for the year (note 6)	**52**	52
At 30 September	**206**	154
Net book value at 30 September	**215**	198

Additions of £69m (2012: £62m) relate predominantly to the Group's continuing investment in new systems to meet the requirements of the business. To the extent that the systems are in use within the business amortisation has been charged at the rates set out in note 2.

Management perform impairment testing of capitalised software assets in accordance with International Accounting Standards. This highlighted no significant impairment in the year to 30 September 2013 (2012: £36m).

22. Deferred tax

Movement in net deferred tax asset

Group	2013 £m	2012 £m
At 1 October	**266**	101
Recognised in the income statement (note 7)	**6**	124
Recognised directly in equity	**(6)**	61
Transferred to assets held for sale (note 24)	**-**	(20)
	266	266

The Group recognises deferred tax attributable to the following items:

Group	2013 £m	2012 £m
Deferred tax assets		
Defined benefit pension liability	**37**	70
Impairment provision on credit exposures	**9**	14
Employee equity based compensation	**1**	4
Tax losses carried forward	**103**	92
Provisions	**47**	59
Accelerated capital allowances	**66**	38
Other	**10**	10
	273	287
Deferred tax liabilities		
Accelerated capital allowances	**-**	(18)
Net gain on revaluation of properties	**1**	1
Cash flow hedge reserve	**6**	37
Other	**-**	1
	7	21
Net deferred tax asset	**266**	266

The Group considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The largest deferred tax asset held within the Group relates to tax losses carried forward. The tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses, despite this the losses are expected to be fully utilised within the assessment period.

The headline rate of UK corporation tax reduced from 24% to 23% on 1 April 2013, and through the enactment of Finance Act 2013 will reduce further to 21% from 1 April 2014 and 20% from 1 April 2015. Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Accordingly, as the future reductions of the corporation tax rate to 21% and 20% were enacted on 17 July 2013, the deferred tax balances at 30 September 2013 have been reflected at the tax rates they are expected to be realised or settled.

23. Other assets

Group	2013 £m	2012 £m
Prepayments and accrued income	**277**	273
Other	**362**	242
	639	515

24. Assets held for sale

Group	2013 £m	2012 £m
Assets held for sale		
Other financial assets at fair value	**-**	1,475
Gross loans and advances to customers	**-**	4,177
	-	5,652
Impairment provisions on credit exposures (note 15)	**-**	(463)
Derivative financial instruments	**-**	(4)
Deferred tax	**-**	20
Other assets	**-**	20
	-	5,225
Liabilities associated with assets held for sale		
Derivative financial instruments	**-**	142

The assets held for sale were transferred to NAB on 5 October 2012 following the strategic review undertaken by the Group.

25. Due to other banks

Group	2013 £m	2012 £m
Transaction balances with other banks	**6**	9
Securities sold under agreements to repurchase	**-**	78
Deposits from other banks	**515**	470
	521	557

26. Due to customers

Group	2013 £m	2012 £m
Non-interest bearing demand deposits	**1,687**	1,637
Interest bearing demand deposits	**15,278**	14,341
Term deposits	**6,801**	9,779
Other wholesale deposits	**380**	624
	24,146	26,381

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

27. Provisions

	Group		Company	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Payment Protection Insurance redress provision				
Opening balance	**108**	102	**-**	-
Charge to the income statement	**130**	120	**-**	-
Provision utilised	**(86)**	(114)	**-**	-
Closing balance	**152**	108	**-**	-
Customer redress and other provisions				
Opening balance	**58**	9	**-**	2
Charge to the income statement	**108**	57	**-**	-
Provision utilised	**(48)**	(8)	**-**	(2)
Closing balance	**118**	58	**-**	-
Restructuring provision				
Opening balance	**126**	-	**-**	-
Charge to the income statement	**-**	149	**-**	-
Provision utilised	**(73)**	(23)	**-**	-
Transfer to surplus lease space provision	**(20)**	-	**-**	-
Closing balance	**33**	126	**-**	-
Surplus lease space provision				
Opening balance	**-**	-	**-**	-
Charge to the income statement	**2**	-	**-**	-
Provision utilised	**(10)**	-	**-**	-
Transfer from restructuring provision	**20**	-	**-**	-
Closing balance	**12**	-	**-**	-
Total provisions	**315**	292	**-**	-

Payment Protection Insurance redress

The Group has reassessed the level of provision that is considered necessary to meet current and future expectations in relation to the mis-selling of Payment Protection Insurance (“PPI”) policies and has consequently raised an additional provision of £130m (2012: £120m) in the year. This brings the total provisions raised in respect of PPI to £386m (2012: £256m) with £152m of this remaining as at 30 September 2013 (2012: £108m).

As described in note 3, significant judgement is required in determining the key assumptions used to estimate the quantum of the provision. These key assumptions are:

- The level of complaints;
- Uphold rates (how many claims are, or may be, upheld in the customer’s favour);
- The customer contact response rate; and
- Redress costs (the average payment made to customers).

In order to ensure that the assumptions used remain valid, they are regularly reviewed and assessed. This includes:

- Analysis of the causes of complaints and uphold rates;
- The extent of redress paid to customers, including how this may change over time and what would drive this; and
- The impact on complaint levels both from an increased internal focus as well as proactive customer contact.

In addition, the Group continues to review its approach to the regulator’s policy statement issued in August 2010 on the handling of complaints including feedback the Group has received from the FCA on its complaint handling process. The Group also monitors the findings of the Financial Ombudsman Service (“FOS”) and where appropriate updates its processes to reflect learning.

27. Provisions (continued)

The provision reflects our current assessment of the potential failings in our PPI complaint handling policy where the Group fully recognises its obligation to provide a fair and comprehensive complaints process which is not constrained by time period. We will continue to work with the FCA and the FOS to ensure we have a robust complaints process which is in the best interests of our customers. The provision also reflects an assessment of future PPI claims based upon estimates; statistical analysis and assumptions in relation to a wide range of uncertain factors, including how many PPI claims will be made against Clydesdale Bank PLC, for what value, and the prospect of the mis-selling being established in relation to those claims. The number of complaints received is monitored against expectations and while these have continued to fall, the rate of decline is lower than had been previously expected.

Therefore the provision continues to be subject to a number of inherent risks and uncertainties as a result of assumptions used in quantifying the Group's best estimate of expected costs at 30 September 2013. The eventual costs of redress and complaint handling may therefore differ materially from that estimate and further provision could be required.

Provision for customer redress and other provisions

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

On 29 June 2012 the Financial Services Authority ("FSA") announced that it had reached agreement with a number of UK banks in relation to a review and redress exercise on sales of certain interest rate hedging products to small and medium businesses. The Group agreed to participate in this exercise, as announced by the FSA on 23 July 2012, and has embarked on a program to identify small and medium sized customers that may have been affected. The exercise incorporates certain of the Group's tailored business loan products as well as the standalone hedging products identified in the FSA's notice.

A provision of £49m is held for this matter. The income statement effect of this provision is nil due to the recognition of an offsetting receivable from NAB.

The total cost of this exercise and any future, separate, thematic or other consideration of customer complaints in relation to other out of scope tailored business loans, a number of which are currently subject to review and challenge by the FOS, is uncertain.

Other provisions include provisions in respect of legal proceedings and claims arising in the ordinary course of the Group's business. These include £16m for historical mortgage repayment irregularities recently subject to public disclosure, our contribution to the banking industry response to the CPP Scheme of Arrangement, as well as a number of other matters.

Restructuring provision

Following the announcement of the results of the UK Banking strategic review on 30 April 2012, a restructuring provision of £139m was raised in May 2012. The provision covers redundancy payments, lease break fees, surplus space costs and associated enablement costs. In the period to 30 September 2013, £73m was utilised principally for the reduction of roles, the closure of 38 Financial Service Centres and two Customer Service Centres and the associated provisionable enablement costs of delivery of these activities. There was a further reduction of £20m by way of a transfer to a separate surplus lease space provision which is described below.

Surplus lease space provision

The Group provides for committed rental expense on surplus lease space in line with the expected years' exposure on individual leases where the property is unoccupied. The level of surplus lease space has increased as a result of the strategic review. The provision will be utilised over the remaining life of the leases or until the leases are assigned. The provision is measured at present values by discounting anticipated future cash flows.

28. Bonds, notes and subordinated debt

Group	2013 £m	2012 £m
Residential mortgage backed securities	**2,039**	2,094
Covered bonds	**1,096**	1,096
Total bonds, notes and subordinated debt	**3,135**	3,190
Fair value hedge adjustments	**(64)**	(27)
	3,071	3,163

On 13 June 2013, USD$300m and £350m of residential mortgage backed securities were issued through Lanark 2013-1.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC to parties outside of the NAB Group as at 30 September 2013 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Maturity date
Class A residential mortgage backed securities				
28 February 2012	EUR	**488**	3M EURIBOR + 1.95%	22 May 2015
27 July 2012	USD	**494**	3M USD LIBOR + 1.40%	22 May 2016
27 July 2012	GBP	**523**	3M GBP LIBOR + 1.63%	22 November 2017
13 June 2013	GBP	**349**	3M GBP LIBOR + 0.45%	22 August 2016
13 June 2013	USD	**185**	3M USD LIBOR + 0.50%	22 August 2016
		2,039		
Covered bonds				
31 May 2012	GBP	**696**	4.63%	08 June 2026
31 May 2012	GBP	**400**	3M GBP LIBOR + 1.70%	08 June 2015
		1,096		
		3,135		

29. Retirement benefit obligations

The Group is the sponsoring employer of one funded defined benefit scheme, the Yorkshire and Clydesdale Bank Pension Scheme ("the Scheme"). The assets of the Scheme are held in a trustee administered fund. The Group also provides post-retirement health care benefits under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made.

	2013 £m	2012 £m
Defined benefit assets	**2,718**	2,485
Defined benefit obligations	**(2,915)**	(2,786)
Net defined benefit pension scheme obligations	**(197)**	(301)
Post-retirement medical benefits obligations	**(5)**	(5)
Net retirement benefits obligations	**(202)**	(306)

The Group has implemented a number of reforms to the Scheme to control the liability. It closed the Scheme to new members in 2004 and has determined benefits accruing after April 2006 on a career average revalued earnings basis. The principal pension available to new employees since the closure of the Scheme is a defined contribution scheme, "Total Pension". The pension charge for the year in relation to Total Pension is shown in note 6.

29. Retirement benefit obligations (continued)

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

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.3m (2012: £0.4m) and would have no material impact upon service costs and interest costs.

Reconciliation of the defined benefit pension scheme assets	**2013 £m**	2012 £m
Opening fair value of defined benefit pension scheme assets	**2,485**	2,076
Actual return on scheme assets	**190**	248
Employer contributions (note 10)	**134**	242
Benefits paid	**(91)**	(81)
Closing fair value of defined benefit pension scheme assets	**2,718**	2,485

Reconciliation of the defined benefit pension scheme obligations	**2013 £m**	2012 £m
Opening defined benefit pension scheme obligations	**(2,786)**	(2,256)
Interest cost	**(118)**	(120)
Current service cost	**(30)**	(33)
Benefits paid	**91**	81
Actuarial loss	**(59)**	(456)
Past service cost	**(13)**	(2)
Closing defined benefit pension scheme obligations	**(2,915)**	(2,786)

Employer contributions include a contribution of £Nil from NAB (2012: £130m). This payment in 2012 was negotiated with the Scheme Trustees and formed part of a series of actions by NAB which resulted in its withdrawal as a participating employer in the Scheme during January 2012. The withdrawal as a participating employer did not materially impact the liabilities as measured under IAS 19, and the contribution therefore improved the overall Scheme funding position.

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

	2013 £m	2012 £m
Equities	**789**	990
Government bonds	**924**	557
Global sovereign bonds	**103**	105
Corporate bonds	**717**	709
Property	**93**	99
Cash	**92**	25
Fair value of defined benefit pension scheme assets	**2,718**	2,485

The Scheme is not invested in any of the Group's own financial instruments. There were no plan assets occupied by the Group at 30 September 2013 (2012: £25m).

29. Retirement benefit obligations (continued)

Amounts recognised in the income statement	**2013 £m**	2012 £m
Current service cost	**30**	33
Past service cost	**13**	2
Interest cost	**118**	120
Expected return on scheme assets	**(131)**	(135)
Defined benefit pension expense for the year	**30**	20

The past service cost relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements and in 2013 these were fully offset in the income statement by a corresponding release from the restructure provision.

Amounts recognised in the statement of comprehensive income	**2013 £m**	2012 £m
Opening cumulative actuarial losses	**(695)**	(351)
Experience gains/(losses) on scheme assets	**59**	113
Experience gains/(losses) on scheme liabilities	**4**	(41)
Changes in actuarial assumptions	**(63)**	(416)
Cumulative actuarial losses recognised in the statement of comprehensive income	**(695)**	(695)

Actuarial assumptions	**2013 % p.a.**	2012 % p.a.
Inflation	**3.25**	2.50
Rate of increase for pensions in payment:		
Pre 5 April 1997 benefits (Clydesdale Bank section)	**2.25**	2.25
Pre 5 April 1997 benefits (Yorkshire Bank section)	**3.10**	2.40
5 April 1997 to April 2006 benefits (both sections)	**3.10**	2.40
Post April 2006 benefits (both sections)	**2.25**	2.25
Rate of increase for pensions in deferment [1]	**2.25**	2.00
Discount rate	**4.60**	4.30
Expected rate of return on plan assets		
Equities	**7.70**	7.40
Government bonds	**3.10**	3.00
Global sovereign bonds	**3.50**	3.40
Corporate bonds	**4.30**	3.95
Property	**6.50**	6.40
Cash	**3.10**	3.00

[1] The assumption for the rate of increase for pensions in deferment has been linked to the Consumer Price Index from 30 September 2010, following a government announcement on 8 July 2010 relating to increases in pensions that are not specifically linked to the Retail Prices Index.

Post retirement mortality:	**2013 years**	2012 years
Current pensioners at 60 – male	**28.0**	27.9
Current pensioners at 60 – female	**28.5**	28.4
Future pensioners at 60 – male	**29.5**	29.4
Future pensioners at 60 – female	**30.0**	29.9

The expected return on assets assumption has been determined by considering the assets expected to be held over the following year and the expected returns for each asset class.

29. Retirement benefit obligations (continued)

History of experience gains and (losses)	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
On scheme assets	**59**	113	(97)	46	(112)
On scheme liabilities	**4**	(41)	(16)	45	(2)
Changes in actuarial assumptions	**(63)**	(416)	162	(158)	(477)
	-	(344)	49	(67)	(591)

History of net defined benefit pension scheme obligation	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Defined benefit assets	**2,718**	2,485	2,076	2,011	1,828
Defined benefit obligation	**(2,915)**	(2,786)	(2,256)	(2,323)	(2,138)
Net obligation	**(197)**	(301)	(180)	(312)	(310)

30. Other liabilities

Group	2013 £m	2012 £m
Accruals and deferred income	**80**	83
Notes in circulation	**1,709**	1,567
Accrued interest payable	**367**	362
Other	**207**	149
	2,363	2,161

31. Called up share capital

Allotted, called up and fully paid	2013 £m	2012 £m
Ordinary shares of £1 each		
At 1 October	**1,582**	1,082
Issued during the year	**-**	500
At 30 September	**1,582**	1,582
Preference shares of £1 each	**100**	100
Closing called up share capital	**1,682**	1,682

The preference shares in issue have all been classified as equity instruments. The preference shares issued on 17 December 2008 entitle the holder to a discretionary fixed non-cumulative dividend of 12% per annum payable every six months on the capital paid up thereon.

The dividends payable on the preference shares are at the Group's discretion based on a number of factors. The preference shares are redeemable, in whole only, at the option of the Company on the first business day following the fifth anniversary of the date of issue. No such redemption may be made without the consent of the PRA.

There is also one non-voting income share of £1 in issue (2012: £1).

32. Total equity

	Group		Company	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Share capital	**1,682**	1,682	**1,682**	1,682
Share premium account	**-**	893	**-**	893
Total share capital and share premium	**1,682**	2,575	**1,682**	2,575
Share option reserve	**2**	5	**-**	-
Asset revaluation reserve	**2**	1	**-**	-
Available for sale investments reserve	**5**	12	**-**	-
Cash flow hedge reserve	**23**	124	**-**	-
Total other reserves	**32**	142	**-**	-
Retained earnings	**535**	(298)	**489**	(315)
Total parent entity interest	**2,249**	2,419	**2,171**	2,260
Non-controlling interest	**200**	200	**-**	-
Total equity	**2,449**	2,619	**2,171**	2,260

Share premium

The share premium was cancelled during the year and transferred to retained earnings.

Share option reserve

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

Asset revaluation reserve

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

Available for sale investments reserve

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

Cash flow hedge reserve

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

As at 30 September 2013 the cash flow hedge reserve principally comprises crystallised fair value gains arising from the de-designated cash flow hedge (£75m) partially offset by deferred losses on interest rate swaps in the new macro cash flow hedge (£46m). The balance on the cash flow hedge reserve is net of tax.

£51m was recycled into the income statement in relation to the de-designated hedge in the period.

Non-controlling interests

On 15 December 2010, NAGE subscribed for £200m of preference shares issued by Clydesdale Bank PLC. NAGE funded the acquisition by restructuring its subordinated loans debt. As part of the restructure £200m was invested into the UK operations by National HK Investments Limited ("NHKI"), a Hong Kong incorporated holding company, indirectly owned by NAB. The NHKI investment was by way of a capital contribution to a limited partnership controlled by NAGE. The investment is shown as an equity interest attributable to a non-controlling party.

33. Contingent liabilities and commitments

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

Group

	2013	2012
Contingent liabilities	**£m**	£m
Guarantees and assets pledged as collateral security:		
At call	**1**	1
Due in less than 3 months	**34**	57
Due between 3 months and 1 year	**63**	44
Due between 1 year and 3 years	**12**	70
Due between 3 years and 5 years	**4**	4
Due after 5 years	**90**	102
No specified maturity	**9**	8
	213	286
Other credit commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**8,696**	9,290

The Company has issued a letter of support to the value of £10m (2012: £10m) in respect of one of its subsidiaries.

Capital commitments

The Group had future capital expenditure which had been contracted for but not provided for in the financial statements at 30 September 2013 of £4.5m (2012: £5.7m).

Operating lease commitments

Group

	2013	2012
Leases as lessor	**£m**	£m
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	**2**	2
between 1 year and 5 years	**3**	5
over 5 years	**2**	6
	7	13
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	**31**	35
between 1 year and 5 years	**91**	112
over 5 years	**115**	224
	237	371

33. Contingent liabilities and commitments (continued)

Other contingent liabilities

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme ("FSCS") provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be largely repaid from the realisation of the assets of the institutions. During the last year, the FSCS has also invoiced institutions for the first of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings which remains after the three annual levies have been paid is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2014 and an accrual of £7m (2012: £8m) is held for the Group's calculated liability to that date, with £6m of the current year charge having already been paid. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

The Group has provided for its best estimate of conduct risk related liabilities at 30 September 2013 as a result of its historical products and past sales practices (note 27). This has required management to exercise judgement and use estimation techniques, therefore a high degree of estimation uncertainty still exists as further described in note 3. Ongoing regulatory review and input, as well as changes in the rulings from the FOS over time, and the Group's own reviews of customer complaints will continue to impact upon the nature and extent of conduct-related customer redress and associated costs for which the Group may ultimately become liable. Accordingly the total cost associated with such conduct related matters is inherently uncertain.

Legal claims

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

34. Notes to the statements of cash flows

	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Adjustments included in the loss before tax				
Interest receivable	**(1,209)**	(1,461)	**(13)**	(15)
Interest payable	**453**	592	**55**	78
Depreciation and amortisation (note 6)	**75**	75	**-**	-
Profit on sale of tangible fixed assets *	**(1)**	(10)	**-**	-
Loss on revaluation of land and buildings *	**-**	10	**-**	-
Transfer from available for sale reserve	**-**	(4)	**-**	-
Transfer from cash flow hedge reserve	**3**	(1)	**-**	-
Loss on sale of AFS investments	**-**	3	**-**	-
Derivative financial instruments fair value movements	**11**	(9)	**-**	-
Impairment losses on credit exposures (note 15)	**144**	737	**-**	-
Impairment losses on goodwill (note 6)	**-**	141	**-**	-
Impairment losses on software (note 6)	**-**	36	**-**	-
Dividends received from subsidiaries	**-**	-	**(77)**	(60)
Adjustment to carrying value of investments	**-**	-	**123**	1,181
Movement in share option reserve	**(3)**	(9)	**-**	-
	(527)	100	**88**	1,184
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	**(12)**	(2)	**-**	-
Due from other banks	**(170)**	(2)	**-**	-
Derivative financial instruments	**247**	429	**-**	-
Financial assets at fair value through profit or loss	**636**	2,055	**-**	-
Loans and advances to customers	**307**	3,155	**-**	-
Due from customers on acceptances	**3**	-	**-**	-
Other assets	**(114)**	47	**-**	-
Assets held for sale (note 24)	**5,225**	(5,225)	**-**	-
	6,122	457	**-**	-
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	**(55)**	(783)	**-**	-
Derivative financial instruments	**(289)**	21	**-**	-
Financial liabilities at fair value through profit or loss	**(27)**	(8)	**-**	-
Due to customers	**(2,235)**	(1,789)	**-**	-
Liabilities on acceptances	**(3)**	-	**-**	-
Provisions (note 27)	**23**	181	**-**	(2)
Defined benefit pension obligations	**(104)**	(223)	**-**	-
Other liabilities	**177**	274	**-**	-
Liabilities associated with assets held for sale (note 24)	**(142)**	142	**-**	-
	(2,655)	(2,185)	**-**	(2)

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

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

	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Cash and balances with central banks (note 9)	**6,677**	7,896	**5**	3
Other assets	**178**	153	-	-
Due to other banks	**(28)**	(9)	-	-
Due to related entities	**(182)**	(13)	**-**	-
Other liabilities	**(95)**	(74)	**-**	-
	6,550	7,953	**5**	3

35. Employees

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

	2013 Number	2012 Number
Managers	**1,963**	2,588
Clerical staff	**4,863**	5,078
	6,826	7,666

36. Equity based compensation

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

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

Short term incentive ("STI")

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

Recognition and retention shares

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

Commencement shares

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

UK Share Incentive Plan

The UK Share Incentive Plan is an approved HM Revenue and Customs share plan. Employees are entitled to purchase up to £1,500 worth of NAB shares each year through the Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on the market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

36. Equity based compensation (continued)

General employee shares

Up to a target value of A$1,000 of NAB shares are offered to each eligible employee when the NAB Group's performance is on target, measured against a scorecard of objectives for the financial year. These shares are held in trust, restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Group Executive Long term Incentive plan ("LTI")

LTI helps to drive management decisions focused on the long-term prosperity of the NAB Group through the use of challenging performance hurdles. The Executive LTI programme is awarded to senior executives across the NAB Group and is provided wholly as performance rights. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. External and/or internal performance hurdles are measured at the end of a four year restriction period and during the restriction period an executive will forfeit their performance rights for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

UK Long Term Incentive plan

The UK LTI programme applies to the UK Executive Committee and is provided equally between a deferred cash award and performance rights. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. External and/or internal performance hurdles are measured at the end of a four year restriction period and during the restriction period an executive will forfeit the cash award and the performance rights for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

Each performance right is exchanged for one fully paid ordinary share in NAB upon exercise, subject to standard adjustments for capital actions. No exercise price is payable by the holder on exercise of performance rights.

Performance options

Performance options are predominantly offered only to key senior executives of the Group and generally lapse after a specified number of days after cessation of employment as determined by the NAB Board.

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

Performance options	**2013**		2012	
	Number	**Weighted average exercise price A$**	Number	Weighted average exercise price A$
Outstanding at 1 October	**278,946**	**26.12**	3,432,798	36.65
Granted during the year	**-**	**-**	-	-
Forfeited and lapsed during the year	**(55,527)**	**30.65**	(3,095,354)	37.92
Exercised during the year	**(41,177)**	**19.89**	(58,498)	19.89
Expired during the year	**(96,527)**	**31.70**	-	-
Outstanding at 30 September	**85,715**	**19.89**	278,946	26.12
Exercisable at 30 September	**-**		65,343	

The number of performance options exercised during the year was 41,177 (2012: 58,498). For performance options outstanding at 30 September 2013, the weighted average remaining contractual life is 0.79 years (2012: 1.3 years). The exercise price for performance options outstanding at the end of the year was A$19.89 (2012: the range of exercise prices was A$19.89 - A$31.70).

36. Equity based compensation (continued)

Performance rights	**2013 Number**	2012 Number
Outstanding at 1 October	**145,729**	745,984
Granted during the year	**61,258**	145,729
Forfeited and lapsed during the year	**(20,868)**	(717,699)
Exercised during the year	**-**	(28,285)
Outstanding at 30 September	**186,119**	145,729
Exercisable at 30 September	**-**	-

No performance rights were exercised during the year (2012: 28,285). For performance rights outstanding at 30 September 2013, the weighted average remaining contractual life is 2.87 years (2012: 3.21 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

No performance options were granted during the year ended 30 September 2013 (2013:Nil). 61,258 performance rights were granted during the year ended 30 September 2013 (2012: 145,729). Included within personnel expenses (note 6) is a fair value of goods or services to the value of £0.8m, which was measured indirectly by reference to the fair value on the performance rights granted during the year (2012: £1.4m).

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Notes to the consolidated financial statements (continued)

37. Directors' emoluments

2013 £'000			Performance related pay							
			Short term incentive schemes (3)			Long term incentive schemes (6)				
	Salary and fees (1)	Benefits and allowances (2)	Annual (cash)	Deferred (shares)	Total short term	Deferred (cash)	Deferred (performance rights)	Deferred (shares)	Total long term	Total emoluments
Executive Directors										
Cameron Clyne (5)	-	-	-	-	-	-	-	-	-	-
John Hooper	591	242	70	211	281	267	267	1	535	1,649
Mark Joiner (5)	-	-	-	-	-	-	-	-	-	-
Richard Sawers (5)	-	-	-	-	-	-	-	-	-	-
David Thorburn	450	101	63	253	316	338	338	1	677	1,544
Total Executive	**1,041**	**343**	**133**	**464**	**597**	**605**	**605**	**2**	**1,212**	**3,193**
Non-executive Directors										
David Allvey (4)	78	-	-	-	-	-	-	-	-	78
David Browne (4)	78	-	-	-	-	-	-	-	-	78
Richard Gregory OBE (4)	138	-	-	-	-	-	-	-	-	138
James Pettigrew (4)	80	-	-	-	-	-	-	-	-	80
Barbara Ridpath (4)	69	-	-	-	-	-	-	-	-	69
Alexander Shapland (4)	69	-	-	-	-	-	-	-	-	69
Total Non-executive	**512**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**512**
Total Directors	**1,553**	**343**	**133**	**464**	**597**	**605**	**605**	**2**	**1,212**	**3,705**

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for Directors amounting to £405,000 (2012: £430,000) and in respect of emoluments for the Highest Paid Director of £175,000 (2012: £178,000). The table also includes deferred cash and deferred performance rights awarded on 20 February 2013 in respect of the previous financial year.

37. Directors' emoluments (continued)

2012 £'000			Performance related pay							
			Short term incentive schemes (3)			Long term incentive schemes(6)				
	Salary and fees (1)	Benefits and allowances (2)	Annual (cash)	Deferred (shares)	Total short term	Deferred (cash)	Deferred (performance rights)	Deferred (shares)	Total long term	Total emoluments
Executive Directors										
Cameron Clyne (5)	-	-	-	-	-	-	-	-	-	-
John Hooper	703	214	-	-	-	-	-	1	1	918
Mark Joiner (5)	-	-	-	-	-	-	-	-	-	-
Richard Sawers (5)	-	-	-	-	-	-	-	-	-	-
David Thorburn	400	109	-	-	-	-	-	1	1	510
Total Executive	1,103	323	-	-	-	-	-	2	2	1,428
Non-executive Directors										
David Allvey (4)	25	-	-	-	-	-	-	-	-	25
David Browne (4)	25	-	-	-	-	-	-	-	-	25
Jonathan Dawson	50	-	-	-	-	-	-	-	-	50
Sir David Fell	85	-	-	-	-	-	-	-	-	85
Richard Gregory OBE (4)	93	-	-	-	-	-	-	-	-	93
Roy Nicolson	69	-	-	-	-	-	-	-	-	69
Elizabeth Padmore	55	-	-	-	-	-	-	-	-	55
James Pettigrew (4)	-	-	-	-	-	-	-	-	-	-
Barbara Ridpath (4)	25	-	-	-	-	-	-	-	-	25
Alexander Shapland (4)	25	-	-	-	-	-	-	-	-	25
Sir Malcolm Williamson	156	-	-	-	-	-	-	-	-	156
Peter Wood	4	-	-	-	-	-	-	-	-	4
Total Non-executive	612		-	-	-	-	-	-	-	612
Total Directors	1,715	323	-	-	-	-	-	2	2	2,040

37. Directors' emoluments (continued)

Notes

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

(2) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to One Director (2012: One) under a defined benefit pension plan. Pension contributions amounting to £16,730 (2012: £18,000) were paid during the year of which contributions for the highest paid Director amounts to £16,730 (2012: £Nil).

(3) Performance related pay relates to the respective financial year. The short term incentive scheme includes a cash element will be paid in the forthcoming year and the deferred amount represents shares deferred for one and two years. The highest paid Director received 110,331 shares (2012: 165,132) that vested during the year, with a fair value of £422,940 (2012: £960,372).

(4) Current year figures represent a full year of directorship fees for Non-executive Directors who were appointed during FY 2012. Richard Gregory was appointed Senior Independent Director on 18 September 2012 and his directorship fees reflect increased compensation for this role.

(5) Cameron Clyne, Mark Joiner and Richard Sawers are remunerated as employees of NAB, and do not receive incremental remuneration in respect of their duties as Directors of the Company. The Directors believe it would be appropriate to apportion A$782,000 (2012: A$510,000) of their remuneration as being in respect of their duties to the Company.

(6) The long term incentive scheme amounts principally represent deferred cash, deferred performance rights and deferred shares for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. Typically, the performance period is four years. The value attributed is the fair value of the shares at the date of granting. Two Directors (2012: None) received benefits under an executive long term incentive scheme. The 2013 table also includes deferred cash and performance rights awarded on 20 February 2013 in relation to the previous financial year. One Director exercised share options during the year (2012: One). In 2012, the amounts disclosed relate solely to the general employee shares described in note 36.

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

2013 Number	**Performance options**	**Performance rights**	**Short term incentive shares**	**Long term incentive shares**	**Other employee share plans**
Outstanding at 1 October	245,716	21,146	17,802	29,790	8,219
Granted during the year	-	12,060	-	-	36
Exercised/disposed during the year	(33,802)	-	(5,728)	(4,774)	-
Expired during the year	(90,216)	-	-	-	-
Forfeited and lapsed during the year	(51,334)	-	-	(8,314)	-
Restrictions ceased	-	-	(6,347)	-	-
Outstanding at 30 September	**70,364**	**33,206**	**5,727**	**16,702**	**8,255**

2012 Number	Performance options	Performance rights	Short term incentive shares	Long term incentive shares	Other employee share plans
Outstanding at 1 October	430,238	28,390	48,091	60,155	26,348
Granted during the year	-	21,146	19,636	-	3,182
Exercised/disposed during the year	(48,022)	(8,760)		-	-
Expired during the year	(136,500)	(19,630)	-	-	-
Forfeited and lapsed during the year	-	-	(12,714)	-	-
Restrictions ceased	-	-	(37,211)	(30,365)	(21,311)
Outstanding at 30 September	245,716	21,146	17,802	29,790	8,219

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Notes to the consolidated financial statements (continued)

38. Fair value of financial instruments

Financial instruments include both financial assets and financial liabilities and also derivatives. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. For the purposes of this note, carrying value refers to amounts reflected in the Consolidated Balance Sheet.

Group		**2013**		2012	
	Footnote	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets					
Cash and balances with central banks	(a)	**6,720**	**6,720**	7,927	7,927
Due from related entities	(b)	**1,381**	**1,381**	1,256	1,256
Due from other banks	(c)	**184**	**184**	14	14
Investments – available for sale	(d)	**973**	**973**	1,039	1,039
Other financial assets at fair value	(e)	**2,155**	**2,155**	2,791	2,791
Derivative financial assets	(f)	**240**	**240**	600	600
Loans and advances to customers	(g)	**23,895**	**23,939**	24,346	24,401
Due from customers on acceptances	(a)	**4**	**4**	7	7
Other assets	(h)	**235**	**235**	232	232
Assets held for sale	(i)	**-**	**-**	5,225	5,225
Financial liabilities					
Due to other banks	(g)	**521**	**521**	557	557
Other financial liabilities at fair value	(e)	**120**	**120**	147	147
Derivative financial liabilities	(f)	**663**	**663**	952	952
Due to customers	(g)	**24,146**	**24,194**	26,381	26,460
Liabilities on acceptances	(a)	**4**	**4**	7	7
Due to related entities	(b)	**3,026**	**3,026**	7,716	7,716
Bonds, notes and subordinated debt	(g)	**3,071**	**3,073**	3,163	3,164
Other liabilities	(j)	**2,076**	**2,076**	1,929	1,929
Liabilities associated with assets held for sale	(i)	**-**	**-**	142	142

The fair value estimates are based on the following methodologies and assumptions:

(a) The carrying amounts of these financial assets and financial liabilities approximate fair value.

(b) The carrying value of amounts due from and due to related entities is considered to approximate fair value. Amounts due from related entities are repayable on demand or within twelve months. Amounts due to related entities are repayable under varying maturities but are materially repriced every 3-6 months relative to market rates. As a result, the carrying value approximates the fair value.

(c) The carrying value of amounts due from other banks is net of allowances for impairment losses and unearned income. The fair value of amounts due from other banks equates to the carrying value at 30 September 2013 as they are short term in nature.

(d) The fair values of investments are based on quoted closing market prices. Where investments are unlisted and quoted market prices are not available, the Group obtains fair value by means of other valuation techniques that are commonly used by market participants.

(e) The fair value of assets and liabilities designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based upon observable market data as appropriate to the nature and type of the underlying instrument. Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 13).

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

(g) The fair value of financial assets and financial liabilities are obtained from discounted cash flow models.

(h) Other assets include accrued interest receivable and other short term receivables whose carrying values approximate fair value.

38. Fair value of financial instruments (continued)

(i) The fair value of assets held for sale and associated liabilities is estimated in accordance with the methodologies and assumptions applied to the classifications that were applicable for the underlying assets before classification as held for sale. The breakdown of the assets held for sale and associated liabilities is shown in note 24. The assets were transferred on 5 October 2012.

(j) Other liabilities include accrued interest payable and notes in circulation whose carrying values approximate fair value.

Fair value hierarchy

For financial instruments carried at fair value on the balance sheet the fair value measurement is in accordance with the following hierarchy as defined by IFRS 7:

- Level 1: Financial instruments with quoted prices for identical instruments in active markets;
- Level 2: Financial instruments with quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable; and
- Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The classification of assets and liabilities into the fair value hierarchy is outlined for each class of financial instrument within the relevant notes for those assets and liabilities.

Level 3 movements analysis		**Group**	
	Investments – available for sale £m	**Other financial assets at fair value £m**	**Other financial liabilities at fair value £m**
At 1 October 2011	7	-	-
Gains recorded in the income statement	1	-	-
Losses recorded in equity	(1)	-	-
Transfers into level 3 from level 2	-	4,266	147
At 30 September 2012	**7**	**4,266**	**147**
Gains recorded in the income statement	-	-	(6)
Losses recorded in the income statement	-	(176)	-
Sales	-	(1,452)	-
Settlements	-	(483)	(21)
At 30 September 2013	**7**	**2,155**	**120**

Other financial assets at fair value incorporates a suite of loan products which were removed from sale with effect from 30 April 2012. Alternative products are now offered for future advances and these are accounted for within loans and advances to customers.

A sensitivity analysis of the valuation of the level 3 other financial assets at fair value is included in note 3. Reasonable changes in the assumptions used in valuing the level 3 available for sale investments would not result in material changes in the valuation. Financial liabilities at fair value are not considered to be material, therefore no sensitivity analysis is provided.

39. Financial risk management

Strategy in using financial instruments

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

Fair value hedges

The Group hedges part of its existing interest rate and foreign currency risk from any decrease in the fair value of fixed rate assets or increase in fair value of fixed rate liabilities using interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 13. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate risk arising from variable interest rate assets and liabilities using interest rate swaps. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. As explained further in note 13 the Group adjusted its cash flow hedging strategy during the year. The fair value of derivatives entered into is also disclosed in note 13.

Credit risk

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

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

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

Derivatives

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

Credit-related commitments

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

39. Financial risk management (continued)

Credit risk (continued)

Credit-related commitments (continued)

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

Forbearance

The Group operates a range of forbearance measures across its retail home loan and commercial book when customers have been identified as experiencing a period of financial difficulty or distress. A range of parameters are considered when the Group looks to identify those customers to whom forbearance would be applicable and these parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions.

The Group considers that forbearance takes place when a concession is granted to a customer with affordable terms and conditions that are more suitable to the customer's current circumstances than those originally contracted for. The Group remains committed in ensuring that any forbearance strategy agreed with a customer is both affordable and sustainable for the customer with the ultimate aim of minimising the risk of losses for the Group and its customers.

The Group exercises forbearance in two distinct areas: retail and non-retail.

Retail forbearance

The Group's approach to retail forbearance is represented in the following table:

	The customer advises they are in financial difficulty	***The customer is in arrears***	***The customer recovers their financial position***	***The customer is in litigation/repossession***
Solutions available	Income and expenditure assessment and other financial management support available	Forbearance measures applied on a case by case basis	Position monitored when arrears recovered Remains forbearance if permanent solution applied	Not forbearance as legal redress being sought
Reporting and disclosure	Where forbearance is applied – this is disclosed	Disclosed as forbearance	Not disclosed as forbearance unless permanent	Repossessions are separately disclosed

39. Financial risk management (continued)

Forbearance (continued)

For retail (primarily mortgage) forbearance, the Group makes every effort to follow its principles of treating customers fairly by working with customers, at as early a stage as possible, in times of distress in order to find a solution that enables the Group to continue its relationship with the customer but with the ultimate aim of minimising the risk of the customer losing their home where this is in the interests of the customer.

The Group utilises a number of tools for retail customers that have been identified as experiencing financial distress with appropriate policies and procedures in place to ensure consistent application. The operation and maintenance of these policies are under continuous review to confirm they remain relevant, appropriate and most importantly of value to our retail customers who have been identified as requiring forbearance.

At an operational level, forbearance measures that either extend the loan term or relate to a conversion to interest only are undertaken within a dedicated Financial Management and Customer Solutions unit ("FM & CS"), part of whose remit is to assist retail customers in financial difficulty to manage their finances more effectively. All other forbearance measures are exercised within Mortgage Collections, which is the first line of defence in negotiating positive outcomes for customers who have fallen into arrears.

The Group operates the following range of forbearance measures for retail customers on a case by case basis:

- Formal rehabilitations – including:
  - arrangements with the customer to repay any arrears over a shorter period;
  - capitalisation of arrears which are then added to the remaining capital balance of the loan to be repaid over the remaining term. This is only considered when there is no other realistic forbearance measure available.
- Temporary concessions – primarily short term measures and can include:
  - reduced payment concessions;
  - non-contractual payment holidays/redraw of previous overpayments.
- Conversion to interest only repayments:
  - allows the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term.
- Extensions to the loan term:
  - the customer is permitted to make lower repayments whilst still repaying the outstanding balance in full.

39. Financial risk management (continued)

Forbearance (continued)

Retail home loans subject to forbearance are of low financial significance in the context of the Group's overall lending operations. The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

2013	**Number**	**£m**	**% of total portfolio %**	**Impairment allowance £m**	**% coverage %**
Temporary forbearance	173	15	0.09	-	-
Interest only conversion	12	1	0.01	-	-
Term extension	26	2	0.01	-	-
Capitalisation of arrears	585	41	0.26	1	2.44
Other arrangements	6	-	-	-	-
	802	**59**	**0.37**	**1**	**1.69**

2012	Number	£m	% of total portfolio %	Impairment allowance £m	% coverage %
Temporary forbearance	210	17	0.11	1	5.88
Interest only conversion	27	2	0.01	-	-
Term extension	15	1	-	-	-
Capitalisation of arrears	673	52	0.34	2	3.85
Other arrangements	9	-	-	-	-
	934	72	0.46	3	4.17

The Group also has a number of customers with interest only mortgages past maturity; the management of which continues to evolve and can be considered to be forbearance even though a formal arrangement is not in place. The Group has formal processes embedded to track and facilitate pro-active customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months of maturity. At 30 September 2013, the Group had 210 customers on interest only mortgages which were post six month maturity with a total value of £28.5m.

A further forbearance reserve of £4m (2012: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £5m (2012: £7m) and to increase overall coverage to 8.47% (2012: 9.72%).

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2013 there were 174 repossessions of which 39 were voluntary (2012: 200 including 50 voluntary).

The Group also currently exercises limited forbearance strategies in relation to unsecured loans and credit cards which mainly consist of term extensions (subject to negotiations with the customer) for the former and reduced payment arrangements for the latter. Forbearance strategies implemented on unsecured loans and credit cards are of low financial significance in the context of the Group's overall lending operations.

Forbearance is not exercised in cases where a Court has ordered the customer to repay the arrears under the terms of a suspended Repossession Order. As the terms and level of the arrangement are at the discretion of the Court and the Group have no control over the formal arrangement, this is not considered to be forbearance.

39. Financial risk management (continued)

Forbearance (continued)

Non-retail forbearance

Non-retail forbearance is considered to take place where the Group grants a concession for reasons relating to the actual, or apparent, financial stress of a non-retail customer, which provides the customer with more favourable terms and conditions than those provided at drawdown of the facility. It is a consequence of concerns about the borrower's ability to meet the contracted repayments when due and specifically relates to such instances where the changes to the arrangement have been made on terms that the Group would not ordinarily consider on a commercial basis. In these instances, non-retail forbearance would be considered to be in place until such time (minimum six months or three payment cycles) as there is evidence to show a significant reduction in the risk of non-payment from future cash flows.

Forbearance is considered to exist where one or more of the following occurs, on a non-commercial basis, for reasons relating to the actual or apparent stress of a customer:

- Extending of loan facility payment term or an overdraft which is not fluctuating (e.g. where a Term Loan has matured and the balance passed to an overdraft, which is then extended on a non-commercial basis then forbearance is considered to exist);
- Deferral of contracted capital repayments (i.e. capital repayment holiday, conversion to interest only for an extended period, or rescheduling);
- Reduction in the contracted interest rate, including a reduction in the level of accrued interest or amendment to original fee structure;
- Alternative forms of payment, including debt for equity and asset transfer; and
- Debt forgiveness.

Where a customer has multiple facilities and forbearance is considered to exist for one or more of these facilities, then the total amount of the debt will be considered as forbearance. Where a customer is part of a larger group, forbearance is exercised and reported across the group at the individual entity level and would include all group entities.

39. Financial risk management (continued)

Forbearance (continued)

The tables below summarise the total number of arrangements in place and the loan and impairment provisions associated with those arrangements, with the September 2012 comparative position being shown excluding the assets classified as held for sale which were subsequently sold in October 2012 to aid comparison. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

2013	**Number**	**£m**	**% of total portfolio %**	**Impairment allowance £m**	**% coverage %**
Term extension	281	220	2.41	22	10.00
Deferral of contracted capital payments	112	144	1.58	29	20.14
Reduction in contracted interest rate	7	6	0.07	2	33.33
Alternative forms of payment	7	43	0.47	9	20.93
Debt forgiveness	16	34	0.37	7	20.59
	423	**447**	**4.90**	**69**	**15.44**

2012	Number	£m	% of total portfolio %	Impairment allowance £m	% coverage %
Term extension	307	129	1.19	8	6.20
Deferral of contracted capital payments	112	116	1.07	11	9.48
Reduction in contracted interest rate	8	9	0.08	-	-
Alternative forms of payment	12	59	0.54	13	22.03
Debt forgiveness	14	40	0.37	10	25.00
	453	353	3.25	42	11.90

The Group now reports non-retail forbearance at a customer level rather than a facility level, resulting in a customer with forbearance on one or more facilities now being recorded as a single customer but at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Comparative disclosures have been amended to conform with current year presentation. This has resulted in adjustments to the category numbers and values of facilities recorded as non-retail forbearance as at 30 September 2012 and an overall increase in the level of the related impairment allowance of £11m.

The following situations are not considered to be forbearance where they are identified as the sole reason as to whether a non-retail customer may be considered for forbearance:

- A waiver of a Covenant breach, or amendment to the terms of a Covenant. Where Covenant breaches have occurred which could imply financial stress, normal impaired asset review procedures are followed in line with Group Credit Policy;
- Facilities that have been temporarily extended pending review and no concession has been granted for reasons relating to the actual or apparent financial stress of a customer;
- A reduction in asset quality;
- Where changes are made to the terms of a borrower's repayment arrangement on a commercial basis; and
- Where the Group has made a demand for repayment.

39. Financial risk management (continued)

Credit risk (continued)

Maximum exposure to credit risk

The Group's credit exposure has been determined in accordance with capital adequacy guidelines. The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

	Group	
	2013	2012
	£m	£m
Cash and balances with central banks (note 9)	**6,720**	7,927
Due from related entities (note 10)	**1,381**	1,256
Due from other banks	**184**	14
Investments – available for sale (note 11)	**973**	1,039
Other financial assets at fair value (note 12)	**2,155**	2,791
Derivative financial assets (note 13)	**240**	600
Loans and advances to customers (note 14)	**23,895**	24,346
Due from customers on acceptances	**4**	7
Assets held for sale (note 24)	**-**	5,225
	35,552	43,205
Contingent liabilities (note 33)	**213**	286
Other credit commitments (note 33)	**8,696**	9,290
Commitments relating to assets held for sale	**-**	140
Maximum credit risk exposure	**44,461**	52,921

Credit quality of financial assets

An assessment of the credit quality of loans and advances to customers can be found in note 14 with an assessment of the credit quality of investments contained in note 11.

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

39. Financial risk management (continued)

Credit risk (continued)

Risk concentration

Concentration of risk is managed by customer / counterparty, by product, by geographical region and by industry sector. In addition single name exposure limits exist to limit exposure to a single entity / counterparty.

Eurozone risk

The Group and Company have no material operations outside the UK and have no direct sovereign exposure to any Eurozone countries (2012: Nil). The Group had an exposure to the European Investment Bank of £100m at 30 September 2013 (2012: £100m).

Industry concentration of credit risk

The following tables show the levels of industry concentration of credit risk as at 30 September:

Gross loans and advances to customers including loans designated at fair value through profit or loss	**Group**	
	2013	2012 *
	£m	£m
Government and public authorities	**35**	39
Agriculture, forestry, fishing and mining	**1,758**	1,913
Financial, investment and insurance	**553**	886
Property – construction	**516**	3,722
Manufacturing	**723**	922
Instalment loans to individuals and other personal lending (including credit cards)	**1,902**	2,372
Property – mortgage	**16,148**	15,369
Asset and lease financing	**482**	694
Other commercial and industrial	**4,303**	7,303
	26,420	33,220

* 30 September 2012 includes assets classified as held for sale.

Contingent liabilities and credit related commitments	**Group**	
	2013	2012
	£m	£m
Agriculture, forestry, fishing and mining	**1,006**	753
Financial, investment and insurance	**56**	66
Property – construction	**98**	543
Manufacturing	**228**	211
Instalment loans to individuals and other personal lending (including credit cards)	**3,939**	3,674
Property – mortgage	**2,010**	1,724
Other commercial and industrial	**1,572**	2,745
	8,909	9,716

Available for sale investments	**Group**	
	2013	2012
	£m	£m
Government and public authorities	**973**	1,039

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

39. Financial risk management (continued)

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Group's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

Interest rate risk in the banking book ("IRRBB")

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with NAB IRRBB policy. Risk measurement techniques include: Value at Risk ("VaR"), Earnings at Risk ("EaR"), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- Historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a consistent statistical basis: 99% confidence level; three month holding period.
- Economic capital is allocated for IRRBB based on a higher confidence interval and a longer holding period.
- EaR utilises a twelve month forecast period.
- Eight years of business day historical data.
- VaR methodology is based on proportional rather than absolute changes in historical interest rates.
- Investment term for capital is modelled with an established benchmark term of between one and five years.
- Investment term for core "non-interest" bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between one and five years.

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of the UK Asset & Liability Committee ("UK ALCO").

Interest rate risk	**Value at risk**		**Earnings at risk**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
As at 30 September	**30**	31	**7**	4
Average value during the year	**32**	37	**9**	6
Minimum value during the year	**29**	31	**3**	2
Maximum value during the year	**35**	45	**20**	13

39. Financial risk management (continued)

Market risk (continued)

The following table shows the Group's principal financial assets and liabilities and the main non traded market risk types they are exposed to:

	2013 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	**6,720**				✔
Available for sale investments	**973**	✔	✔		✔
Loans and advances to customers	**23,895**	✔	✔	✔	✔
Derivative financial instruments	**240**		✔		✔
Other financial assets at fair value	**2,155**		✔		✔
Liabilities					
Due to customers	**24,146**	✔	✔	✔	
Due to other banks	**521**	✔	✔	✔	
Derivative financial instruments	**663**		✔		
Other financial liabilities at fair value	**120**	✔	✔		
Bonds, notes and subordinated debt	**3,071**	✔	✔	✔	

Prepayment risk

Customers may prepay certain loans and advances ahead of the contractual repayment schedule. This form of optionality gives rise to prepayment risk for the Bank whereby the expected timing of cashflows from loan repayments differs from the actual experience. The impact on the Bank would differ according to changes in the level of interest rates.

The Group assesses the risks arising from prepayment behaviour in order to show the potential impact on future cashflows. The impact is also managed through terms and conditions within loans and advances.

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Group 2013	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Assets							
Cash and balances with central banks	5,508	-	-	-	-	1,212	**6,720**
Due from related entities	1,372	-	-	9	-	-	**1,381**
Due from other banks	19	100	65	-	-	-	**184**
Investments – available for sale	-	-	-	101	866	6	**973**
Other financial assets at fair value	11	71	242	530	1,301	-	**2,155**
Derivative financial assets	-	19	24	106	91	-	**240**
Loans and advances to customers	2,880	281	722	4,089	15,527	396	**23,895**
Due from customers on acceptances	-	4	-	-	-	-	**4**
All other assets	178	408	58	-	-	691	**1,335**
Total assets	**9,968**	**883**	**1,111**	**4,835**	**17,785**	**2,305**	**36,887**
Liabilities							
Due to other banks	-	484	37	-	-	-	**521**
Other financial liabilities at fair value	-	-	9	52	59	-	**120**
Derivative financial liabilities	1	66	53	184	359	-	**663**
Due to customers	16,659	2,447	2,515	2,525	-	-	**24,146**
Liabilities on acceptances	-	4	-	-	-	-	**4**
Due to related entities	613	61	-	1,227	1,125	-	**3,026**
Bonds, notes and subordinated debt	-	-	-	2,429	642	-	**3,071**
All other liabilities	1,804	462	74	-	-	547	**2,887**
Total liabilities	**19,077**	**3,524**	**2,688**	**6,417**	**2,185**	**547**	**34,438**
Off balance sheet items							
Contingent liabilities	1	34	63	16	90	9	**213**
Other credit commitments	8,696	-	-	-	-	-	**8,696**
Total off balance sheet items	**8,697**	**34**	**63**	**16**	**90**	**9**	**8,909**

39. Financial risk management (continued)

Market risk (continued)

Maturity analysis of assets and liabilities (continued)

Group 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	6,800	-	-	-	-	1,127	7,927
Due from related entities	1,223	-	-	-	33	-	1,256
Due from other banks	-	14	-	-	-	-	14
Investments – available for sale	-	-	-	100	932	7	1,039
Other financial assets at fair value	1	45	165	1,006	1,574	-	2,791
Derivative financial assets	-	37	50	314	199	-	600
Loans and advances to customers	4,132	488	796	3,799	14,695	436	24,346
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	153	315	78	-	-	713	1,259
Assets held for sale	587	135	723	2,462	1,298	20	5,225
Total assets	12,896	1,041	1,812	7,681	18,731	2,303	44,464
Liabilities							
Due to other banks	-	521	36	-	-	-	557
Other financial liabilities at fair value	-	-	5	74	68	-	147
Derivative financial liabilities	7	87	51	236	571	-	952
Due to customers	15,990	3,136	3,453	3,802	-	-	26,381
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	735	25	4,350	1,006	1,600	-	7,716
Bonds, notes and subordinated debt	-	-	590	1,370	1,203	-	3,163
All other liabilities	1,641	455	59	-	-	625	2,780
Liabilities associated with asset held for sale	-	-	6	48	88	-	142
Total liabilities	18,373	4,231	8,550	6,536	3,530	625	41,845
Off balance sheet items							
Contingent liabilities	1	57	44	74	102	8	286
Other credit commitments	9,290	-	-	-	-	-	9,290
Total off balance sheet items	9,291	57	44	74	102	8	9,576

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

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

Group 2013	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	-	484	37	-	-	-	**521**
Other financial liabilities at fair value	-	1	14	71	65	-	**151**
Derivative financial liabilities	1	66	53	107	340	-	**567**
Due to customers	16,659	2,459	2,553	2,559	-	-	**24,230**
Liabilities on acceptances	-	4	-	-	-	-	**4**
Bonds, notes and subordinated debt	-	19	57	2,627	751	-	**3,454**
All other financial liabilities	1,696	-	-	-	-	-	**1,696**
Hedging derivatives							
Contractual amounts payable	-	66	172	1,109	78	-	**1,425**
Contractual amounts receivable	-	(59)	(173)	(1,002)	-	-	**(1,234)**
Total liabilities	**18,356**	**3,040**	**2,713**	**5,471**	**1,234**	**-**	**30,814**

Group 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	522	36	-	-	-	558
Other financial liabilities at fair value	-	2	9	103	81	-	195
Derivative financial liabilities	7	87	51	240	597	-	982
Due to customers	15,990	3,158	3,492	3,873	-	-	26,513
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	20	647	1,598	1,313	-	3,578
All other financial liabilities	1,567	-	-	-	-	-	1,567
Hedging derivatives							
Contractual amounts payable	-	12	48	1,089	75	-	1,224
Contractual amounts receivable	-	(5)	(36)	(995)	-	-	(1,036)
Total liabilities	17,564	3,803	4,247	5,908	2,066	-	33,588

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

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

40. Management of risk

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group’s strategy, as well as that of its parent entity NAB Limited. A key component of the Group’s risk management strategy is the establishment by the Board of a formal 'Risk Appetite Statement'.

This places an overall limit on the total amount and types of risk that the Group is prepared to take. This is set with respect to the returns that the Group is seeking to provide to its shareholder, the credit rating that the Group is seeking to maintain and the Group's capital position and desired capital ratios.

This informs the Group's risk, capital and business limits and policies. It is regularly reviewed by the Board as a part of the strategic planning process, or otherwise as the commercial circumstances of the Group change.

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the businesses' front-line teams to be effective. This overriding principle embodies the following concepts:

- all business decisions proactively consider risk and the impact on the Group’s customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components; and
- all employees are responsible for risk management in their day-to-day activities.

Within this context, the Group manages risk within a “three lines of defence” framework. Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are accountable for establishing risk policy, standards and the oversight of risk management effectiveness within the business. The third line of defence is Internal Audit who are responsible for independently reviewing, monitoring, and testing business unit compliance and regularly assessing the overall effectiveness of the Risk Management Framework.

The NAB Group Risk and Reward Management Committee, chaired by the NAB Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance on the performance of the overall Risk Management Framework. This Committee is supported by three sub-committees - the NAB Group Credit Risk Committee, the NAB Group Asset and Liability Committee (“NAB Group ALCO”), and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated through the Boards’ Risk Committee, which enables Board members to challenge Executives on the profile and management of risk. This is supplemented by the bi-annual Internal Capital Adequacy Assessment Process (“ICAAP”) Board submission, which is completed alongside the Capital Plan, Strategic Plan, the Internal Liquidity Adequacy Assessment (“ILAA”), Recovery and Resolution Plan and the Risk Appetite Statement. There is also a UK Risk Committee, chaired by the UK Chief Executive Officer, and comprised of senior executives, which serves to provide leadership focus on key risk issues from a Group perspective. The Committee is supported by the following UK Governance Committees: UK Asset & Liability Committee (“UK ALCO”), Pension Risk Management Committee and Model Oversight Committee.

The UK Risk Management team independently monitors and systematically assesses the risk profile within the Group against established risk appetite parameters. They also assist the front line business units in the design and implementation of appropriate risk management policies / strategies and work with the business units to promote awareness of the need to manage risk.

40. Management of risk (continued)

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality.

The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities within the Group are clearly defined.

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Group Credit Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the NAB Group Chief Credit Officer (and associated teams) provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management within the UK, with appropriate oversight through the UK executive management governance committees.

The Group's credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

Single large exposure policies are in place within the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems or from external events. This includes legal risks as well as operational risk components associated with other risks categories (e.g. credit, traded market, non-traded market).

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.

These risk categories are defined as follows:

- Customer, products and sales practices (“conduct risk”) – the treatment of customers and the management of customers impacts on all the Group’s core activities. This is a principal focus of the Board, Senior Management and the regulators and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, that customer expectations are met and complaints are dealt with effectively and fairly. Consideration of customer outcomes is embedded within the Group’s operating processes and metrics are regularly monitored to ensure outcomes are appropriate.
- Regulatory environment and market practices – the Group is required to comply with a large volume of laws and regulations and the regulatory environment has also been subject to substantial change in recent years. This is likely to continue and represents an on-going focus of the Group’s management in ensuring the Group continues to operate within prudential parameters and that the conduct of the Group’s activities meets the expectations of the Group’s customers, shareholders and regulators. The Group operates a zero tolerance for regulatory breaches and organises its activities to ensure controls over regulatory risk are maintained in addition to maintaining a strong, open and trusted relationship with its regulators.
- Monitoring, reporting and oversight – effective controls over business operations are essential for the protection of the Group’s customers and shareholders and is a key responsibility of all employees and managers. The Group continues to reinforce frameworks, standards and oversight arrangements to enhance the quality of risk management in the organisation. Each business unit maintains a risk profile with embedded controls and actions to manage inherent risks.

40. Management of risk (continued)

Operational risk (continued)

- Payments and process management – the Group processes a large volume of transactions for customers every day and manages the risks in this and other operations to ensure these activities are conducted safely and efficiently. However, in all operational activity there is a potential risk of established procedures not being followed, a failure to detect errors or that inadequate controls are in place.
- External fraud and criminal activities – the Group takes seriously its responsibilities to protect customers against financial crime. This includes preventing fraud activities in all channels through which customers transact; the prevention of money laundering; and compliance with legal sanctions requirements. Fraud management is an ongoing challenge for the financial services industry and presents a constant risk to the Group as criminal activities evolve on a national and global basis. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Internal fraud and criminal activities – The Group recognises the risk of internal fraud associated with internal acts intended to defraud, misappropriate funds, information and physical assets, and circumvent policy. The Group has zero tolerance for internal fraud and has a strong control framework in place to mitigate this risk.
- Workplace practices and environment – providing a safe environment for customers and colleagues is important for the success of the business and the Group seeks to ensure adequate safeguards are in place and are operating effectively.
- Systems and infrastructure – There is a risk of service interruption due to failure of the Group's systems leading to a period of service disruption. The Group has a strong framework of controls over the continuity of service provision for all critical processes including recovery procedures in the event of unplanned service interruption.
- Third party providers - Failure to manage third party providers effectively may also impact on the level of service available to customers. The Group's controls to mitigate this risk include regular oversight of third party processes and assurance testing of the effectiveness of relationship management.

Responsibility for the management of operational risk rests with the business managers with oversight from the risk management function and independent assurance activities undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. It is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes and includes:

- an established governance structure that is used to ensure consistent application, control and reporting of the Operational Risk Management process. This element also includes the establishment and communication of the Group's operational risk appetite; and
- a structured process to facilitate the identification, quantification and management of risks underpinned by clear policies and guidelines. Material risks are reported monthly to the Management Assurance Committees and the UK Risk Committee, and to each Boards' Risk Committee to provide visibility and understanding of the Group's overall risk profile.

40. Management of risk (continued)

Non-traded market risk

Non-traded market risks include liquidity and funding risk, structural interest rate risk, foreign exchange risk and risks associated with the Group's defined benefit pension scheme. The primary objective for the management and oversight of non-traded market risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

Policies relating to non-traded market risks are approved by the Board of the NAB Group. The consistent application of NAB Group polices across the Group is the responsibility of the Group's Board with the support of executive management governance committees. In relation to non-traded market risks, the primary management committee is the UK ALCO.

Risk appetite and limits are approved for non-traded market risk by the Company's Board, with authority delegated to the UK ALCO for their subsequent implementation and monitoring.

The UK ALCO oversees the management of non-traded market risks. The UK ALCO meets monthly and reports to the UK Risk Committee. The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from UK Risk.

Liquidity and funding risk

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

Liquidity within the Group is managed in accordance with the ILAA that is approved by the Board. The ILAA includes the manner in which the Group meets all regulatory requirements of the PRA and includes the Group's policy for the management of liquidity risk. Oversight of liquidity risk is undertaken by the UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group is monitored by the NAB Group ALCO in accordance with the NAB Group Non-Traded Market Risk Policy. To meet the requirements of local regulatory authorities the liquidity of the Group is managed on a daily basis as a stand-alone undertaking using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. The UK ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances. The Group has a Contingency Funding Plan which is used to detail actions to be taken in the event of an escalated liquidity requirement.

A contingency plan has also been established for management of an escalated liquidity requirement if the Group or the NAB Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, currency, counterparty, term structure and market.

The Group's main sources of funding include the following:

- Retail, SME, corporate deposits;
- Commercial paper programme;
- Access to sterling money markets through cash deposits and certificates of deposit;
- Medium Term Note programme;

40. Management of risk (continued)

Non-traded market risk

Liquidity and funding risk (continued)

- “Lanark” residential mortgage securitisation programme (owner occupied);
- “Lannraig” buy-to-let mortgage securitisation programme;
- Structured Covered Bond programme;
- Regulated Covered Bond programme;
- Access to Bank of England open market operations in addition to extended collateral term repo and Funding for Lending Scheme; and
- Access to the Bank of England Discount Window Facility in times of stress.

These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet. The Group’s securitisation and covered bond programmes offer investors the opportunity to purchase secured assets.

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and NAB Group ALCO.

There are three major contributors to interest rate risk:

- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities; and
- the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets i.e. basis risk.

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk management across the Group is directed by UK ALCO with delegation for day-to-day management to the Group’s Treasury division. The UK Risk Committee, through UK ALCO oversight, monitors risk to ensure it remains within approved policy and Board approved risk appetite.

Basis risk is managed through a combination of wholesale market basis risk products, pricing strategies and product innovation.

A key feature of the risk management and oversight framework is the use of VaR as a measure of interest rate risk, along with EaR to measure the impact on future net interest income. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group’s Balance Sheet & Liquidity Risk Oversight team that is independent of the Treasury division.

40. Management of risk (continued)

Non-traded market risk (continued)

Foreign exchange risk

Exposures arise if future cash flows can only be converted to Sterling at less favourable rates than at the time of the original transaction. The Group's policy is to fully hedge these exposures at the time of commitment for all exposures that are considered to be of a marketable size.

The transactional currency exposures principally arise from dealings with customers and the Group maintains a matched position through transactions with a range of counterparties including the NAB Group in order to comply with the Group's Trading Policy Statement.

Pension risk

Pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. The operation of a pension scheme gives rise to a number of risks, e.g. movements in equity valuations, changes in bond yields and life expectancy of scheme members. The Scheme is managed by independent Trustees. However, the impact of the Scheme on the Group is subject to management by the Group and corresponding risk oversight. The Group's Pension Risk Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

The Group is governed by NAB Group's Capital Management Policy. The objectives of the NAB Group's Capital Management Policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators requirements and managing the ratings agencies assessment of the Group.

The Group implemented Basel II requirements from 1 January 2008 in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Group calculates its minimum capital requirements based on 8% of RWAs. The PRA then adjusts this requirement to cover risks under Pillar II of Basel II and generate an Individual Capital Guidance ("ICG") and a Capital Planning Buffer ("CPB"). The CPB is designed to be available to absorb losses and / or to cover increased capital requirements in adverse circumstances that are outside the firm's normal and direct control.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The UK ALCO, which consists of the Chief Executive Officer, Executive Director, the Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Group actively manages its capital position and reports this on a regular basis to senior management through the UK ALCO and other governance committees. Capital requirements are included within an annual capital management plan presented to and approved by the Board of Directors.

The UK Government released draft secondary legislation for the Banking Reform Bill in July 2013. The Bill seeks to protect deposit holders and ensure the PRA can hold banks to account. Once enacted, the reforms may affect the structure of banks and the amount of capital held.

The European Union published the final rules to implement Basel III, known as the Capital Requirements Directive IV Package ("CRD IV"), in June 2013 which will be effective from 1 January 2014. These form the prudential rules that all banks in the UK must follow. The PRA issued its consultation paper outlining their approach on implementing CRD IV within the UK, in August 2013, and it is anticipated that the final rules and supervisory statements will be published by the PRA in December 2013. The Group is currently assessing the potential impacts that may affect the amount and structure of the capital that will be required to be held.

42. Pillar 3 disclosures

Basel II Capital Requirements Directive

The PRA automatically transitioned the FSA granted waiver direction held by Clydesdale Bank PLC under BIPRU 11.2.5: (Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a non-EEA state).

The waiver direction can be found on the PRA website: http://www.fsa.gov.uk/register/pdf/A1375943P.pdf

In line with the PRA waiver direction, the Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations. It has already included additional capital resources disclosure made on pages 9 and 12 of these financial statements.

National Australia Bank Limited 2013 Pillar 3 Report: http://www.nabgroup.com/0,,32863,00.html

National Australia Bank Limited 2013 Full Year Financial Results, Section 6 (Supplementary Information): http://www.nab.com.au/content/dam/nab/about-us/shareholder-centre/financial-results/documents/full-year-results-2013.pdf

National Australia Bank Limited 2013 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html

The first published disclosure was based on the financial position of the Group and NAB as at 30 September 2008. After due consideration by the Group Directors, subsequent Pillar 3 disclosures are made annually by way of the National Australia Bank Limited Pillar 3 Report. These disclosures will be in line with the PRA Waiver direction as outlined above.

The information contained in these qualitative disclosures has not been audited by the Group's external auditors except to the extent that they are equivalent to those made under accounting requirements and is limited to those required by BIPRU 11.

PRA remuneration Pillar 3 disclosures

In December 2010, the FSA issued Policy Statement 10/21 'Implementing CRD3 requirements on the disclosure of remuneration'. The Pillar 3 remuneration disclosure guidance transitioned across to the PRA on 1 April 2013. The Pillar 3 disclosures required are specified within BIPRU 11.5.18R to BIPRU 11.5.21G. The Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosures plus additional aggregate disclosures for UK Code Staff to satisfy the Pillar 3 disclosure obligations.

UK Code Staff disclosures will be available within the Regulatory Disclosures section of the NAB Group website http://www.nab.com.au/about-us/shareholder-centre/regulatory-disclosures.

The remuneration report is held within the Report of the Directors on pages 29 - 50 of the National Australia Bank Limited 2013 Annual Financial Report.

National Australia Bank Limited 2013 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html.

43. Events after the balance sheet date

On 13 November 2013, the Directors approved a distribution payment of £8m (2012: £Nil) to the Non-controlling Interest (note 32).

National Australia Group Europe Limited
Enhanced disclosure task force recommendations

Below is a tabular overview of how the Group has responded to the EDTF recommendations as referred to on page 17 of the annual report and consolidated financial statements. The Group already provides risk disclosures in accordance with International Financial Reporting Standards which can predominantly be found in notes 39, 40 and 41 to the financial statements and the appropriate cross reference between these and the relevant EDTF recommendation is provided as necessary to avoid duplicating information. Disclosures that have been added in proportionate response to the EDTF recommendations but do not represent logical additions to existing disclosures are provided below this table.

EDTF recommendation	Description	The Group's approach
1	Amalgamate all risk related information and if not possible provide an aid to help users locate risk disclosures	The Group has taken an index based approach this year. In future years it will consider whether there are ways of combining all risk related information into a separate section of the annual report and consolidated financial statements whilst retaining the integrity of the audited accounts.
2	Define the Group's risk terminology and risk measures	Relevant definitions are included within the glossary to the annual report and consolidated financial statements.
3	Describe and discuss top and emerging risks	Commentary on the Group's top and emerging risks can be found within the Strategic Report starting on page 2.
4	Outline plans to meet each new key regulatory ratio once the applicable rules are finalised. These include: • net stable funding ratio ("NSFR"); • liquidity coverage ratio ("LCR"); and • leverage ratio	The final rules for CRR/CRD IV were agreed by the European Parliament in June 2013 with the PRA issuing a consultation document on how these should be implemented in the UK in August 2013. Presently the Group calculates the proposed Basel III ratios of the NSFR and LCR which are both in excess of 100% as at 30 September 2013. The estimated leverage ratio for the Group calculated on a Basel III basis is above minimum requirements.
5	Summarise the Group's risk management organisation	The Group's risk management organisation is described in note 40 and diagrammatically represented on page 115.
6	Describe the Group's risk culture and how procedures and strategies are applied to support the culture	Commentary on the Group's risk culture can be found on page 116.
7	Describe the Group's key risks from the business model and activities along with the Group's risk appetite and how these risks are managed	Commentary on the Group's business model risks can be found within the Strategic Report starting on page 2.
8	Describe the use of stress testing within the Group's risk governance and capital frameworks	Commentary on the use of stress testing within the Group's risk governance and capital frameworks is provided on pages 116 and 117.

9	Provide minimum Pillar 1 capital requirements, including any capital surcharges or capital conversion buffers, or the minimum internal ratio	The Group's Pillar 1 requirements can be found in the capital position section within the Strategic Report starting on page 2.
10	Summarise composition of capital and provide a reconciliation of the accounting balance sheet to the regulatory balance sheet	The Group provides a summary of its Tier 1 capital position along with a reconciliation of regulatory capital to statutory equity in the capital position section within the Strategic Report starting on page 2.
11	Present a flow statement of movements in regulatory capital for the year, including changes in common equity tier 1, tier 1 and tier 2 capital	The Group's regulatory capital flow statement can be found in the capital position section within the Strategic Report starting on page 2.
12	Capital planning within a more general discussion of management's strategic planning	An overview of the Group's capital management approach can be found in note 41 to the annual report and consolidated financial statements which highlights that it is governed by NAB Group's Capital Management Policy. The Group is a wholly owned subsidiary with a significant Global parent. The Group operates a UK Risk Appetite Framework to support the Group's strategic planning and capital planning processes. The framework identifies material risks to which the business is exposed to and for which capital needs to be held. The UK Risk Appetite Statement is the formal articulation of the risk bearing capacity of the Group, it is approved annually by the Board and supports the strategic planning process.
13	How do RWAs relate to business activities and related risks	The Group provides an analysis of RWAs in the capital position section within the Strategic Report starting on page 2. This breaks down the RWA figure into our key business activities with the risks calculated on a standardised basis.
14	Capital requirements for calculating RWAs for credit risk for each Basel asset class including the major portfolios within those classes	The Group's capital requirements for calculating RWAs for credit risk for each Basel asset class can be found in the capital position section within the Strategic Report starting on page 2.
15	Tabulate credit risk in the banking book for Basel asset classes and major portfolios within the Basel asset classes	A table analysing the credit risk in the banking book for Basel asset classes can be found in the capital position section within the Strategic Report starting on page 2. The table discloses our exposure consistent with the standardised approach.

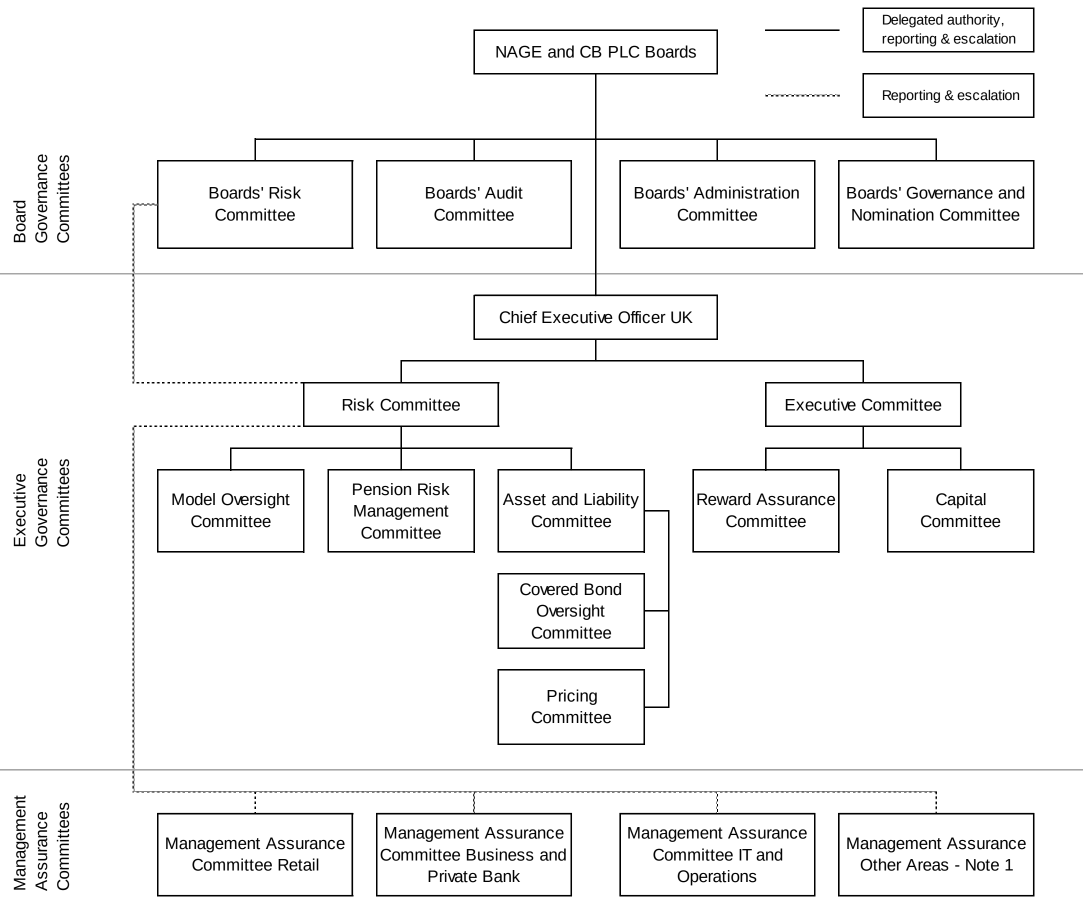
16	RWA flow statement	RWAs significantly reduced in the year primarily as a result of the transfer of the majority of the commercial real estate lending assets to NAB on 5 October 2012. The off month-end date of the transfer has complicated the creation of an RWA flow statement for the year to 30 September 2013. Accordingly, this disclosure will be provided in the 2014 financial statements. In addition to the transfer of the commercial real estate assets, RWA's declined in the year as a result of movements in exposure with the other main factor being a modest impact on the RWAs on Mortgages Secured on Residential Properties due to an improvement in portfolio quality.
17	Contextualising Basel Pillar 3 back-testing requirements	The Group has a Pillar 3 waiver currently in force and as a result has not provided this disclosure.
18	Potential liquidity needs management and the components of the liquidity reserve held to meet these needs	Notes 39 and 40 to the annual report and consolidated financial statements contain information in relation to liquidity risk and non-traded market risk (specifically liquidity and funding risk) respectively. The funding and liquidity section within the Strategic Report starting on page 2 also describes the Group's year end liquidity position.
19	Encumbered and unencumbered assets by balance sheet categories including collateral	The Group's encumbered and unencumbered assets position is shown within the funding and liquidity section within the Strategic Report starting on page 2.
20	Consolidated total assets, liabilities and off-balance sheet commitments by remaining contractual maturity	A table with the Group's consolidated assets, liabilities and off balance sheet commitments by remaining contractual maturity can be found within note 39 of the annual report and consolidated financial statements on page 101.
21	The Group's funding strategy including key sources and any funding concentrations	Commentary on the Group's funding strategy can be found in the liquidity and funding section within note 40.
22	Linking balance sheet and balance sheet line items with positions included in the trading market and non-trading market disclosures	A table showing the balance sheet with values combined with the principal non-traded risk types that affect each significant balance sheet line item can be found within note 39 of the annual report and consolidated financial statements on page 100.

23	Significant trading and non-market trading risk factors	The Group does not operate a trading portfolio. There is no appetite for traded market risk other than de minimus positions arising from the timing of hedging transactions. Market risk is defined as positions in financial instruments, including derivative products and other off-balance sheet instruments, held with trading intent. Interest rate risk is the most significant non-traded market risk the Group faces. Further comment on interest risk and prepayment risk can be found in note 39 to the annual report and consolidated financial statements with additional non-traded market risk factors contained in note 40.
24	Significant market risk measurement model limitations	Note 39 to the annual report and consolidated financial statements provides a summary of key features of the internal interest rate risk management model that is used for non-traded portfolios. The Group does not operate traded portfolios.
25	Primary risk management techniques employed to measure and assess the risk of loss beyond reported risk measures and parameters	Note 39 to the annual report and consolidated financial statements provides detail on the value at risk and earnings at risk methods and also on a series of supporting measures for interest rate risk. As explained above the Group does not operate a trading portfolio.
26	Credit risk profile including any significant credit risk concentrations	Tables showing the levels of industry concentrations (including both on and off-balance sheet commitments) can be found in note 39 to the annual report and consolidated financial statements.
27	Policies for identifying impaired or non-performing loans including forbearance	The Group discusses its approach to identifying impaired or non-performing loans in note 14 to the annual report and consolidated financial statements. The Group's position in relation to both retail and non-retail forbearance has matured over the last few years with the detail of current levels and type of forbearance included in the relevant section within note 39.
28	Reconciliation of non-performing and impaired loans including the allowance for loan losses	The Group's distribution of non-performing (past due but not impaired) and impaired loans and advances across product types can be found in note 14 to the financial statements with the associated impairment allowances in note 15 to the financial statements.
29	Counterparty credit risk that arises from derivative transactions	The Group's disclosures on derivative transactions can be found in note 13 of the annual report and consolidated financial statements. The Group's principal non customer derivative counterparty is NAB.

30	Credit risk mitigation, including collateral held for all sources of credit risk	A description of the Group's risk mitigation techniques can be found on pages 117 and 118 along with a quantitative analysis on the non-property collateral held. Disclosures on collateral held as security and other credit enhancements can be found in note 39.
31	"Other risk" types including how these are identified, governed, measured and managed	The Group has not identified other risk types that are deemed to be material for disclosure purposes.
32	Publically known risk events related to other risks, including operational, regulatory compliance and legal risks, where material or potentially material loss events have occurred	The Group is exposed to a number of risks that are in the public domain, particularly around conduct related matters. These are discussed within note 27 to the annual report and consolidated financial statements and in the relevant sections of the Strategic Report starting on page 2.

The Group's risk management organisation

The Group's risk management structure is diagrammatically represented below:



Note 1: for Human Resources, Risk Management, Finance and Office of the CEO the responsibilities of the Management Assurance Committee will be discharged through either existing Leadership Team or Management Fora focussing on Risk

The Group's risk management organisation (continued)

The primary business unit Management Assurance Committees cover Retail, Business & Private Bank and IT & Ops.

The overall responsibility for the oversight of risk management falls to the Group's Risk Committee ("UKRC") as described in note 40, which is responsible for supporting the Chief Executive Officer ("CEO") in leading the Group in respect of risk matters through the provision of advice, guidance, challenge and recommendations in relation to the following:

- recommending the RAS for Board approval, then monitoring performance against risk settings and tolerances;
- the performance of the enterprise wide risk profile across all relevant Group risk inventory categories;
- the performance of business unit risk profiles including which risks should be prioritised and escalated;
- the action required to remediate risk profiles and control environments;
- the strength of the control environment including effective use of policy, frameworks and tools; the strength of risk capability; the effectiveness of risk culture and on-going compliance with regulatory requirements;
- the approval of business unit management assurance plans and the risk oversight and monitoring plan, and recommending the internal audit risk based assurance plan to the Boards' Audit Committee for approval;
- the overview of high residual risk change initiatives and new products;
- monitoring the changing state of the risk environment and the regulatory landscape, the impacts for and readiness of the Group; and
- monitoring the state of regulatory relationships

The Group's risk culture and how this is supported

Establishing and maintaining an appropriate risk culture within the Group is a key objective. The culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite which aligns to, and supports, the strategic objectives of the Group. These provide guidance to staff on what is expected of them with the Group complementing these elements with other messages and frameworks which guide behaviour and inform the Group as to the culture and its appropriateness. These initiatives include: messaging from the CEO and ExCo members; the Group's performance management framework which incorporates a balanced assessment of factors (including risk management, behaviour and a transparent compliance gateway assessment); training; and escalation procedures (both through the management hierarchy or anonymously through the Group's whistle-blower facility) allowing staff to raise concerns quickly and appropriately.

Underpinning the risk management operating model, and at the heart of the Group's risk culture, is the notion of personal accountability for risk management at source. This is enabled through a risk management accountability model (which articulates specific accountabilities for core elements of risk management across the Group) and a formal delegation framework; where staff are able to make risk based decisions.

Stress testing within the Group's risk governance and capital framework

Stress testing within the Group has been developed to inform future business and risk planning initiatives, strategic risk management (including risk appetite setting) and capital management. Specifically, stress testing is used or considered in informing the following management decisions:

Risk appetite and strategic business planning

As part of an annual assessment of future opportunities for, and threats to, the Group, stress testing outputs are used to inform the strategic planning process and to develop risk posture and risk appetite settings.

Stress testing within the Group's risk governance and capital framework (continued)

Capital planning

Stress testing informs the bi-annual assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP process.

Liquidity management ("ILAA")

Scenarios provide insight into potential vulnerabilities in the Group's funding strategies and leverage profile and the knock-on implications on the growth and capital adequacy of the Group. Regular stress tests are undertaken to understand and monitor exposure to liquidity with their regularity being aligned to the nature of, and exposure to, the risk type.

Recovery & resolution planning ("RRP")

RRP plans help inform both stress testing and reverse stress testing scenario development and management discussions. Reverse stress testing explores circumstances, or a set of circumstances, that render the Group's business model unviable, moving the Group into a resolution by the authorities. As a result, these stresses are recognised as a required risk management tool in the form of an early warning indicator of potential stress events.

Strategic risk management

Stress testing informs the nature and level of risk carried by the Group arising from opportunistic assessments such as investments, divestments and acquisitions through emerging material risks posed by trends in, or changes to, the business environment.

Stress Testing Oversight and Governance

UK Capital Committee ("UK CC")

The UK CC ensures, through its remit as the primary stress testing review forum, that results are sufficiently debated and discussed. Outputs are challenged as appropriate before being endorsed and presented to the UK Executive Committee.

UK Asset and Liability Committee ("UK ALCO")

The UK ALCO reviews the assumptions and scenarios for liquidity stress testing. These are tested monthly with the liquidity stress scenarios approved by the Board as part of the ILAA.

UK Executive Committee ("UK ExCo")

UK ExCo members are engaged in scenario selection to provide an appropriate level of review, discussion and debate into the scenario selection process, utilising their business knowledge as Heads of each business unit. The UK ExCo also consider and assess results in context of the future strategic decision making, contingency planning, capital and business planning.

Board of Directors

The Board comprises Non-Executive and Executive Directors of the Group with members engaged at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to scenario selection and development. In addition, the Board considers how the results are integrated into the future strategic decision making, contingency planning, capital and business planning and risk appetite.

Other credit risk mitigation including collateral held

The Group's primary use of collateral as a means of credit risk mitigation is in relation to residential mortgages and commercial property.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to business rules and confidence levels. The loan to value ratio of our mortgage portfolio is disclosed in note 14 to the annual report and consolidated financial statements.

Commercial property

Commercial property is the Group's main source of collateral on commercial lending and means of mitigating loss in the event of default credit risk inherent in its commercial portfolios. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

Non-property related collateral

Apart from Residential and Commercial Property based security, the Group also takes other forms of collateral when lending and this can involve obtaining security against the underlying loan through the use of cash collateral and/or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

The following table shows the total non-property collateral held at 30 September 2013 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high quality) and netting. The exposure amount shown below is the total gross exposure (before any Credit Risk Mitigation and Credit Conversion Factors have been applied were applicable) for arrangements which have some form of associated collateral held against it and is not the total exposure for each asset class, as disclosed as part of EDTF recommendation 15.

	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Corporates	122	109	112	343	566
Institutions	312	3	-	315	370
Past due items	2	-	-	2	12
Regional Governments or Local Authorities	-	-	126	126	126
Secured by mortgages on commercial real estate	26	-	30	56	231
Secured by mortgages on residential property	8	-	4	12	100
	470	**112**	**272**	**854**	**1,405**

Corporates is the largest sector for other risk mitigation techniques, with all three methods utilised dependent on credit quality and the extent to which these will be used will be dependent on the specific circumstances of the customer.

National Australia Group Europe Limited
Glossary

Term	Definition
APRA	Australian Prudential Regulatory Authority.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Bank Levy	This is applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the "International Convergence of Capital Measurement and Capital Standards".
Basel III	In December 2010, the Basel Committee issued final rules "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring". Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2014 with full implementation by 1 January 2019.
Cash earnings	A non-IFRS key performance measure that excludes certain items within the calculation of net profit attributable to owners of the Group. It is also a key performance measure used by the Australian peers of the ultimate parent with a similar business portfolio. These specified items are excluded in order to better reflect what is considered to be the underlying performance of the Group. Net profit attributable to owners of the Group adjusted for (where appropriate): • Distributions • Treasury shares • Fair value and hedge ineffectiveness • Customer redress provision charges • Restructure costs • Litigation expense • Property revaluation • Goodwill impairment • Software impairment
Collateral	The assets of a borrower that are used as security against a loan facility.
Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Commercial paper	An unsecured promissory note issued to finance short term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.

Company	National Australia Group Europe Limited.
Conduct risk	The risk that the Group's behaviours (culture, governance, systems and controls) have led to inappropriate customer outcomes.
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
Core Tier 1 capital	The highest quality form of regulatory capital that comprises total shareholders' equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are an important source of term funding for the Group.
CRD IV	The European Union's ("EU") proposal to implement Basel III, the international agreement on bank capital standards agreed at G20 level. It replaces the EU's earlier capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. The CRD IV package raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision.
CRE	Commercial real estate.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty. Also known as a credit value adjustment ("CVA").
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities.
Customer funding index ("CFI")	An internal NAB metric expressing customer deposits divided by core assets (gross loans and advances including acceptances, financial assets at fair value and held to maturity investments) as a percentage.
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Delinquency	See "Arrears".
Derivative	A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
Earnings at risk ("EaR")	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Effective interest rate method ("EIR")	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	The amount for which an asset could be exchanged or a liability settled, between willing parties in an arm's length transaction.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (level 2 and level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.

FCA	Financial Conduct Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The FCA is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets.
Forbearance	The term generally applied to the facilities provided to assist borrowers, both retail and non-retail, who are experiencing a period of financial stress and can take a variety of forms such as negotiating an arrangement or short term promise to pay, transfer to interest only terms, or term extensions. The granting of a forbearance measure to a borrower is as a consequence of concerns about the borrower's ability to meet their contractual payments when due and specifically relates to such instances where the changes to the existing arrangement have been made on terms that the Group would not ordinarily consider to be on a commercial basis.
FSA	Financial Services Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").
FSCS	Financial Services Compensation Scheme.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	National Australia Group Europe Limited and its controlled entities.
Hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value of hedging instruments not being fully offset by changes in fair value of hedged items.
IFRS	International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB").
Impaired loans	Retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
Impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This may be assessed at either the individual level or collectively.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
Individual Liquidity Adequacy Assessment ("ILAA")	The ILAA documents the Bank's assessment and management of balance sheet risks relating to funding and liquidity.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach ("IRB")	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investments - AFS	Investments - available for sale.
Investment grade	This is the highest possible range of credit ratings, from "AAA" to "BBB", as measured by external credit rating agencies.
IRRBB	Interest rate risk in the banking book.

Key management personnel	Directors of the Group, members of the UK Executive Committee and PRA approved persons with a controlled function 1 – 28 (as defined in SUP 10B.4.3 within the PRA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10B/4) and FCA approved persons with an FCA controlled function 1 – 29 (as defined in SUP 10A.4.4 within the FCA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10A/4#DES95
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio	This is a new regulatory standard ratio proposed by the Basel III reforms and is the Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee has proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.
LIBOR	London Interbank Offered Rate.
Liquidity coverage ratio (“LCR”)	This is a new regulatory standard ratio proposed by the Basel III reforms and is the stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage. The Basel Committee intends to introduce the LCR on 1 January 2015 and phase in minimum requirements with full compliance due from 1 January 2019.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loan to value (“LTV”)	A mathematical calculation that expresses the amount of a loan as a percentage of the value of security. A high LTV indicates that there is less of a cushion to protect the lender against asset price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
Medium Term Notes (“MTNs”)	MTNs are issued by corporates, including financial institutions, across a range of maturities. MTNs are frequently issued by investment grade corporates in senior unsecured form under MTN Programmes whereby notes are offered on a regular and continuous basis to investors.
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of National Australia Group Europe Limited.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net interest margin	Net interest income as a percentage of average interest earning assets.

Net profit attributable to owners of the Group	Represents the Group's statutory profit after tax and reflects the amount of net profit that is attributable to owners.
Net promoter score	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Group, and a consumer.
Net stable funding ratio (“NSFR”)	This is a new regulatory standard ratio proposed by the Basel III reforms and is the total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The NSFR is currently subject to an observation period, with the Basel Committee intending that it will become a minimum standard by 1 January 2018.
Non-impaired assets 90+ days past due	Consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Past due loans and advances	Loans and advances on which repayments are overdue.
PPI	Payment Protection Insurance.
PRA	Prudential Regulation Authority. The FSA was replaced as the UK’s financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Probability of default (“PD”)	The probability that an obligor will default within a one-year time horizon.
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by APRA for the consolidated NAB Group and by local regulators (in the UK the PRA and the FCA) for individual Group companies.
Residential mortgage-backed securities (“RMBSs”)	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: • the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non-market extension of principal repayment period); • the Group has previously made a specific provision for the customer/obligor and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. See also forbearance.
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as residential mortgages, overdrafts and credit card balances.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed.

National Australia Group Europe Limited

Glossary (continued)

Risk-weighted assets ("RWAs")	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Sale and repurchase agreement ("repo")	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically AAA rated securities secured by the underlying financial asset.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Special Purpose Entity ("SPE")	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SPE may take the form of a corporation, trust, partnership or unincorporated entity. SPEs are often created with legal arrangements that impose strict limits on the activities of the SPE. These can also be known as Special Purpose Vehicles ("SPVs").
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Stable funding index ("SFI")	An internal NAB metric of the customer funding index ("CFI") plus the term funding index ("TFI") expressed as a percentage.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ("ECAI") ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Term funding index ("TFI")	An internal NAB metric expressing term wholesale funding (with a remaining maturity to first call date greater than 12 months) divided by core assets (gross loans and advances including acceptances, financial assets at fair value and held to maturity investments) as a percentage.
Tier 1 capital	A component of regulatory capital which is able to absorb losses, is permanent and available when required, ranks for repayment upon winding up/administration or similar procedures after all other debts and liabilities, and has no fixed inescapable costs. It comprises core Tier 1 and other Tier 1 capital, which includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 2 capital	A component of regulatory capital which includes forms of capital that do not meet the requirements for permanency and absence of inescapable fixed servicing costs that apply to Tier 1 Capital. It comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.

Tier 1 ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 ratio	Tier 2 capital as a percentage of risk-weighted assets.
UK ALCO	UK Asset and Liability Committee.
Value at risk ("VaR")	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements.

National Australia Group Europe Limited

Other information

Website	www.cbonline.co.uk
Media	Press office 0845 603 5447 press.office@nab.co.uk
National Australia Bank	NAB Group results are available from www.nab.com.au

Annual report & consolidated financial statements.

National Australia Group Europe Limited.

For the year ended 30 September 2012.

Company Number: 2108635.

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National Australia Group Europe Limited.

Annual report and consolidated financial statements.

For the year ended 30 September 2012.

Contents

Overview

National Australia Group Europe Limited (the “Company”), together with its subsidiary undertakings (which together comprise the “Group”), is the United Kingdom retail and commercial arm of National Australia Bank Limited. The Group operates under both the Clydesdale Bank and Yorkshire Bank brands. It offers a range of banking services for both personal and business customers through retail branches, business centres, direct banking and brokers.

Forward looking statements

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

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

National Australia Group Europe Limited
Officers and professional advisers

Directors	**Executive Chairman**	Cameron Clyne (appointed as Chairman 23 July 2012)
	Non-executive	David Allvey (appointed 18 May 2012) * # David Browne (appointed 2 May 2012) * # Richard Gregory OBE * # ^ James Pettigrew (appointed 25 September 2012) * Barbara Ridpath (appointed 9 May 2012) # Alexander Shapland (appointed 23 May 2012) #
	Executive	David Thorburn, Chief Executive Officer # John Hooper Mark Joiner (appointed 14 June 2012) Richard Sawers (appointed 14 June 2012) #
		* Member of the European Boards' Audit Committee # Member of the European Boards' Risk Committee ^ Appointed Senior Independent Director on 18 September 2012
UK Executive Committee		David Thorburn, Chief Executive Officer John Hooper, Executive Director Scott Butterworth, Chief Financial Officer Debbie Crosbie, Operations and IT Director Jennifer Darbyshire, General Counsel (appointed 31 August 2012) Eric Gunn, Chief Risk Officer Lynn McManus, People and Communications Director Kevin Page, Transformation Director Andrew Pearce, Retail Director (appointed 24 September 2012) Steve Reid, Chief Data Officer Paul Shephard, Business and Private Bank Director (appointed 20 April 2012)
Joint Company Secretary		Jennifer Darbyshire (appointed 18 September 2012) Lorna McMillan
Registered Office		88 Wood Street London, EC2V 7QQ
Bankers		National Australia Bank Limited
Auditor		Ernst & Young LLP 1 More London Place London, SE1 2AF

National Australia Group Europe Limited
Report of the Directors

The Directors of the Company with its subsidiary undertakings (which together comprise “the Group") submit their report and consolidated Financial Statements for the year ended 30 September 2012.

Activities

The Group comprises the United Kingdom (UK) retail and commercial arm of National Australia Bank Limited (“NAB”). The Group's activities in the UK operate under two regional brands - "Clydesdale Bank" and "Yorkshire Bank" primarily in the north of England and in Scotland. Each brand offers a broad range of financial services and solutions to both retail and business customers in the UK.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2012 amounted to £787m (2011: profit of £49m). The loss attributable to the shareholders for the year ended 30 September 2012 amounted to £635m (2011: profit of £47m).

Ordinary shares

No dividends were paid on the ordinary shares during the year ended 30 September 2012 (2011: £Nil). The Directors do not recommend the payment of a final dividend in respect of this financial year (2011: £Nil).

Preference shares

Preference share dividends of £6m (2011: £12m) were paid during the year.

Non-voting income share

The UK Dividend plan was terminated on 5 May 2011 as such no dividends were paid by the Company on the non-voting income share during the year (2011: £4m).

Strategic highlights and business developments

The Group operates a UK-focused retail and commercial banking business under the brand names “Clydesdale Bank” and “Yorkshire Bank”, primarily in the north of England and Scotland. The Group currently has 333 retail branches, 71 Business & Private Banking Centres, and employs 7,666 staff (note 35).

In the year under review, the Group has faced exceptional challenges due to deterioration in economic and operating conditions in the UK. The impact of a credit ratings downgrade and pressure on funding and liquidity costs following increased uncertainty in the Eurozone have also had material impacts on Group performance in the year. These factors have resulted in a loss for the year.

In light of the poor economic and trading conditions, the Group undertook a Strategic Review that resulted in a package of measures to strengthen the business, improve shareholder returns and reduce the Group’s risk profile.

The main focus of these measures is to simplify the business model to focus on retail operations and SME business in our heartland areas and to improve the balance sheet structure by transferring the vast majority of the commercial real estate assets to NAB to be managed separately and run-off.

The results in these Financial Statements reflect the current structure for the Group. On 5 October 2012, the Group transferred the majority of its commercial real estate lending to NAB as part of its response to the Strategic Review.

Operating environment

The UK economy emerged from recession in the third quarter of 2012, growing by 1.0%, following two successive quarters of contraction. This growth was helped by the Olympic Games, with the Office for National Statistics estimating that ticket sales had added 0.2% to the figures. The Q3 GDP figures were also enhanced by comparison with the previous quarter, with the extra public holiday resulting in lower output. Despite these positive impacts in the last quarter underlying growth remains weak and the immediate outlook remains uncertain. The challenging conditions continue to be reflected in most leading economic indicators and in the Group's performance.

Despite the challenging economic conditions the UK's unemployment rate fell to 7.8% in the quarter to September, with the overall number of people in employment hitting a record high of almost 30 million.

The financial markets have been impacted by the uncertainty in the Eurozone. The Bank of England Base Rate remained at 0.5% throughout the year, whilst the rolling average of three month LIBOR in the last 12 months has increased by 18 basis points over the prior year. Basis risk hedging has mitigated the impact of this change, which would otherwise have had a further negative impact on net interest margins. In line with the overall economy, the commercial property market has also experienced a "double dip" in values. This has been exacerbated by banks accelerating the reduction in their CRE exposures.

The regulatory and legislative landscape for financial services in the UK continues to change rapidly. This reflects the ongoing reorganisation in UK regulatory bodies and developments within Europe. There are multiple concurrent initiatives in the areas of prudential and conduct risk. Additionally, in October 2012, the Government issued the draft Financial Services (Banking Reform) Bill recommending ring-fencing of vital banking services and increasing banks' loss absorbency.

Financial instruments

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

Directors and Directors' interests

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

Changes to the composition of the Board

Sir Malcolm Williamson retired as Chairman and Director of the Company on 23 July 2012, having held these roles since 2004. Cameron Clyne was appointed as Executive Chairman of the Company upon Sir Malcolm's retirement. The change was part of an on-going renewal process that the UK Boards have undertaken which included the appointment of the following new Directors to the Board of the Company:

- David Browne, Non-executive, 2 May 2012
- Barbara Ridpath, Non-executive, 9 May 2012
- David Allvey, Non-executive, 18 May 2012
- Alexander Shapland, Non-executive, 23 May 2012
- Mark Joiner, Executive, 14 June 2012
- Richard Sawers, Executive, 14 June 2012
- James Pettigrew, Non-executive, 25 September 2012

Directors and Directors' interests (continued)

The following Directors retired during the year:

- Peter Wood, Non-executive, 21 October 2011
- Jonathan Dawson, Non-executive, 31 May 2012
- Roy Nicolson, Non-executive, 31 May 2012
- Elizabeth Padmore, Non-executive, 31 May 2012
- Sir David Fell, Non-executive, 23 July 2012

Directors' interests

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

Directors' liabilities

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

Employee involvement

The Group carries out an information programme to keep staff informed of business objectives and results. This is achieved through regular meetings, conference calls, circulars, bulletins and specially commissioned communications as well as training courses for staff.

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

During the year, under the UK National Share Incentive Plan, NAB gifted ordinary shares of A$1,000 in total to each eligible employee based on Group performance in respect of the 2011 financial year. Any award of ordinary shares in respect of the financial year 2012 would be based on Group performance for 2012.

Equality of employment opportunities

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

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

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

Charitable and political donations

The total amount given for charitable purposes by the Group during the year ended 30 September 2012 was £659,000 (2011: £816,000). The Group channels its charitable donations through the Yorkshire and Clydesdale Foundation, which was established during 2008. The Foundation has made donations to many charities, including £271,000 during the year to Help the Hospices, the Group's charity partner (2011: £265,000). During the past four years and together with staff led initiatives, over £2.4m has been raised and donated to Help the Hospices and 112 local hospices.

No political donations were made during the year (2011: £Nil).

Corporate governance

It is the Group's policy not to include all of the disclosures in respect of voluntary corporate governance Codes of Practice as it is a wholly owned subsidiary of NAB. The NAB Group's Annual Financial Report details the Corporate Governance framework applicable to the Company and its subsidiaries. These disclosures are made after consideration of authoritative pronouncements on Audit Committees and associated disclosures in Australia, the USA, and the UK. Remuneration policy is not the responsibility of the Board. The remuneration policy that applies to employees and Directors of the Company is decided at the NAB Group level.

Management of risk

The Group has a well established European Boards' Risk Committee for the consideration of risks (note 40). The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals. The NAB Group publishes an annual and half-yearly "Risk and Capital Report" which provides extensive and rigorous coverage of all aspects of risk considered relevant including the position in the UK.

Going concern

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

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

Events after the balance sheet date

On 5 October 2012, the Group successfully completed the transfer of the vast majority of its commercial real estate lending portfolio to NAB. Further detail is provided in notes 24 and 44.

Auditors

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

Directors' statement as to disclosure of information to the auditor

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

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

By order of the Board

Lorna McMillan
Joint Company Secretary
16 November 2012

National Australia Group Europe Limited
Statement of Directors' responsibilities

The Directors are responsible for preparing the Directors' Report and the Financial Statements in accordance with applicable law and regulations.

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

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

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

Lorna McMillan
Joint Company Secretary
16 November 2012

Ernst & Young

Independent auditor's report to the members of National Australia Group Europe Limited

We have audited the Financial Statements of National Australia Group Europe Limited for the year ended 30 September 2012 which comprise the Consolidated Income Statement, the Group and Company Statements of Comprehensive Income, the Group and Company Balance Sheets, the Group and Company Statements of Changes in Equity, the Group and Company Statements of Cash Flow and the related notes 1 to 44. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of Directors and Auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 7, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Financial Statements

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

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group and Company's affairs as at 30 September 2012 and of the Group's loss for the year then ended;
- the Group and Company's Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the Group and Company's Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Matters on which we are required to report by exception

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

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

Ernst & Young LLP

Peter Wallace (Senior statutory auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
16 November 2012

National Australia Group Europe Limited
Consolidated financial statements
Contents

National Australia Group Europe Limited
Consolidated income statement
for the year ended 30 September 2012

	Note	**2012 £m**	2011 £m
Interest income and similar income		**1,461**	1,425
Interest expense and similar charges		**(592)**	(442)
Net interest income	4	**869**	983
Gains less losses on financial instruments at fair value		**(123)**	(89)
Other operating income		**258**	188
Non interest income	5	**135**	99
Total operating income		**1,004**	1,082
Personnel expenses		**(313)**	(360)
Depreciation expense		**(75)**	(70)
Other operating expenses		**(517)**	(295)
Restructuring and Efficiency, quality and service initiatives		**(149)**	(11)
Total operating expenses before impairment losses	6	**(1,054)**	(736)
Operating profit before impairment losses		**(50)**	346
Impairment losses on credit exposures	15	**(737)**	(297)
(Loss)/profit on ordinary activities before tax		**(787)**	49
Analysed as:			
(Loss)/profit before tax, pension scheme reforms benefit, PPI redress expense, FSCS levy and Bank levy		**(787)**	172
Pension scheme reforms benefit	29	**130**	-
Payment Protection Insurance redress expense	27	**(120)**	(116)
Financial Services Compensation Scheme levy	33	**(8)**	(4)
Bank levy		**(2)**	(3)
(Loss)/profit on ordinary activities before tax		**(787)**	49
Tax credit/(expense)	7	**152**	(2)
(Loss)/profit for the year		**(635)**	47
Attributable to			
Equity holders of the parent		**(644)**	38
Non controlling interest		**9**	9
		(635)	47

The notes on pages 17 to 95 form an integral part of these Financial Statements.

National Australia Group Europe Limited
Statements of comprehensive income
for the year ended 30 September 2012

	Notes	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
(Loss)/profit for the year		**(635)**	47	**(1,191)**	40
Other comprehensive (losses)/income					
Change in asset revaluation reserve		**(1)**	(7)	**-**	-
Change in available for sale investments reserve					
Gains during the year		**2**	17	**-**	-
Transfers to the income statement		**(4)**	(5)	**-**	-
Taxation thereon		**-**	(4)	**-**	-
		(2)	8	**-**	-
Change in cash flow hedge reserve					
Gains/(losses) during the year		**2**	(23)	**-**	-
Transfers to the income statement		**(1)**	4	**-**	-
Taxation thereon		**3**	9	**-**	-
		4	(10)	**-**	-
Actuarial (losses)/gains on defined benefit pension plans	29	**(344)**	49	**-**	-
Taxation thereon		**64**	(27)	**-**	-
		(280)	22	**-**	-
Taxation on employee share compensation		**-**	(2)	**-**	-
Other comprehensive (losses)/income net of tax		**(279)**	11	**-**	-
Total comprehensive (losses)/income for the year net of tax		**(914)**	58	**(1,191)**	40
Attributable to:					
Equity holders of the parent		**(923)**	49	**-**	40
Non controlling interest		**9**	9	**-**	-
		(914)	58	**(1,191)**	40

The notes on pages 17 to 95 form an integral part of these Financial Statements.

National Australia Group Europe Limited
Balance sheets
as at 30 September 2012

		Group		Company	
		2012	2011	**2012**	2011
	Note	**£m**	£m	**£m**	£m
Assets					
Cash and balances with central banks	9	**7,927**	6,052	**3**	35
Due from related entities	10	**1,256**	4,952	**748**	748
Due from other banks		**14**	12	**-**	-
Investments – available for sale	11	**1,039**	1,117	**-**	-
Other financial assets at fair value	12	**2,791**	4,846	**-**	-
Derivative financial instruments	13	**600**	1,018	**-**	-
Loans and advances to customers	14	**24,346**	28,238	**-**	-
Due from customers on acceptances		**7**	7	**-**	-
Current tax assets		**30**	-	**10**	4
Property, plant and equipment	17	**140**	165	**-**	-
Investment properties	18	**77**	81	**-**	-
Property inventory	19	**9**	27	**-**	-
Investments in controlled entities and associates	20	**3**	3	**6,953**	7,634
Goodwill and other intangible assets	21	**198**	365	**-**	-
Deferred tax assets	22	**287**	132	**-**	-
Other assets	23	**515**	670	**-**	-
Assets held for sale	24	**5,225**	-	**-**	-
Total assets		**44,464**	47,685	**7,714**	8,421
Liabilities					
Due to other banks	25	**557**	1,507	**-**	-
Other financial liabilities at fair value	12	**147**	155	**-**	-
Derivative financial instruments	13	**952**	931	**-**	-
Due to customers	26	**26,381**	28,170	**-**	-
Liabilities on acceptances		**7**	7	**-**	-
Current tax liabilities		**-**	2	**-**	-
Provisions	27	**292**	111	**-**	2
Due to related entities	10	**7,716**	7,962	**5,454**	5,462
Bonds, notes and subordinated debt	28	**3,163**	3,553	**-**	-
Retirement benefit obligations	29	**306**	185	**-**	-
Deferred tax liabilities	22	**21**	31	**-**	-
Other liabilities	30	**2,161**	2,014	**-**	-
Liabilities associated with assets held for sale	24	**142**	-	**-**	-
Total liabilities		**41,845**	44,628	**5,454**	5,464
Equity					
Share capital and share premium	31,32	**2,575**	2,075	**2,575**	2,075
Other reserves	32	**142**	150	**-**	-
Retained earnings	32	**(298)**	632	**(315)**	882
Total parent entity interest		**2,419**	2,857	**2,260**	2,957
Non controlling interest	32	**200**	200	**-**	-
Total equity		**2,619**	3,057	**2,260**	2,957
Total liabilities and equity		**44,464**	47,685	**7,714**	8,421

The notes on pages 17 to 95 form an integral part of these Financial Statements.

These Financial Statements were approved by the Board of Directors on 16 November 2012 and were signed on its behalf by:

D Thorburn

David Thorburn
Chief Executive Officer

National Australia Group Europe Limited
Statements of changes in equity
for the year ended 30 September 2012

Group	Note	Share Capital £m	Share Premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total parent entity interest £m	Non controlling interest £m	Total equity £m
As at 1 October 2010		1,082	893	1	(9)	6	130	606	2,709	-	2,709
Profit for the year		-	-	-	-	-	-	38	38	9	47
Other comprehensive income/(losses)		-	-	(2)	11	8	(10)	4	11	-	11
Total Comprehensive income/(losses) for the year		-	-	(2)	11	8	(10)	42	49	9	58
Dividends paid	8	-	-	-	-	-	-	(16)	(16)	-	(16)
Distribution		-	-	-	-	-	-	-	-	(9)	(9)
Shares issued – ordinary	31	100	-	-	-	-	-	-	100	-	100
Capital contribution		-	-	-	-	-	-	-	-	200	200
Share options granted		-	-	15	-	-	-	-	15	-	15
As at 30 September 2011	31,32	**1,182**	**893**	**14**	**2**	**14**	**120**	**632**	**2,857**	**200**	**3,057**
Loss for the year		-	-	-	-	-	-	(644)	**(644)**	9	**(635)**
Other comprehensive income/(losses)		-	-	-	(1)	(2)	4	(280)	**(279)**	-	**(279)**
Total Comprehensive income/(losses) for the year		-	-	-	(1)	(2)	4	(924)	**(923)**	9	**(914)**
Dividends paid	8	-	-	-	-	-	-	(6)	**(6)**	-	**(6)**
Distribution		-	-	-	-	-	-	-	**-**	(9)	**(9)**
Shares issued – ordinary	31	500	-	-	-	-	-	-	**500**	-	**500**
Share options expensed		-	-	11	-	-	-	-	**11**	-	**11**
Share options settled		-	-	(20)	-	-	-	**-**	**(20)**	-	**(20)**
As at 30 September 2012	31,32	**1,682**	**893**	**5**	**1**	**12**	**124**	**(298)**	**2,419**	**200**	**2,619**

The notes on pages 17 to 95 form an integral part of these Financial Statements.

National Australia Group Europe Limited
Statements of changes in equity (continued)
for the year ended 30 September 2012

Company	Note	Share Capital £m	Share Premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total parent entity interest £m	Non controlling interest £m	Total equity £m
As at 1 October 2010		1,082	893	-	-	-	-	858	2,833	-	2,833
Profit for the year		-	-	-	-	-	-	40	40	-	40
Other comprehensive income/(losses)		-	-	-	-	-	-	-	-	-	-
Total Comprehensive income/(losses) for the year		-	-	-	-	-	-	40	40	-	40
Dividends paid	8	-	-	-	-	-	-	(16)	(16)	-	(16)
Shares issued – ordinary	31	100	-	-	-	-	-	-	100	-	100
As at 30 September 2011	31,32	**1,182**	**893**	**-**	**-**	**-**	**-**	**882**	**2,957**	**-**	**2,957**
Loss for the year		-	-	-	-	-	-	(1,191)	**(1,191)**	-	**(1,191)**
Other comprehensive income/(losses)		-	-	-	-	-	-	-	**-**	-	**-**
Total Comprehensive income/(losses) for the year		-	-	-	-	-	-	(1,191)	**(1,191)**	-	**(1,191)**
Dividends paid	8	-	-	-	-	-	-	(6)	**(6)**	-	**(6)**
Shares issued – ordinary	31	500	-	-	-	-	-	-	**500**	-	**500**
Share options granted		-	-	-	-	-	-	-	**-**	-	**-**
As at 30 September 2012	31,32	**1,682**	**893**	**-**	**-**	**-**	**-**	**(315)**	**2,260**	**-**	**2,260**

The notes on pages 17 to 95 form an integral part of these Financial Statements.

National Australia Group Europe Limited
Statements of cash flows
for the year ended 30 September 2012

		Group		Company	
		2012	2011	**2012**	2011
Operating activities	Note	**£m**	£m	**£m**	£m
(Loss)/profit on ordinary activities before tax		**(787)**	49	**(1,218)**	23
Adjustments for:					
Non cash or non operating items included in (loss)/profit before tax	34	**100**	(575)	**1,184**	(23)
Changes in operating assets	34	**457**	(1,303)	**-**	-
Changes in operating liabilities	34	**(2,185)**	40	**(2)**	2
Interest received		**1,563**	1,646	**-**	-
Interest paid		**(451)**	(553)	**-**	-
Tax received/(paid)		**3**	(24)	**21**	(5)
Net cash used in operating activities		**(1,300)**	(720)	**(15)**	(3)
Cash flows from investing activities					
Dividends received		**-**	-	**60**	75
Interest received		**12**	25	**-**	-
Investment in controlled entities		**-**	-	**(500)**	(300)
Proceeds from sale or maturity of investments		**79**	1,174	**-**	-
Proceeds from sale of tangible fixed assets *		**39**	30	**-**	-
Purchase of tangible fixed assets *		**(16)**	(48)	**-**	-
Purchase of intangible assets		**(62)**	(70)	**-**	-
Proceeds from sale of intangible assets		**-**	2	**-**	-
Investment in joint ventures		**-**	(1)	**-**	-
Net cash provided by investing activities		**52**	1,112	**(440)**	(225)
Cash flows from financing activities					
Interest received		**13**	21	**15**	14
Interest paid		**(229)**	(141)	**(78)**	(66)
Proceeds from ordinary shares issued	31	**500**	100	**500**	100
Proceeds from preference shares issued	32	**-**	200	**-**	-
Redemption of subordinated debt	28	**(200)**	(250)	**-**	-
Maturity of medium term notes	28	**(1,898)**	(350)	**-**	-
Other movements in bonds and notes		**(936)**	(256)	**-**	-
Issuance of residential mortgage backed securities and covered bonds	28	**2,644**	-	**-**	-
Net decrease/(increase) in amount due from related entities		**3,696**	(2,110)	**-**	(119)
Net increase in amounts due to related entities		**(248)**	4,394	**(8)**	346
Amounts paid to non controlling interest		**(9)**	(9)		-
Dividends paid		**(6)**	(16)	**(6)**	(16)
Net cash provided by financing activities		**3,327**	1,583	**423**	259
Net increase/(decrease) in cash and cash equivalents		**2,079**	1,975	**(32)**	31
Cash and cash equivalents at the beginning of the year		**5,874**	3,899	**35**	4
Cash and cash equivalents at the end of the year	34	**7,953**	5,874	**3**	35

The notes on pages 17 to 95 form an integral part of these Financial Statements.

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

National Australia Group Europe Limited
Notes to the consolidated financial statements

1. Basis of preparation

Reporting entity

The Company is incorporated in the UK and registered in England and Wales. The consolidated Financial Statements comprise the Company and its controlled entities (together the "Group"). The Company's principal controlled entities are listed in note 20.

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

Statement of compliance

The consolidated Financial Statements of the Company have been prepared in accordance with IFRS as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. As permitted by section 408 of the Companies Act 2006, no Income Statement is presented for the Company.

The consolidated Financial Statements of the Company for the year ended 30 September 2012 were authorised for issue by the Board of Directors on 16 November 2012.

Basis of measurement

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

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Report of the Directors on pages 2 to 6. In addition, note 40 to the Financial Statements includes the Group's risk management objectives and note 41 to the Financial Statements includes the Group's objectives, policies and processes for managing its capital.

The Group's ultimate parent, NAB, provides funding to the Group in the ordinary course of business. Additionally, on 5 October 2012, the Group transferred the vast majority of its commercial real estate assets to its ultimate parent (note 44). As a consequence the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the consolidated Financial Statements.

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including special purpose entities ("SPEs")) over which the Group has the power to govern the financial and operating policies so as to obtain economic benefits from their activities. The Group sponsors the formation of SPEs, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well defined objectives. SPEs require consolidation in circumstances such as those where the Group in substance has control over them through access to the majority of the residual income or is exposed to the majority of the residual risk associated with the SPE.

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

Foreign currency

Functional and presentation currency

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

Transactions and balances

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

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

Fair value measurement

Fair value is defined as the amount for which an asset could be exchanged or a liability transferred, between willing parties in an arm's length transaction.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm’s length basis. Assets are measured at a bid price; liabilities are measured at an asking price.

2. Accounting policies (continued)

Fair value measurement (continued)

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

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

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

Assets and liabilities classified as held for sale

On 30 April 2012 the Group announced its intention to transfer the vast majority of its commercial property assets to NAB.

IFRS requires that groups of assets and liabilities are classified as held for sale when:

- their carrying amounts will be recovered principally through sale;
- they are available for sale in their present condition; and
- their sale is highly probable.

Accordingly, the Group has reclassified certain of its assets and liabilities on this basis (note 24). The assets and liabilities are being transferred at their carrying value and also fall within the scope of IAS 39 and as such continue to be measured in accordance with that Standard.

Income earned and expenses incurred on assets and liabilities classified as held for sale continue to be recognised in the appropriate line items in the income statement until the transaction is complete.

Items classified as fair value through profit or loss

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

Financial assets held for trading

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

Financial instruments designated at fair value through profit or loss

Upon initial recognition, financial assets may be designated as held at fair value through profit or loss. Financial assets classified as fair value through profit or loss are initially recognised at fair value, with transaction costs being recognised in the income statement immediately. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise.

2. Accounting policies (continued)

Items classified as fair value through profit or loss (continued)

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

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

Derivative financial instruments and hedge accounting

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

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

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

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

Fair value hedge

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

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the period in which the hedged item will affect profit or loss.

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

Derivatives that do not qualify for hedge accounting

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

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

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

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of (i) fair value through profit or loss (ii) loans and receivables or (iii) held to maturity.

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

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

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the period in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities and an immaterial investment in equity securities.

Held to maturity financial assets

Held to maturity investments are non derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

2. Accounting policies (continued)

Loans and advances

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

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

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value and not within loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Repurchase and reverse repurchase agreements

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

Securities purchased under agreements to resell (“reverse repos”) are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the Financial Statements. Securities borrowed are not recognised in the Financial Statements unless they are sold to third parties in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Impairment of financial assets other than fair value loans

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

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

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

2. Accounting policies (continued)

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

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

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

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

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

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

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

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

If the originally contracted terms of loans and advances are amended, the amounts are classified as restructured. Such accounts accrue interest as long as the loan performs in accordance with the restructured terms.

Equity and debt instruments

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

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

2. Accounting policies (continued)

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

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. This includes cash and liquid assets, amounts due from other banks (to the extent less than 90 days) and short-term government securities (which have the same characteristics as cash).

Investments in controlled entities and associates

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

Goodwill and other intangibles

Goodwill arises on the acquisition of an entity, and represents the excess of the fair value of the purchase consideration and direct costs of making the acquisition, over the fair value of the Group's share of the assets at the time of the acquisition. Goodwill is capitalised and reviewed annually for impairment, or more frequently when there are indications that impairment may have occurred.

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

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

Property, plant and equipment

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

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

2. Accounting policies (continued)

Property, plant and equipment (continued)

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

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

With the exception of freehold land, all items of property, plant and equipment are depreciated or amortised using the straight-line method, at rates appropriate to their estimated useful life to the Group. For major classes of property, plant and equipment, the annual rates of depreciation or amortisation are:

- buildings - 2%;
- leases (leasehold improvements) - the lower of the expected lease term the assets useful life; and
- motor vehicles, fixtures and equipment - 10% to 33.33%.

Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Investment properties

Investment property is property (land or buildings, or part of a building, or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business.

Investment property assets are carried at fair value, with fair value increments and decrements taken to the income statement in the year in which they arise. Investment property assets are revalued annually by Directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis being the amounts for which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's length transaction at the valuation date. Newly acquired investment property assets are held at cost (i.e. equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding twelve months.

Property inventory

Property acquired or being constructed for sale in the ordinary course of business, rather than to be held for rental or capital appreciation, is held as inventory and is measured at the lower of cost and net realisable value.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- fulfilment of the arrangement is dependent on the use of a specific asset or assets; and
- the arrangement conveys a right to use the asset.

2. Accounting policies (continued)

Leases (continued)

As lessee

The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Sale and leaseback leases entered into by the Group as lessee are primarily operating leases. Where an operating lease is established at fair value, any excess of sales proceeds over the carrying amount is recognised immediately in the income statement.

As lessor

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within 'Other operating income' in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within 'Depreciation expense' in the income statement consistent with the nature of the asset (refer to note 17, Property plant and equipment).

Financial liabilities

Financial liabilities comprise items such as due to other banks, due to customers, liabilities on acceptances, trading liabilities and deposits and other borrowings.

Financial liabilities may be held at fair value through profit or loss or at amortised cost. Items held at fair value through profit or loss comprise both items held for trading and items specifically designated as fair value through profit or loss at initial recognition.

Financial liabilities held at fair value through profit or loss are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Liabilities may be designated as fair value through profit or loss if they meet the following criteria:

- designating instruments will eliminate or significantly reduce measurement or recognition inconsistencies (eliminate an accounting mismatch) that would otherwise arise from measuring assets or liabilities on a different basis; or
- if a host contract contains one or more embedded derivatives the Group may designate the entire contract as being held at fair value; or
- assets and liabilities are both arranged and their performance evaluated on a fair value basis in accordance with documented risk management and investment strategies.

A financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

2. Accounting policies (continued)

Financial liabilities (continued)

All other financial liabilities are measured at amortised cost using the effective interest method. A financial liability is derecognised from the balance sheet when the Group has discharged its obligation, the contract is cancelled or expires.

Provisions

Provisions are recognised when a legal or constructive obligation exists as a result of past events, it is probable that an outflow of economic benefits will be necessary to settle the obligation, and the obligation can be reliably estimated. Provisions are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the balance sheet but are disclosed unless they are remote.

Dividends on ordinary and preference shares

Dividends on ordinary and preference shares classified as equity instruments are recognised as a liability and deducted from equity when they are approved by the Company's Directors. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Company.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

Financial guarantees

The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

The financial guarantee contract is initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary. Subsequently, the Group records and measures the financial guarantee contract at the higher of:

- where it is likely the Group will incur a loss as a result of issuing the contract, a liability is recognised for the estimated amount of the loss payable; and
- the amount initially recognised less, when appropriate, amortisation of the fee which is recognised over the life of the guarantee.

Pension and post retirement costs

Employees of the Group are entitled to benefits on retirement, disability or death from the Group's pension plans. The Group operates both defined benefit and defined contribution pension schemes.

Defined contribution pension scheme

The defined contribution scheme receives fixed contributions from Group companies and the Group's obligation for contributions to these plans is recognised as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

2. Accounting policies (continued)

Pension and post retirement costs (continued)

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings. A liability or asset in respect of the defined benefit scheme is recognised in the balance sheet. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the Group's defined benefit obligation.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, interest cost, expected return on plan assets, curtailment gains and past service cost. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly in retained earnings through the statement of comprehensive income.

The Group also provides post retirement health care for certain retired employees. The calculation of the post retirement health care liability is calculated in the same manner as the defined benefit pension obligation.

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

Preference shares

Preference shares are classified as an equity instrument if and only if both of the following conditions are met:

- The instrument includes no contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- If the instrument will or may be settled in the issuer’s own equity instruments and it is:
  - a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer’s own equity instruments.

Where preference shares do not satisfy the above conditions, then they are classified as a financial liability. The Company's preference shares currently issued meet the criteria for classification as equity.

Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it is related to items recognised in equity, in which case the tax is also recognised in equity.

Income tax expense or revenue is the tax payable (or receivable) on the current year's taxable income based on the applicable tax rate adjusted by changes in deferred tax assets and liabilities.

2. Accounting policies (continued)

Income tax (continued)

Current tax

Current tax is the expected tax payable (or receivable) on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated Financial Statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise to utilise those temporary differences and losses.

Deferred tax liabilities are not recognised for temporary differences arising from investments in subsidiaries and associates where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Deferred tax assets are not recognised for temporary differences arising from investments in subsidiaries and associates where it is probable that the difference will not reverse in the foreseeable future, and it is not probable that taxable profit will be available against which the temporary difference can be utilised.

The effects of income taxes arising from asset revaluation adjustments are recognised directly in the asset revaluation reserve where relevant.

Deferred tax assets and liabilities related to fair value re-measurement of cash flow hedges, which are charged or credited directly to equity, are also credited or charged directly to equity. The tax associated with these transactions will be recognised in the income statement at the same time as the underlying transaction.

Subordinated liability and related entity balances

Subordinated liabilities and related entity balances are recorded at amortised cost. Subordinated liabilities comprise undated and dated loan capital which is provided to the Group by NAB. Subordinated liabilities are included within amounts due to related entities on the balance sheet.

Debt issues

Debt issues are short and long term debt issued by the Group including commercial paper, notes, term loans, medium term notes and residential mortgage backed securities. Debt issues are typically recorded at amortised cost using the effective interest method. Premiums, discounts and associated issue expenses are recognised using the effective interest method through the income statement from the date of issue to accrete the carrying value of securities to redemption values by maturity date. Interest is charged to the income statement using the effective interest method.

Where debt issues are classified as held at fair value through profit or loss they are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently, they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

2. Accounting policies (continued)

Equity

Share option reserve

The share option reserve records the outstanding balance payable to NAB for equity benefits provided to employees and Directors as part of their remuneration including deferred tax.

Cash flow hedge reserve

The cash flow hedge reserve records the effective portion of the fair value revaluation of derivatives designated as cash flow hedging instruments.

Offsetting financial instruments

A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet if, and only if, the Company has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Net interest income

Interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating amortisation using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses.

The calculation of the effective interest rate includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Where it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination and commitment fees are recognised as revenue within the effective interest rate calculation. When the non-utilisation of a commitment fee occurs, this is taken as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Direct loan origination costs are netted against loan origination fees and the net amount recognised as revenue over the life of the loan as an adjustment of yield. All other loan related costs are expensed as incurred.

Fees and commissions

Unless included in the effective interest calculation, fees and commissions are recognised on an accruals basis when the service has been provided. Fees and commissions not integral to the effective interest rate arising from services provided to customers and third parties are recognised once the service has been provided.

2. Accounting policies (continued)

Gains less losses on financial instruments at fair value through profit or loss

Gains less losses on financial instruments at fair value through profit or loss comprises fair value gains and losses from three distinct activities:

- trading financial instruments;
- hedging assets, liabilities and derivatives designated in hedge relationships; and
- financial assets and liabilities designated at fair value through profit or loss.

Trading financial instruments recognises fair value movements on all trading financial instruments. For trading derivatives a full fair value is determined inclusive of interest income and expense arising on those derivatives.

Hedging assets, liabilities and derivatives designated in hedge relationships result in the recognition of fair value movements on both the hedged item and hedging derivative in a fair value hedge relationship, and hedge ineffectiveness for both fair value and cash flow hedge relationships.

Financial instruments designated at fair value through profit or loss recognise fair value movements (excluding interest) on those items designated as fair value through profit or loss at inception.

Interest income and interest expense on hedging assets, liabilities and derivatives and financial assets and liabilities designated as fair value through profit or loss at initial recognition are recognised in net interest income.

Equity based compensation

The Group engages in share-based payment transactions in respect of services received from certain of its employees and to provide long term incentives. The fair value of the services received is measured by reference to the fair value of the NAB shares or share options granted, on the date of the grant. This is recognised as an expense in the income statement over the relevant vesting period and results in an increase in the share option reserve which is reduced on repayment to the ultimate parent company.

The grant date fair value of shares is generally determined by reference to the weighted average price of the NAB shares in the week up to, and including, the date on which the shares are granted. Employee share plans are linked to internal performance, market performance and/or service conditions. The fair value of shares with a market performance condition is determined using a Monte Carlo simulation. The grant date fair value of the performance options and performance rights is determined using a simulated version of the Black-Scholes model. The key assumptions and inputs used in the valuation model are the exercise price of the performance options or performance rights, the expected volatility of the share price, the risk-free interest rate and the expected dividend yield on the shares for the life of the performance options and performance rights. The simulation takes into account both the probability of achieving market performance conditions and the potential for early exercise of vested performance options or performance rights.

While market performance conditions are incorporated into the grant date fair values, non-market conditions are not taken into account when determining the fair value and expected time to vesting of shares, performance options and performance rights. Instead, non-market conditions are taken into account by adjusting the number of shares, performance options and performance rights included in the measurement of the expense so that the amount recognised in the income statement reflects the number of shares, performance options or performance rights that actually vest.

Accounting developments

The following Standards and amendments have been adopted in the current financial year. None of these Standards or amendments have had a material impact on the Group's Financial Statements.

- *Revision to IAS 24 Related Party Disclosures*, issued 4 November 2009 and effective for financial years beginning on or after 1 January 2011. The revision provided clarification of the definition of related parties to enhance consistency; it also introduced a partial exemption for government related entities.

2. Accounting policies (continued)

Accounting developments (continued)

- *Amendment to IFRIC 14 Prepayment of a Minimum Funding Requirement*, issued 26 November 2009 and effective for financial years beginning on or after 1 January 2011. The amendment permits early payments of minimum funding requirements into defined benefit pension schemes to be treated as an asset.
- *Amendment to IFRS 7 Financial Instruments: Disclosures*, issued 7 October 2010 and effective for financial years beginning on or after 1 July 2011. The amendment sets out enhanced disclosure requirements around transfers of financial assets.
- *Improvements to IFRSs 2010*, issued 6 May 2010 and effective for financial years beginning on or after 1 January 2011. This sets out minor amendments to IFRS Standards as part of the IASB's annual improvement process.

The following amendments are relevant to the Group and were available for adoption in the European Union, but are not mandatory and have not been applied by the Group in the 30 September 2012 reporting year:

- *Amendments to IAS 1*, issued 16 June 2011 and effective for financial years beginning on or after 1 July 2012. The amendment sets out enhanced presentation requirements of items of other comprehensive income.
- *Amendments to IAS 19*, issued 16 June 2011 and effective for financial years beginning on or after 1 January 2013. The amendment sets out enhanced disclosures around post-employment benefit plans and removes the option to defer the recognition of gains and losses on these. The Group currently recognises all gains and losses on post-employment benefit plans as they arise.

The following Standards, revisions and amendments are relevant to the Group but were not available for adoption in the European Union and have not been applied by the Group in the 30 September 2012 reporting year:

- *IFRS 9 Financial Instruments,* issued 12 November 2009, amended 16 December 2011 and effective for financial years beginning on or after 1 January 2015. The new Standard will gradually replace IAS 39: Financial Instruments: Recognition and Measurement. IFRS 9 requires financial assets to be classified at either amortised cost, fair value through profit or loss (FVTPL) or fair value through other comprehensive income (FVTOCI) thus removing the available for sale category, which is currently used by the Group. There are however certain similarities between available for sale and the new FVTOCI category. IFRS 9 retains IAS 39's treatment of financial liabilities except for fair value movements due to own credit risk, which would be recognised in other comprehensive income. IFRS 9 will also provide guidance on other areas such as impairments and hedge accounting. The impact of IFRS 9 is likely to be material to the Group and while a detailed assessment has commenced, the final results of this remain uncertain and will remain so until the Standard's changing scope has ultimately been resolved.
- *IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities,* issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013 (with the application date for EU entities being financial years beginning on or after 1 January 2014). The Group will look to early adopt these Standards to align with the ultimate parent company provided the Standards are adopted by the EU. These are part of a suite of Standards covering the amended accounting requirements for consolidations and joint arrangements and their related disclosures. The impacts of these Standards are not considered to be material to the Group.
- *IFRS 13 Fair Value Measurement,* issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013. The Standard brings together the measurement and disclosures for fair values under the one standard. The standard does not alter the requirements for what should be fair valued but does require some enhanced disclosures. The impact of this Standard is not considered to be material to the Group.
- *Amendments to IAS 12 Income Taxes,* issued 20 December 2010 and effective for financial years beginning on or after 1 January 2012. This amendment enhances the methodology for measuring the effect of deferred tax relating to the recovery of an entity's investment property assets. The impact of this Amendment is not considered to be material to Group.

2. Accounting policies (continued)

Accounting developments (continued)

- *Amendments to IFRS 7 Financial Instruments: Disclosures,* issued 16 December 2011 and effective for financial years beginning on or after 1 January 2013. This amendment places further disclosure requirements on netting arrangements of financial assets and liabilities. The impact of this Amendment is not considered to be material to the Group.
- *Amendments to IAS 32 Financial Instruments: Presentation,* issued 16 December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment provides clarification on the criteria that already exist for offsetting. The impact of this Amendment is not considered to be material to the Group.
- *Improvements to IFRSs 2009 – 2011 cycle,* issued 17 May 2012 and effective for financial years beginning on or after 1 January 2013. As part of the IASB's annual improvement process, this makes numerous non-essential changes to accounting standards which are necessary to maintain the overall integrity of Financial Statements. The impact of these Improvements are not considered to be material to the Group.

3. Critical accounting estimates and judgements

The preparation of Financial Statements requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The most significant use of judgements and estimates are as follows:

Equity based compensation

The Company's ultimate parent, NAB, grants shares and share options to the Company's employees as a part of employee remuneration which is recharged to the Company. IFRS 2 requires recognition of an expense for those shares and share options at the fair value on the grant date. For shares granted to employees, the fair value is measured directly at the market price of NAB Group's shares, adjusted to take into account the terms and conditions upon which the shares were granted. For share options granted to employees, the fair value of the equity instruments granted is estimated using a valuation technique consistent with generally accepted valuation methodologies. Further details are given in note 36.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The most significant judgement is in relation to the Group's fair value loan portfolio.

The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected repayment profile of the loans. If the loans were to be repaid six months earlier than currently predicted the value would decline by £9m. Similarly, if the level of prepayment is less than expected the loan value would increase by up to £51m. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £14m, and vice versa. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged. The valuation of these financial instruments is described in more detail in note 12.

3. Critical accounting estimates and judgements (continued)

Impairment losses on loans and advances

The Group reviews its individually significant loans and advances at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Group makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £14m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m.

The impairment loss on loans and advances is disclosed in more detail in note 15.

Goodwill and carrying value of investments

In accordance with the requirements of IAS 36 the Group is required to test the carrying value of Goodwill on an annual basis or more frequently where impairment indicators have been identified. The Strategic Review assessment in the first half of the year was considered to be an impairment indicator and the trigger to conduct an impairment review on the carrying value of Goodwill. The impairment test resulted in the previously reported goodwill figure of £141m in relation to the acquisition of Clydesdale Bank PLC being impaired and fully written down. The Group tested the goodwill figure along with the related net assets of Clydesdale Bank PLC.

Impairment tests were also performed on the carrying value of Clydesdale Bank PLC in the Company at that time and at the Group's standard annual impairment test date in August 2012. The results of these tests highlighted a reduction in the carrying value of Clydesdale Bank PLC to £2,467m and a subsequent impairment charge of £1,181m has been recognised in these Financial Statements.

The key assumptions involved in these calculations are discussed further in note 21.

Payment Protection Insurance redress provision

The Group held a provision of £108 million for this matter at 30 September 2012 (2011: £102m). Significant judgement is required in determining the assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates and redress costs. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall likely position at 30 September 2012. Consequently, the provision calculated at 30 September 2012 may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. The most significant of the individual assumptions are the level of complaints and average pay out per complaint. If the number of complaints were to be 5% higher or lower than that originally estimated, the provision would have increased / decreased by approximately £3m. If the average redress cost was to be 5% higher or lower than that originally estimated, the provision would have increased / decreased by approximately £4m. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

3. Critical accounting estimates and judgements (continued)

Retirement benefit obligations

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. Refer to note 29 for the assumptions used.

4. Net interest income

	2012 £m	2011 £m
Interest income		
Loans and advances to other banks	**27**	19
Available for sale investments	**13**	25
Loans and advances to customers	**1,271**	1,238
Due from related entities (note 10)	**14**	22
Other interest income	**7**	2
	1,332	1,306
Financial assets at fair value through profit or loss	**129**	119
Total interest income	**1,461**	1,425
Interest expense		
Due to other banks	**6**	13
Financial liabilities at fair value through profit or loss	**2**	2
Due to customers	**347**	286
Bonds and notes	**53**	63
Due to related entities (note 10)	**176**	78
Other interest expense	**8**	-
Total interest expense	**592**	442
Net interest income	**869**	983

Included in interest income is income received from assets classified as held for sale.

5. Non interest income

	2012 £m	2011 £m
Gains less losses on financial instruments at fair value		
Movement in fair value of assets	**(121)**	(109)
Interest rate derivatives	**(12)**	9
Foreign exchange derivatives	**21**	21
Ineffectiveness arising from fair value hedges (note 13)	**(12)**	(6)
Ineffectiveness arising from cash flow hedges (note 13)	**1**	(4)
	(123)	(89)
Other operating income		
Fees and commission	**106**	139
Net fair value movement on investment properties	**(7)**	1
Gain on disposal of tangible fixed assets *	**10**	2
Other income	**149**	46
	258	188
Total non interest income	**135**	99

Included in non interest income is income received from assets classified as held for sale.

Fees and commission income includes £5m (2011: £9m) in relation to financial instruments at fair value through profit or loss and is reported net of charges of £120m (2011: £116m) for Payment Protection Insurance redress costs. Other income includes a one-off contribution of £130m (2011: £Nil) to the defined benefit pension scheme from the parent company, NAB (note 29).

The movement in the fair value of assets incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans which are individually hedged. They are fair valued with the movements in fair value taken through the income statement as part of non interest income. The fair value of the loan is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. This valuation technique is regularly reviewed to ensure that it captures the continued economic uncertainty and volatility being experienced.

As interest rates fall, the carrying value of the loan increases. Similarly, as interest rates increase, the carrying value of the loan decreases. To the extent that the fair value of the loan reflects movements in interest rates there will be an offsetting movement in the underlying derivative. Movements in the fair value of loans that relate to changes in the creditworthiness of the loan counterparty and the margin earned on the loan are not offset with a movement in the hedging derivative valuation. The difference in the fair value movement between the loan and derivative is the net present value of the credit margin.

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

6. Operating expenses

	2012 £m	2011 £m
Personnel expenses		
Salaries, wages and non cash benefits	**203**	238
Related personnel expenses	**23**	26
Defined contribution pension expense	**15**	15
Defined benefit pension expense (note 29)	**20**	24
Equity-based compensation	**11**	15
Other personnel expenses	**41**	42
	313	360
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (note 17)	**23**	21
Amortisation of intangible assets (note 21)	**52**	49
	75	70
Other operating expenses		
Operating lease rental	**38**	42
Other occupancy charges	**42**	41
Related entity recharges (note 10)	**17**	17
Impairment losses on goodwill (note 21)	**141**	-
Impairment losses on software (note 21)	**36**	-
Other operating expenses	**243**	195
	517	295
Restructuring and Efficiency, quality and service initiatives		
Other personnel expenses	**96**	10
Other occupancy expenses	**32**	-
Other expenses	**21**	1
	149	11
Total operating expenses	**1,054**	736

Other operating expenses include £2m (2011: £3m) in respect of the Bank levy.

Auditor's remuneration

Included within other operating expenses:	2012 £'000	2011 £'000
Audit of the Financial Statements	**230**	190
Other fees to the auditor:		
Audit of the Group pension scheme	**75**	151
Local statutory audits for subsidiaries	**1,424**	1,135
Other assurance including regulatory compliance based work	**262**	30
	1,991	1,506

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

7. Taxation

	2012	2011
Current tax	**£m**	£m
UK corporation tax		
Current year	**(32)**	(2)
Adjustment in respect of prior years	**1**	10
Other overseas taxation	**3**	10
	(28)	18
Deferred tax (note 22)		
Current year	**(120)**	(4)
Adjustment in respect of prior years	**(4)**	(12)
	(124)	(16)
Tax (credit)/expense	**(152)**	2

The tax assessed for the year differs from the standard rate of corporation tax in the UK (25%). A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	2012	2011
	£m	£m
(Loss)/profit on ordinary activities before tax	**(787)**	49
Tax (credit)/expense based on the standard rate of Corporation Tax in the UK of 25% (September 2011: 27%)	**(197)**	13
Effects of:		
Expenses not deductible for tax purposes	**41**	3
Bank levy	**1**	1
Amounts not subject to UK tax	**(2)**	(10)
Rate differences	**6**	(4)
Adjustments in respect of prior years	**(3)**	(3)
Other	**2**	2
Actual tax (credit)/expense for the year	**(152)**	2

8. Dividends paid

	2012	2011
	£m	£m
Preference dividends paid – 12% per annum payable semi-annually (6p per share)	**6**	12
Non-equity non-voting income share dividends paid	**-**	4
	6	16

The Company has one non-equity, non-redeemable non-voting share in issue under the terms of the UK Dividend Plan (UKDP). The UKDP was established in 1989 to allow UK resident NAB ordinary shareholders to elect to receive dividends from the Company in Sterling. On 5 May 2011, following legislative changes, NAB announced the termination of the UKDP. UK resident shareholders now receive dividends directly from NAB. The first payment by NAB to UK resident shareholders was the 2011 interim dividend.

9. Cash and balances with central banks

	Group		Company	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Cash assets	**1,127**	981	**3**	35
Balances with central banks	**6,800**	5,071	**-**	-
	7,927	6,052	**3**	35
Less mandatory deposits with central banks	**(31)**	(29)	**-**	-
Included in cash and cash equivalents (note 34)	**7,896**	6,023	**3**	35

Mandatory deposits are not available for use in the Group or Company's day to day business and are non-interest bearing.

10. Related party transactions

During the year there have been transactions between the Group, its ultimate parent, controlled entities of the ultimate parent, controlled entities of the Group, and other related parties.

The Group provides a range of services to related parties, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, forward exchange and interest cover.

The Group receives a range of services from the parent and related parties, including loans and deposits, forward exchange and interest rate cover and various administrative services. Fees may be charged for these services.

The assets held for sale as referred to in note 24 and 44 have been sold to NAB subsequent to the year end.

Amounts due from related entities	Group		Company	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Loans				
Ultimate parent	**1,215**	4,922	**-**	-
Controlled entities of the Company	**-**	-	**219**	219
	1,215	4,922	**219**	219
Subordinated loans				
Controlled entities of the Company	**-**	-	**526**	526
Other receivables				
Ultimate parent	**34**	14	**-**	-
Controlled entities of the ultimate parent	**7**	16	**-**	-
Controlled entities of the Company	**-**	-	**3**	3
	41	30	**3**	3
Total amounts due from related entities	**1,256**	4,952	**748**	748
Interest income on the above amounts was as follows:				
Ultimate parent (note 4)	**14**	22	**-**	-
Controlled entities of the Company	**-**	-	**15**	12
	14	22	**15**	12

10. Related party transactions (continued)

Reverse repurchase agreements

Included in amounts due from related entities is £Nil (2011: £4,284m) for securities purchased under agreements to resell. As part of these reverse repurchase agreements, the Group received securities that it is allowed to sell or re-pledge. The fair value of the securities accepted under these terms as at 30 September 2012 amounts to £Nil (2011: £4,343m) for the Group, of which £Nil (2011: £204m) has been sold or re-pledged to third parties in connection with financing activities or to comply with commitments under short sale transactions.

Amounts due to related entities	**Group**		**Company**	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
		As restated		
Deposits				
Ultimate parent	**6,452**	6,687	**-**	180
Controlled entities of the ultimate parent	**100**	100	**-**	-
Controlled entities of the Company	**-**	-	**4,877**	4,205
	6,552	6,787	**4,877**	4,385
Subordinated liabilities				
Ultimate parent	**782**	782	**232**	232
Immediate parent	**343**	343	**343**	343
Controlled entities of the Company	**-**	-	**-**	500
	1,125	1,125	**575**	1,075
Other payables				
Ultimate parent	**23**	36	**-**	-
Immediate parent	**2**	2	**2**	2
Controlled entities of the ultimate parent	**14**	12	**-**	-
	39	50	**2**	2
Total amounts due to related entities	**7,716**	7,962	**5,454**	5,462
Interest expense on the above amounts was as follows (note 4):				
Ultimate parent	**166**	71	**3**	2
Immediate parent	**6**	5	**6**	5
Controlled entities of ultimate parent	**4**	2	**-**	-
Controlled entities of the Company	**-**	-	**69**	58
	176	78	**78**	65

Subordinated liabilities

Subordinated liabilities comprise undated and dated loan capital which is provided to the Company by NAB. Interest on the loans is payable at rates related to the London Interbank Offered Rate ("LIBOR"). The undated loans are subject to five years and one day's notice of redemption by the lenders and are repayable at par. Early repayment is at the option of the borrower, subject to the prior consent of the Financial Services Authority. The loans are subordinated to the claims of other creditors and are unsecured. The loans are employed in the general business of the Company.

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

10. Related party transactions (continued)

Subordinated liabilities (continued)

Details of subordinated liabilities in excess of 10% of the total balance of the subordinated loans of the Group are disclosed below:

The rates of interest stated below apply at 30 September 2012:	**2012**	2011
	£m	£m
		As restated
6.40438% (2011: 6.55219%) 10 year, non-call five years with a final maturity of 17 February 2019	**300**	300
5.17900% (2011: 5.25281%) 10 year, non-call with a final maturity of 25 January 2021	**250**	250
0.90313% (2011: 1.16781%) Undated subordinated notes	**285**	285
1.81344% (2011: 1.59500%) Undated subordinated notes	**258**	258
	1,093	1,093
Other subordinated notes	**32**	32
Total subordinated liabilities	**1,125**	1,125

Securitisation

The Group has securitised part of its residential mortgage portfolio and the cash raised through the issue of residential mortgage backed securities ("RMBS") through special purpose entities forms part of the Group's medium term funding. A portfolio of Buy to Let mortgages has been securitised via the Lannraig Master Trust Issuer programme and a total of £474m (2011: £500m) of the securities issued have been purchased by the Group's ultimate parent.

Other transactions with related entities	**Group**	
	2012	2011
	£m	£m
Non interest income received		
Ultimate parent	**8**	8
Controlled entities of the ultimate parent	**10**	9
	18	17
Administrative expenses (note 6)		
Ultimate parent	**13**	12
Controlled entities of the ultimate parent	**4**	5
	17	17

Compensation of key management personnel (KMP)

For the purposes of IAS 24 "Related Party Disclosures" KMPs comprise Directors of the Company, members of the UK Executive Committee and FSA approved persons with a control function of 1 to 29.

Group	**2012**	2011
	£m	£m
Salaries and other short-term benefits	**11**	13
Share based payments	**3**	4
	14	17

Directors' emoluments are analysed in note 37.

10. Related party transactions (continued)

Transactions with key management personnel

KMPs, their close family members and any entities controlled or significantly influenced by the KMPs have undertaken the following transactions with the Group in the normal course of business. The transactions were made on the same terms and conditions as applicable to other Group employees, or on normal commercial terms.

Group	2012 £m	2011 £m
Loans and advances	**5**	6
Deposits	**1**	4

No provisions have been recognised in respect of loans provided to key management personnel. There were no debts written off or forgiven during the year to 30 September 2012 (2011: £Nil). Included in the above are seven (2011: ten) loans totalling £1.6m (2011: £1.9m) made to Directors.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2012 (2011: £0.4m) were charged to the Group sponsored Scheme. The Group has deposits of £3.1m (2011: £2.8m) at the year end placed by the Scheme at market rates.

Pension contributions of £242m (2011: £107m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (see note 29).

The following derivative positions are held with the ultimate parent:

	2012 £m	2011 £m
Derivative financial assets (note 13)	**179**	157
Derivative financial liabilities (note 13)	**710**	806

11. Investments

Group	2012 £m	2011 £m
Available for sale – listed	**1,032**	1,110
Available for sale – unlisted	**7**	7
	1,039	1,117

Included in the available for sale (AFS) listed securities are £Nil (2011: £0.06bn) investments in other banks' debt securities, which are subject to a UK Government backed guarantee plus £0.8bn (2011: £0.9bn) in UK Government Gilts and £0.1bn (2011: £0.1bn) in other banks' debt securities.

11. Investments (continued)

The listed available for sale investments are classified as level 1 in the fair value hierarchy, with the unlisted available for sale investments classified as level 3 (note 38).

Credit quality of investments

	2012 £m	2011 £m
Available for sale		
Senior investment grade	**1,032**	1,110
Other	**7**	7
	1,039	1,117

12. Other financial assets and liabilities at fair value

Group	2012 £m	2011 £m
Other financial assets at fair value through profit or loss		
Loans and advances	**2,791**	4,846
Not included in the above:		
Assets classified as held for sale (note 24)	**1,475**	-
Other financial liabilities at fair value through profit or loss		
Due to customers – term deposits	**147**	155

Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as derivative financial instruments (note 13).

Loans and advances at fair value

Included in other financial assets at fair value is a portfolio of loans which have embedded derivative characteristics. Interest rate risk associated with these loans is managed using interest rate derivative contracts, and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £2,791m (2011: £4,846m). The cumulative reserves movement in the fair value of the loans attributable to changes in credit risk losses amounts to £82m (2011: £157m) and the change for the current year is a reduction of £75m (2011: increase of £26m) which incorporates an £86m reduction relating to the transfer of certain commercial property loans into assets held for sale (see note 24).

The designated loans were historically classified as level 2 in the fair value hierarchy as their value was principally determined using directly observable inputs other than directly quoted prices. The expected changes in fair value of the designated loans attributable to credit risk are calculated using an established statistical based calculation to estimate expected losses attributable to adverse movements in credit risk. The Group ceased further sales of this suite of loan products with effect from 30 April 2012. This led to a reduction in the level of observable inputs resulting in the loans being reclassified at 30 September 2012 as level 3 in the fair value hierarchy (see note 38).

12. Other financial assets and liabilities at fair value (continued)

Due to customers - term deposits

Included in other financial liabilities at fair value are fixed rate deposits which have been hedged with interest rate derivative contracts with matching cash flows.

The change in fair value attributable to changes in the Company credit risk is £Nil (2011: £Nil). The Company is contractually obligated to pay £16m (2011: £17m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as level 3 in the fair value hierarchy as their value is determined using valuation techniques where one or more significant inputs are unobservable (see note 38).

13. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, certain derivatives do not meet the hedging criteria within IAS 39 and are therefore accounted for as held for trading, though they are used for risk mitigation purposes. The tables below analyse derivatives between those held as hedging instruments and those that do not meet the hedging criteria within IAS 39.

Group	**2012 £m**	2011 £m
Fair value of derivative financial assets		
Designated as hedging instruments	**160**	537
Designated as held for trading	**261**	324
Designated as held for trading – related entities (note 10)	**179**	157
	600	1,018
Not included in the above:		
Assets classified as held for sale (note 24)	**(4)**	-
Fair value of derivative financial liabilities		
Designated as hedging instruments	**187**	81
Designated as held for trading	**55**	44
Designated as held for trading – related entities (note 10)	**710**	806
	952	931
Not included in the above:		
Liabilities associated with assets held for sale (note 24)	**142**	-

The derivative financial instruments held by the Group are classified as level 2 in the fair value hierarchy as their value is determined using directly observable inputs other than directly quoted prices.

13. Derivative financial instruments (continued)

Group

Total derivative contracts as at 30 September 2012	**Contract amount**	**Fair value of assets**	**Fair value of liabilities**
Derivatives designated as hedging instruments	**£m**	**£m**	**£m**
Cash flow hedges			
Interest rate swaps	8,970	160	2
Fair value hedges			
Interest rate swaps	1,458	-	133
Foreign exchange rate swaps	1,023	-	52
	2,481	-	185
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,785	43	48
Swaps	504	78	6
Options	542	6	6
	4,831	127	60
Interest rate related contracts			
Swaps	41,476	280	638
Swaptions	398	11	11
Options	1,350	20	54
	43,224	311	703
Commodity related contracts	75	2	2
Total derivative contracts	**59,581**	**600**	**952**

The contract amount is the amount from which the cash flows from the derivative contracts are derived and is not an indication of the amounts at risk relating to these contracts.

Certain derivative financial assets and liabilities have been booked in consolidated special purpose entities.

Derivative financial assets and liabilities held at fair value through profit or loss ("FVTPL") include the hedges for the Group securitisation programme, medium term note ("MTN") programmes and cash flow hedges.

The carrying value of the currency liabilities issued through securitisation and MTN programmes fluctuates as a result of foreign exchange movements. There is a corresponding movement in the value of the hedging derivative.

The carrying value of the cash flow hedge derivatives increases as LIBOR yield curves used to discount the future cash flows reduce.

13. Derivative financial instruments (continued)

Group

Total derivative contracts as at 30 September 2011	Contract amount	Fair value of assets	Fair value of liabilities
Derivatives designated as hedging instruments	£m	£m	£m
Cash flow hedges			
Interest rate swaps	7,320	176	19
Fair value hedges			
Interest rate swaps	2,408	17	62
Foreign exchange rate swaps	1,167	344	-
	3,575	361	62
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	5,328	92	56
Swaps	563	86	1
Options	572	9	9
	6,463	187	66
Interest rate related contracts			
Swaps	32,924	268	719
Swaptions	539	12	13
Options	2,072	13	51
	35,535	293	783
Commodity related contracts	40	1	1
Total derivative contracts	52,933	1,018	931

The Group macro hedges its interest rate exposure using cash flow hedges. These are vanilla fixed rate interest rate swaps for which the Group has the following commitments in the time bands noted:

Nominal values per time period	**2012 £m**	2011 £m
0 to 6 months	**2,810**	2,795
6 to 12 months	**995**	1,440
1 to 2 years	**2,145**	800
2 to 5 years	**3,020**	2,285
	8,970	7,320

The Group has hedged the following forecast cash flows, which primarily vary with interest rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows 2012 £m	**Forecast payable cash flows 2012 £m**	Forecast receivable cash flows 2011 £m	Forecast payable cash flows 2011 £m
within one year	**-**	**132**	6	143
between one and two years	**-**	**80**	-	78
between two and three years	**-**	**45**	-	54
between three and four years	**-**	**17**	-	32
between four and five years	**-**	**5**	-	8
	-	**279**	6	315

13. Derivative financial instruments (continued)

	2012 £m	2011 £m
Gain/(loss) from cash flow hedges recognised in income due to hedge ineffectiveness (note 5)	**1**	(4)

	2012 £m	2011 £m
Gain/(loss) *arising from fair value hedges (note 5)*		
Hedged item attributable to the hedged risk	**551**	131
Hedging instrument	**(563)**	(137)
	(12)	(6)

14. Loans and advances to customers

Group	**2012 £m**	2011 £m
Overdrafts	**2,346**	4,075
Credit cards	**436**	483
Lease finance	**694**	901
Mortgages	**15,369**	13,981
Other term lending – business	**5,151**	8,503
Other term lending – retail	**730**	858
Other lending	**51**	30
Gross loans and advances to customers	**24,777**	28,831
Unearned income	**(78)**	(150)
Deferred and unamortised fee income	**(58)**	(69)
Impairment provisions on credit exposures (note 15)	**(295)**	(374)
	24,346	28,238

Not included in the above:

Assets classified as held for sale (note 24)	**4,177**	-
Impairment provisions on credit exposures in respect of assets held for sale (note 24)	**(463)**	-
	3,714	-

The Group has transferred £4,364m (September 2011: £2,916m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 16). The mortgages do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements the Group continues to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £2,553m (2011: £1,939m).

Included within Group loans and advances to customers are £2,498m (2011: £809m) of mortgages assigned to two bankruptcy remote special purpose entities, Clydesdale Covered Bonds LLP and Clydesdale Covered Bonds No. 2 LLP. These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2012 there were £1,084m (September 2011: £Nil) of covered bonds in issue under the covered bond programmes.

14. Loans and advances to customers (continued)

Lease finance

The Group leases a variety of assets to third parties under operating and finance lease arrangements, including vehicles and general plant and machinery. The costs of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £4m (2011: £24m) and £314m (2011: £480m) respectively. The total closing balances of finance leases and hire purchase contracts were £20m (2011: £38m) and £629m (2011: £802m) respectively.

Finance lease receivables	Group 2012 £m	Group 2011 £m
Gross investment in finance lease receivables		
Due within one year	**301**	351
Due within one to five years	**365**	505
Due after more than five years	**28**	45
	694	901
Unearned income	**(45)**	(61)
Net investment in finance lease receivables	**649**	840

There are specific provisions of £5.8m (2011: £4.8m) in relation to finance lease receivables, with a collective provision of £0.6m (2011: £1.2m) as at 30 September 2012.

Maximum exposure to credit risk

The maximum exposure to credit risk is disclosed in note 39.

Distribution of loans and advances by credit quality

Group	Business lending 2012 £m	Business lending 2011 £m	Retail lending 2012 £m	Retail lending 2011 £m
Gross loans and advances:				
Neither past due nor impaired	**7,677**	12,245	**16,070**	14,988
Past due but not impaired	**293**	350	**394**	380
Impaired	**272**	797	**71**	71
	8,242	13,392	**16,535**	15,439

The distribution of loans and advances by credit quality can be further analysed as follows:

Group 2012	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Gross loans and advances:							
Neither past due nor impaired	132	415	661	14,994	7,016	529	**23,747**
Past due but not impaired	12	21	19	304	274	57	**687**
Impaired	-	-	14	71	258	-	**343**
	144	**436**	**694**	**15,369**	**7,548**	**586**	**24,777**

Group 2011	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	104	455	855	13,620	11,337	862	27,233
Past due but not impaired	13	28	28	300	335	26	730
Impaired	-	-	18	61	789	-	868
	117	483	901	13,981	12,461	888	28,831

***** Business lending includes business overdrafts.

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

14. Loans and advances to customers (continued)

Credit quality of loans and advances

The Group has an internally developed credit rating system that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the probability of default for each customer and can be broadly mapped to external agencies rating scales. Impaired assets consist of business lending and secured personal lending where current circumstances indicate that losses of loan principal and/or interest may be incurred.

Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's standard credit rating system. The credit rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories of accounts and customer and are derived in accordance with the Group's ratings policy**.**

The table below presents the analysis of business lending credit quality of loans and advances that are neither past due nor impaired:

Group	**2012** **£m**	2011 £m
Senior investment grade	**1,419**	1,473
Investment grade	**2,020**	2,496
Sub-investment grade	**4,238**	8,276
	7,677	12,245

For the business lending analysis, investment grades are determined by the Customer Rating System (eCRS) as defined under the Credit Risk Management policy:

- senior investment grade is eCRS ratings 1 to 5;
- investment grade is eCRS ratings 6 to 11; and
- sub-investment grade is ratings 12 to 23.

The loan to value (LTV) of retail mortgage lending coupled with the relationship of the debt to customers income are key to the credit quality of the Group's mortgages. The table below sets out the indexed loan to value analysis of the Group's retail mortgages:

Group	**2012** **%**	2011 %
Less than 50%	**21**	22
50% to 75%	**40**	36
76% to 80%	**9**	9
81% to 85%	**7**	7
86% to 90%	**6**	6
91% to 95%	**5**	6
96% to 100%	**4**	4
Greater than 100%	**4**	5
Unknown	**4**	5
	100	100

14. Loans and advances to customers (continued)

Loans and advances which were past due but not impaired

Loans and advances that are past due but are not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility. The distribution of loans and advances that are past due but not impaired are analysed below:

Group 2012	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
1 to 29 days past due	8	8	18	111	173	44	**362**
30 to 59 days past due	2	3	1	79	9	4	**98**
60 to 89 days past due	1	3	-	36	6	3	**49**
Past due over 90 days	1	7	-	78	86	6	**178**
	12	**21**	**19**	**304**	**274**	**57**	**687**

Group 2011	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	14	25	102	231	8	388
30 to 59 days past due	2	3	2	74	10	5	96
60 to 89 days past due	1	3	1	37	1	4	47
Past due over 90 days	2	8	-	87	93	9	199
	13	28	28	300	335	26	730

***** Business lending includes business overdrafts

15. Impairment provisions on credit exposures

Group 2012	**Business lending £m**	**Retail lending £m**	**Total £m**
Opening balance	300	74	**374**
Charge for the year	698	39	**737**
Amounts written off	(314)	(68)	**(382)**
Recoveries of amounts written off in previous years	14	15	**29**
Transfer to assets held for sale (note 24)	(463)	-	**(463)**
Closing balance	**235**	**60**	**295**
Specific	112	14	**126**
Collective	123	46	**169**
	235	**60**	**295**

Not included in the above:

Impairment provisions on credit exposures held for sale (note 24)	**463**	**-**	**463**
Specific	278	-	**278**
Collective	185	-	**185**
	463	**-**	**463**

National Australia Group Europe Limited
Notes to the consolidated financial statements (continued)

15. Impairment provisions on credit exposures (continued)

This can be further analysed as follows:

Group 2012	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Opening balance	10	17	6	26	294	21	**374**
Charge for the year	7	13	7	10	691	9	**737**
Amounts written off	(10)	(22)	(6)	(14)	(308)	(22)	**(382)**
Recoveries of amounts written off in previous years	3	5	-	-	14	7	**29**
Transfer to assets held for sale (note 24)	-	-	-	-	(463)	-	**(463)**
Closing balance	**10**	**13**	**7**	**22**	**228**	**15**	**295**
Specific	-	-	6	14	106	-	**126**
Collective	10	13	1	8	122	15	**169**
	10	**13**	**7**	**22**	**228**	**15**	**295**

***** Business lending includes business overdrafts

Group 2011	Business lending £m	Retail lending £m	Total £m
Opening balance	282	80	362
Charge for the year	243	54	297
Amounts written off	(242)	(91)	(333)
Recoveries of amounts written off in previous years	17	31	48
Closing balance	300	74	374
Specific	112	19	131
Collective	188	55	243
	300	74	374

Group	**2012 £m**	2011 £m
Amounts included in		
Loans and advances to customers (note 14)	**295**	374
Non accrual loans		
Loans and advances to customers	**343**	868
Specific provisions	**(126)**	(131)
	217	737

16. Securitisation and covered bonds

Securitised advances are subject to non-recourse finance arrangements. These loans have been transferred at principal value to SPEs and have been funded through the issue of amortising mortgage backed securities to investors. The transfers do not meet the criteria for derecognition in IAS 39 as the Group has retained the risks and rewards of the assets. The Group consolidated Financial Statements include the results, assets and liabilities of the securitisation SPEs, on a line by line basis.

The balances of assets and liabilities in relation to securitisation notes in issue at 30 September 2012 within the Group's balance sheet are as follows:

Group	**2012**	2011
	£m	£m
Assets		
Derivative financial assets	**-**	204
Loans and advances to customers (note 14)	**4,364**	2,916
Accrued interest receivable	**28**	14
Other assets	**-**	-
	4,392	3,134
Liabilities		
Derivative financial liabilities	**52**	-
Bonds and notes	**2,079**	1,439
Due to related entities (note 10)	**474**	500
Accrued interest payable	**33**	11
	2,638	1,950

At 30 September 2012 the SPEs had cash deposits with the Group amounting to £Nil (2011: £67m). This balance is restricted in use to the repayment of the debt securities issued by the SPEs and other legal obligations.

The balances of assets and liabilities in relation to covered bond notes in issue at 30 September 2012 within the Group's balance sheet are as follows:

Group	**2012**	2011
	£m	£m
Assets		
Loans and advances to customers (note 14)	**2,498**	809
Accrued interest receivable	**32**	9
Other assets	**-**	-
	2,530	818
Liabilities		
Derivative financial liabilities	**17**	-
Bonds and notes	**1,084**	-
Accrued interest payable	**25**	-
	1,126	-

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. Where relevant, the table also sets out the net position of the fair value of financial assets where the counterparty to the associated liabilities has recourse only to the financial assets:

Group	**2012**		2011	
	Securitisation	**Covered bonds**	Securitisation	Covered bonds
	£m	**£m**	£m	£m
Carrying amount of transferred assets	**4,364**	**2,498**	2,916	809
Carrying amount of associated liabilities	**2,553**	**1,084**	1,939	-

16. Securitisation and covered bonds (continued)

For those liabilities that have recourse only to the transferred assets:

Group	**2012**		2011	
	Securitisation £m	**Covered bonds £m**	Securitisation £m	Covered bonds £m
Fair value of transferred assets	**4,364**	**-**	2,916	-
Fair value of associated liabilities	**2,553**	**-**	1,939	-
	1,811	**-**	977	-

There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

Securitisation

The loans do not qualify for derecognition because the Group remains exposed to the risks and rewards of ownership on an on-going basis. The Group continues to be exposed primarily to liquidity risk, interest rate risk and credit risk of the loans. The securitisation trusts are consolidated into the Group. The note holders have only recourse to the mortgage pool of assets.

Covered Bonds

The residential mortgages do not qualify for derecognition because the Group retain all of the risks and rewards associated with them and where derivatives have not been externalised, interest rate and foreign currency risks are held in the Group. The covered bonds SPEs are consolidated, the residual mortgages are retained on the Group's balance sheet and the covered bonds issued are included within debt securities in issue. The covered bond holders have dual recourse to Clydesdale Bank PLC or the covered bond pool assets.

17. Property, plant and equipment

Group	Freehold land and buildings	Long-term Leasehold land and buildings	Short-term Leasehold land and buildings	Motor vehicles, fixtures and equipment	Total
	£m	£m	£m	£m	£m
Cost or valuation					
At 1 October 2010	36	3	141	184	364
Additions	-	-	11	13	24
Disposals	(1)	-	(14)	(39)	(54)
Transfers	(1)	1	-	-	-
At 30 September 2011	**34**	**4**	**138**	**158**	**334**
Additions	-	-	9	5	**14**
Disposals	(12)	-	(3)	(16)	**(31)**
On revaluation	(2)	(1)	-	-	**(3)**
Transfers	-	-	-	-	**-**
At 30 September 2012	**20**	**3**	**144**	**147**	**314**
Accumulated depreciation					
At 1 October 2010	1	1	72	122	196
Charge for the year	-	1	7	13	21
Disposals	-	(1)	(11)	(36)	(48)
Transfers	-	(1)	1	-	-
At 30 September 2011	**1**	**-**	**69**	**99**	**169**
Charge for the year	-	-	11	12	**23**
Disposals	-	-	(2)	(16)	**(18)**
On revaluation	-	-	-	-	**-**
Transfers	-	-	-	-	**-**
At 30 September 2012	**1**	**-**	**78**	**95**	**174**
Net book value					
At 30 September 2012	**19**	**3**	**66**	**52**	**140**
At 30 September 2011	33	4	69	59	165

Valuations

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Company's own Director valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors. Valuations are performed annually in July. A comparison of the carrying value under the revaluation basis and if the historical cost basis had been used is shown below:

Group	2012	2011
	£m	£m
Carrying value as included under the revaluation basis	**22**	37
Carrying value if the historical cost basis had been used	**15**	26

18. Investment properties

Group	**2012** **£m**	2011 £m
At 1 October	**81**	77
Additions	**1**	12
Disposals	**(2)**	(8)
Deficit on revaluation	**(3)**	-
	77	81

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Company's own Director valuations. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards.

During the year 99% (2011: 93%) of the investment properties generated total rental income of £3m (2011: £3m) and incurred operating expenses of £2m (2011: £2m). The operating expenses of the investment properties that did not generate rental income were £Nil (2011: £Nil).

19. Property inventory

Group	**2012** **£m**	2011 £m
At 1 October	**27**	31
Additions	**1**	12
Disposals	**(14)**	(16)
Write down of property inventory	**(5)**	-
	9	27

Included within property inventory is property under construction of £2m (2011: £16m). The remaining property inventory is complete and available for sale.

20. Investments in controlled entities and associates

	Group		**Company**	
	2012 **£m**	2011 £m	**2012** **£m**	2011 £m
At 30 September	**3**	3	**6,953**	7,634

As highlighted in note 3, impairment tests on the carrying value of the Company's investment in Clydesdale Bank PLC have been undertaken during the year and resulted in a cumulative impairment charge of £1,181m as at 30 September 2012. For the purposes of the impairment test, Clydesdale Bank PLC is regarded as the cash generating unit with the value in use calculation compared to the current carrying value of the investment in Clydesdale Bank PLC in the Company balance sheet.

The key assumptions involved in these calculations are discussed further in note 21.

The details of all subsidiary undertakings will be annexed to the next annual return of the Company.

20. Investments in controlled entities and associates (continued)

The Company's principal controlled entities are as follows:

Wholly owned subsidiary undertakings as at 30 September 2012	Nature of business	Country of incorporation
Clydesdale Bank PLC	Banking	Scotland
National Australia Group Europe Investments Limited	Investment company	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	England

The following companies are SPEs established in connection with the Group's securitisation and covered bond programmes (note 16). Although the Company has no direct or indirect ownership interest in these companies, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's Financial Statements.

Other controlled entities as at 30 September 2012	Nature of business	Country of incorporation
Clydesdale Covered Bonds LLP	Acquisition of mortgage loans	England
Clydesdale Covered Bonds No.2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

All of the above controlled entities have a 30 September financial year end.

Associates

Associates are undertakings over which the Company exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2012. The associated undertaking is The Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is in the provision of finance and the Group's interest of 33.33% in the issued equity capital of £2m is held by the Company. The associated undertaking has a 31 March year end.

21. Goodwill and other intangible assets

Group	**2012 £m**	2011 £m
Goodwill	**-**	141
Capitalised software costs	**198**	224
	198	365

Impairment testing of goodwill

Goodwill is subject to testing for impairment as described in note 3. A test for impairment took place in March 2012 as part of the UK Operation's Strategic Review and resulted in the entire goodwill figure of £141m being impaired. In accordance with IAS 36, impairment losses recognised for goodwill cannot be reversed in subsequent years.

Accordingly a goodwill impairment loss of £141m has been recognised in these Financial Statements (2011: £Nil).

21. Goodwill and other intangible assets (continued)

Cash generating unit

Goodwill acquired through business combinations was allocated to one cash generating unit for the purpose of impairment testing. This cash generating unit reflects Clydesdale Bank PLC.

Key assumptions used in impairment testing

The recoverable amount of the cash generating unit has been derived from a value in use calculation using discounted cash flow techniques and a forecasted performance approved by the Board. Cash flows beyond the forecasted period have been extrapolated using similar forecasted assumptions as in the forecast period. The following rates are used by the Company:

	2012	2011
	%	%
Post tax discount rate	**10**	12
Projected terminal growth rate	**3.3**	2.3

The calculation of the value in use is based on a Board approved three year forecast projection and is then extrapolated forward with a terminal growth rate applied. The three year forecast projections encompass a range of economic indications such as GDP growth, unemployment statistics as well as a range of other business assumptions specific to Clydesdale Bank PLC such as asset volumes, product volumes and margins which are commercially sensitive. The Board is satisfied that the assumptions used both within and beyond the forecasted period are appropriate and reasonable at the balance sheet date.

Discount rate

The discount rate applied reflects the current market assessment of the risk specific to Clydesdale Bank PLC. The discount rate was calculated by reference to a series of internal indicators combined with certain identifiable and available sector specific information. The impairment model used is based on post-tax cash flows and utilises a post-tax discount rate. A comparable pre-tax discount rate for the year would be 12% (2011: 14%).

Projected terminal growth rate

The projected terminal growth rate is based on management's expectation of the long term average growth prospects for UK GDP after taking into account the broader historic UK economic outlook and trends.

Sensitivity to changes in assumptions

Changes such as a 1% increase in the post-tax discount rate or a 1% decrease in the projected terminal growth rate would have no effect on the amount of impaired goodwill as the full amount of goodwill (£141m) has already been impaired and cannot be reversed once it has been impaired.

21. Goodwill and other intangible assets (continued)

Incorporating these sensitivity changes in the Company's assessment of the carrying value of Clydesdale Bank PLC in the Company, if adjusted independently of all other variables, would result in a further impairment of £356m from a 1% increase in the post-tax discount rate and a further impairment of £185m from a 1% decrease in the projected terminal growth rate.

Capitalised software costs	**2012 £m**	2011 £m
Cost		
At 1 October	**404**	339
Additions	**62**	70
Disposals	**-**	(5)
Write down of software	**(114)**	-
At 30 September	**352**	404
Accumulated amortisation		
At 1 October	**180**	134
Disposals	**-**	(3)
Charge for the year (note 6)	**52**	49
Write down of software	**(78)**	-
At 30 September	**154**	180
Net book value at 30 September	**198**	224

Additions of £62m (2011: £70m) relate predominantly to the Group's continuing investment in new systems to meet the requirements of the business. To the extent that the systems are in use within the business amortisation has been charged at the rates set out in note 2.

Management has performed impairment testing of capitalised software assets during 2012. This review identified capitalised costs which are considered impaired as a consequence of the Strategic Review. The total impairment charge of £36m has been recognised in these Financial Statements (2011:£Nil).

22. Deferred tax

Movement in net deferred tax asset

Group	**2012 £m**	2011 £m
At 1 October	**101**	117
Recognised in the income statement (note 7)	**124**	16
Recognised directly in equity	**61**	(26)
Transferred to assets held for sale (note 24)	**(20)**	-
Other	**-**	(6)
	266	101

Not included in the above:

Deferred tax in respect of assets held for sale (note 24)	**20**	-

22. Deferred tax (continued)

The Group recognises deferred tax attributable to the following items:

Group	**2012 £m**	2011 £m
Deferred tax assets		
Defined benefit pension liability	**70**	48
Impairment provision on credit exposures	**14**	24
Employee equity based compensation	**4**	4
Tax losses carried forward	**92**	-
Provisions	**59**	26
Other	**48**	30
	287	132
Deferred tax liabilities		
Accelerated capital allowances	**(18)**	(10)
Net gain on revaluation of properties	**1**	2
Cash flow hedge reserve	**37**	39
Other	**1**	-
	21	31
Net deferred tax asset	**266**	101

The Group considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The largest deferred tax asset held within the Group relates to tax losses carried forward. The tax losses carried forward have been assessed for recoverability against the Group's 5 year forecast which includes adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses, despite this the losses are expected to be fully utilised within 3 to 5 years.

The Finance Bill 2012 was substantively enacted on 3 July 2012. The announced corporation tax rate of 23% will be effective from 1 April 2013. Accordingly this rate has been used to calculate the deferred tax asset held by the Group. A further reduction of 1% per annum is anticipated until the rate reaches 22% in 2014.

The maximum effect on deferred tax of the reduction in the UK corporation tax rate to 22% is expected to be £12m (equivalent to 1% of the closing gross deferred tax balance).

23. Other assets

Group	**2012 £m**	2011 £m
Prepayments and accrued income	**273**	412
Other	**242**	258
	515	670

Not included in the above:

Assets classified as held for sale (note 24)	**20**	-

24. Assets held for sale

Group	2012 £m
Assets held for sale	
Other financial assets at fair value	**1,475**
Gross loans and advances to customers	**4,177**
	5,652
Impairment provisions on credit exposures (note 15)	**(463)**
Derivative financial instruments	**(4)**
Deferred tax	**20**
Other assets	**20**
	5,225
Liabilities associated with assets held for sale	
Derivative financial instruments	**142**

Assets held for sale principally comprise assets with balances before provisions of approximately £5.6bn. The assets held for sale were transferred to NAB on 5 October 2012 following the Strategic Review undertaken by the Group.

As part of the transaction NAB has assumed the credit risk on certain customer derivatives. Accordingly, the carrying value of derivatives in the Group has increased by £4m as there is a reduction in the level of credit valuation adjustment. This reduction in risk is part of the settlement of the net transaction.

The credit quality of the loans and advances held for sale is as follows:

Group	2012 £m
Gross loans and advances:	
Neither past due nor impaired	**3,095**
Past due but not impaired	**240**
Impaired	**842**
	4,177
Impairment provisions on credit exposures (note 15)	**(463)**
Loans and advances held for sale (note 14)	**3,714**

The table below presents the analysis of business lending credit quality of loans and advances for assets held for sale that are neither past due nor impaired:

	Group 2012 £m
Senior investment grade	**25**
Investment grade	**622**
Sub-investment grade	**2,448**
	3,095

The distribution of loans and advances held for sale that are past due but not impaired are analysed below:

	Group 2012 £m
1 to 29 days past due	**83**
30 to 59 days past due	**12**
60 to 89 days past due	**1**
Past due over 90 days	**144**
	240

24. Assets held for sale (continued)

The value of undrawn formal standby facilities, credit lines and other commitments to lend at call in respect of assets held for sale is disclosed in note 33.

25. Due to other banks

Group	2012 £m	2011 £m
Transaction balances with other banks	**9**	8
Securities sold under agreements to repurchase	**78**	510
Deposits from other banks	**470**	989
	557	1,507

26. Due to customers

Group	2012 £m	2011 £m
Non interest bearing demand deposits	**1,637**	1,370
Interest bearing demand deposits	**16,141**	16,816
Term deposits	**7,979**	6,586
Other wholesale deposits	**624**	3,398
	26,381	28,170

The £2,774m movement in other wholesale deposits was driven by wholesale counterparty action in response to the reduction in the Group's credit rating. This was partially offset by an increase in term deposit flows.

27. Provisions

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Payment Protection Insurance redress provision				
Opening balance	**102**	15	**-**	-
Charge to the income statement	**120**	116	**-**	-
Provision utilised	**(114)**	(29)	**-**	-
Closing balance	**108**	102	**-**	-
Customer redress and other provisions				
Opening balance	**9**	14	**2**	-
Charge to the income statement	**57**	3	**-**	-
Provision utilised	**(8)**	(8)	**(2)**	-
Provisions transferred	**-**	-	**-**	2
Closing balance	**58**	9	**-**	2
Restructuring provision				
Opening balance	-	-	**-**	
Charge to the income statement	**149**	-	**-**	-
Provision utilised	**(23)**	-	**-**	-
Closing balance	**126**	-	**-**	-
Total provisions	**292**	111	**-**	2

27. Provisions (continued)

Payment Protection Insurance redress

As at 30 September 2012, the Group is carrying a provision of £108m (2011: £102m) to cover potential customer claims for refunds of premiums associated to the alleged mis-selling of Payment Protection Insurance (PPI) policies. The provision is based upon known pipeline cases and expectations of future claims. It is management's current best estimate of expected costs. During the year to 30 September 2012, the provision was increased by an additional £120m. This reflected a marked increase in the level of complaints received and the impact on the estimate for future complaints that may ultimately be received.

The provision reflects an assessment of future PPI claims based upon estimates; statistical analysis and assumptions in relation to a wide range of uncertain factors, including how many PPI claims will be made against Clydesdale Bank PLC, for what value, and the prospect of the mis-selling being established in relation to those claims. The final amount required to settle the potential liability is therefore uncertain.

Provision for customer redress and other provisions

A provision for customer redress is held in those instances where the Group has agreed to make payments to customers whether on an ex-gratia or compensatory basis. Provisions can arise as result of legal or regulatory action and incorporate the costs of skilled persons, and where appropriate other elements of administration.

Other provisions include provisions in respect of legal proceedings and claims arising in the ordinary course of the Group's business. None of these are deemed to be individually material in relation to the Group's operations.

On 29 June 2012, the FSA announced that it had reached agreement with a number of UK Banks in relation to a review and redress exercise on certain interest rate hedging products that were offered to small and medium sized entities.

The Group agreed to participate in this exercise as announced by the FSA on 23 July 2012 and has embarked on a structured programme to identify those small and medium sized customers that may have been affected. The exercise voluntarily incorporates certain of the Group's tailored business loan products as well as the stand alone hedging products identified in the FSA's notice.

The total cost of this exercise is uncertain and subject to a number of estimates, many of which require agreement with the FSA.

A provision of £48m for customer redress including the interest rate hedging review has been raised and reflects management's best estimate of this and a number of other ongoing matters as at 30 September 2012.

Restructuring provision

Following the UK Banking strategic review announced on 30 April 2012 a further restructuring provision of £139m was raised. The provision covers redundancy payments, lease break fees, surplus space costs and associated enablement costs. The provision is expected to be utilised by September 2015. As part of the restructure the majority of the commercial real estate (CRE) assets of the Group transferred to NAB on 5 October 2012. The transferred portfolio will be placed into run-off and will be managed separately by NAB. The restructure reflects the Group's reduced risk appetite and will improve the return and cost profile of the ongoing business by simplifying the business model to focus on retail operations and SME business lending in Scotland and northern England.

28. Bonds, notes and subordinated debt

Group	2012 £m	2011 £m
Medium term notes	**-**	1,898
Subordinated medium term notes	**-**	200
Residential mortgage backed securities	**2,094**	1,439
Covered bonds	**1,096**	-
Total bonds, notes and subordinated debt	**3,190**	3,537
Fair value hedge adjustments	**(27)**	16
	3,163	3,553

On 11 November 2011, £500m of medium term notes matured, a further £750m matured on 9 December 2011 and the remaining £648m matured on 30 May 2012. On 30 March 2012, the callable subordinated debt of £200m was redeemed.

On 28 February 2012, €615m of residential mortgage backed securities were issued via Lanark 2012-1. On 27 July 2012, $800m and £525m of residential mortgage backed securities were issued via Lanark 2012-2. On 31 May 2012, £1,100m of covered bonds were issued via the Clydesdale Regulated Covered Bond structure.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC as at 30 September 2012 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate %	Maturity date
Class A residential mortgage backed securities				
6 August 2007	GBP	**590**	0.85%	22-May-13
28 February 2012	EUR	**490**	3.35%	22-May-15
27 July 2012	USD	**489**	2.19%	22-Feb-16
27 July 2012	GBP	**525**	2.33%	22-Nov-17
		2,094		
31 May 2012	GBP	**696**	4.63%	08-Jun-26
31 May 2012	GBP	**400**	2.69%	08-Jun-15
		1,096		
		3,190		

29. Retirement benefit obligations

The Group is the sponsoring employer of one funded defined benefit scheme, the Yorkshire and Clydesdale Bank Pension Scheme ("the Scheme"). The Scheme is a fully sectionalised arrangement, put in place in 2009, where the discrete assets and liabilities of the two sections (Clydesdale and Yorkshire) are independently calculated in accordance with the previously existing scheme structures. The assets of the Scheme are held in trustee administered funds.

	2012 £m	2011 £m
Defined benefit assets	**2,485**	2,076
Defined benefit obligations	**(2,786)**	(2,256)
Net defined benefit pension scheme obligations	**(301)**	(180)
Post-retirement medical benefits obligations	**(5)**	(5)
Net retirement benefits obligations	**(306)**	(185)

The Group has implemented a number of reforms to the Scheme to control the liability. It closed the Scheme to new members in 2004 and has determined benefits accruing after April 2006 on a career average revalued earnings basis. The principal pension available to new employees since the closure of the Scheme is the defined contribution scheme, ("Total Pension"). The pension charge for the year in relation to Total Pension is shown in note 6.

29. Retirement benefit obligations (continued)

The Group implemented additional reforms to the Scheme which were effective from April 2012. These included changing the inflation index used to determine benefit increases from the Retail Price Index (RPI) to the Consumer Price Index (CPI) for future accrual and introducing members' contributions into the Scheme, increasing annually over a three year period. As an alternative to contributions, employees have the option of reducing their future annual rate of accrual from 1/60th of salary to 1/80th.

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.4m (2011: £0.4m) and would have no material impact upon service costs and interest costs.

Reconciliation of the defined benefit pension scheme assets	**2012 £m**	2011 £m
Opening fair value of defined benefit pension scheme assets	**2,076**	2,011
Actual return on scheme assets	**248**	33
Employer contributions	**242**	107
Benefits paid	**(81)**	(75)
Closing fair value of defined benefit pension scheme assets	**2,485**	2,076

Reconciliation of the defined benefit pension scheme obligations	**2012 £m**	2011 £m
Opening defined benefit pension scheme obligations	**(2,256)**	(2,323)
Interest cost	**(120)**	(117)
Current service cost	**(33)**	(36)
Benefits paid	**81**	75
Actuarial loss/(gain)	**(456)**	146
Past service cost	**(2)**	(1)
Closing defined benefit pension scheme obligations	**(2,786)**	(2,256)

Employer contributions include a contribution of £130m from NAB. This payment was negotiated with the Scheme Trustees and formed part of a series of actions by NAB which resulted in its withdrawal as a participating employer in the Scheme during January 2012. The withdrawal as a participating employer did not materially impact the liabilities as measured under IAS 19, and the contribution therefore improved the overall Scheme funding position. Consequently, the £130m contribution by NAB is recognised within the Group's income statement for the year ended 30 September 2012.

The major categories of plan assets for the Scheme, stated at fair value, are as follows:

	2012 £m	2011 £m
Equities	**990**	1,023
Government bonds	**557**	480
Global Sovereign Bonds	**105**	-
Corporate Bonds	**709**	457
Property	**99**	102
Cash	**25**	14
Fair value of defined benefit pension scheme assets	**2,485**	2,076

The Scheme is not invested in any of the Group's own financial instruments. The Scheme assets include certain property investments leased by the Group. These investments are within the 5% self-investment limit. The fair value of plan assets includes land and buildings occupied by the Group with a fair value of £25m (2011: £26m) for the Group and £Nil (2011: £Nil) for the Company.

29. Retirement benefit obligations (continued)

Amounts recognised in the income statement	**2012** **£m**	2011 £m
Current service cost	**33**	36
Past service cost	**2**	1
Interest cost	**120**	117
Expected return on scheme assets	**(135)**	(130)
Defined benefit pension expense for the year (note 6)	**20**	24

Amounts recognised in the statement of comprehensive income	**2012** **£m**	2011 £m
Opening cumulative actuarial losses	**(351)**	(400)
Experience gains/(losses) on scheme assets	**113**	(97)
Experience gains/(losses) on scheme liabilities	**(41)**	(16)
Changes in actuarial assumptions	**(416)**	162
Cumulative actuarial losses recognised in the statement of comprehensive income	**(695)**	(351)

Actuarial assumptions	**2012** **% p.a.**	2011 %p.a.
Inflation	**2.50**	3.05
Rate of increase for pensions in payment:		
Pre 5 April 1997 benefits (Clydesdale Bank section)	**2.25**	2.25
Pre 5 April 1997 benefits (Yorkshire Bank section)	**2.40**	2.95
5 April 1997 to April 2006 benefits (both sections)	**2.40**	2.95
Post April 2006 benefits (both sections)	**2.25**	2.25
Rate of increase for pensions in deferment[1]	**2.00**	2.05
Discount rate	**4.30**	5.40
Expected rate of return on plan assets		
Equities	**7.40**	7.90
Government bonds	**3.00**	3.55
Global Sovereign Bonds	**3.40**	-
Corporate bonds	**3.95**	4.95
Property	**6.40**	6.85
Cash	**3.00**	3.55
Post retirement mortality:	**years**	years
Current pensioners at 60 – male	**27.9**	26.4
Current pensioners at 60 – female	**28.4**	28.2
Future pensioners at 60 – male	**29.4**	28.0
Future pensioners at 60 – female	**29.9**	29.7

[1] The assumption for the rate of increase for pensions in deferment has been linked to the Consumer Price Index from 30 September 2010, following a government announcement on 8 July 2010 relating to increases in pensions that are not specifically linked to the Retail Prices Index.

29. Retirement benefit obligations (continued)

The expected return on assets assumption has been determined by considering the assets expected to be held over the following year and the expected returns for each asset class.

History of experience gains and (losses)	**2012 £m**	2011 £m	2010 £m	2009 £m	2008 £m
On scheme assets	**113**	(97)	46	(112)	(319)
On scheme liabilities	**(41)**	(16)	45	(2)	4
Changes in actuarial assumptions	**(416)**	162	(158)	(477)	320
	(344)	49	(67)	(591)	5

History of net defined benefit pension scheme obligation	**2012 £m**	2011 £m	2010 £m	2009 £m	2008 £m
Defined benefit assets	**2,485**	2,076	2,011	1,828	1,842
Defined benefit obligation	**(2,786)**	(2,256)	(2,323)	(2,138)	(1,593)
Net (obligation)/asset	**(301)**	(180)	(312)	(310)	249

30. Other liabilities

Group	**2012 £m**	2011 £m
Accruals and deferred income	**83**	66
Notes in circulation	**1,567**	1,335
Accrued interest payable	**362**	450
Other liabilities	**149**	163
	2,161	2,014

31. Called up share capital

Allotted, called up and fully paid	**2012 £**	2011 £
Ordinary shares of £1 each		
At 1 October	**1,082,012,500**	982,012,500
Issued during the year	**500,000,000**	100,000,000
At 30 September	**1,582,012,500**	1,082,012,500
Non-voting income shares of £1 – non-equity		
At 1 October and 30 September	**1**	1
Preference shares of £1 each		
Opening preference share capital	**100,000,000**	100,000,000
Issued during the year	**-**	-
Closing preference share capital	**100,000,000**	100,000,000
Closing called up share capital	**1,682,012,501**	1,182,012,501

During the year, 500,000,000 ordinary shares of £1 each were issued at par, resulting in an increase of £500,000,000 of the allotted, called up and fully paid share capital.

31. Called up share capital (continued)

The preference shares in issue have all been classified as equity instruments. The preference shares issued on 17 December 2008 entitle the holder to a discretionary fixed non-cumulative dividend of 12% per annum payable every six months on the capital paid up thereon.

The dividends payable on the preference shares are at the Group's discretion based on a number of factors. The preference shares are redeemable, in whole only, at the option of the Bank on the first business day following the fifth anniversary of the date of issue. No such redemption may be made without the consent of the FSA.

32. Total equity

	Group		Company	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Share capital	**1,682**	1,182	**1,682**	1,182
Share premium account	**893**	893	**893**	893
Total share capital and share premium	**2,575**	2,075	**2,575**	2,075
Share option reserve	**5**	14	**-**	-
Asset revaluation reserve	**1**	2	**-**	-
Available for sale investments reserve	**12**	14	**-**	-
Cash flow hedge reserve	**124**	120	**-**	-
Total other reserves	**142**	150	**-**	-
Retained earnings	**(298)**	632	**(315)**	882
Total parent entity interest	**2,419**	2,857	**2,260**	2,957
Non-controlling interest	**200**	200	**-**	-
Total equity	**2,619**	3,057	**2,260**	2,957

Share option reserve

The Group's share option reserve represents the outstanding fair value amount in respect of share based payment expense recharged by its ultimate parent that has been charged through the income statement and adjusted for deferred tax.

Asset revaluation reserve

The asset revaluation reserve includes the gross revaluation increments and decrements arising from the revaluation of land and buildings.

Available for sale investments reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale investments.

Cash flow hedge reserve

The cash flow hedge reserve records fair value revaluations of derivatives designated as cash flow hedging instruments to the extent that they are effective.

32. Total equity (continued)

Non-controlling interests

On 15 December 2010, NAGE subscribed for £200m of preference shares issued by Clydesdale Bank PLC. NAGE funded the acquisition by restructuring its subordinated loans debt. As part of the restructure £200m was invested into the UK operations by National HK Investments Limited ("NHKI"), a Hong Kong incorporated holding company, indirectly owned by NAB. The NHKI investment was by way of a capital contribution to a limited partnership controlled by NAGE. The investment is shown as an equity interest attributable to a non-controlling party.

33. Contingent liabilities and commitments

The table below sets out the contractual amounts of contingent liabilities and commitments. Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts do not represent the amounts at risk at the balance sheet date but the amounts that would be at risk should the contracts be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

Group

	2012	2011
Contingent liabilities	**£m**	£m
Guarantees and assets pledged as collateral security:		
At call	**1**	-
Due in less than 3 months	**57**	40
Due between 3 months and 1 year	**44**	46
Due between 1 year and 3 years	**70**	65
Due between 3 years and 5 years	**4**	10
Due after 5 years	**102**	109
No specified maturity	**8**	15
	286	285
Other commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**9,290**	10,568
Not included in the above:		
Undrawn formal standby facilities, credit lines and other commitments to lend at call in respect of assets held for sale (note 24)	**140**	-

The Company has issued a letter of support to the value of £10m (2011: £10m) in respect of one of its subsidiaries.

Capital commitments

The Group and Company had future capital expenditure which had been contracted for but not provided for in the Financial Statements at 30 September 2012 of £5.7m (2011: £5m).

33. Contingent liabilities and commitments (continued)

Operating lease commitments

Group

	2012 £m	2011 £m
Leases as lessor		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	**2**	3
between 1 year and 5 years	**5**	9
over 5 years	**6**	8
	13	20
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	**35**	35
between 1 year and 5 years	**112**	116
over 5 years	**224**	213
	371	364

Other contingent liabilities

The Group is named in and is defending a number of legal claims arising in the ordinary course of business. The current provision is deemed to be adequate based on the known facts and circumstances of each case.

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme (FSCS) provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. The principal borrowings are anticipated to be repaid from the realisation of the assets of the institutions. The FSCS has estimated levies due to 31 March 2013 and an accrued expense of £8m (2011: £4m) is presently held for the Group's calculated liability to this date. If the assets of the failed institutions are insufficient to repay the government loan, additional levies will become payable in future periods.

National Australia Group Europe Limited

Notes to the consolidated financial statements (continued)

34. Notes to the statements of cash flows

	Group		Company	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Adjustments included in the (loss)/profit before tax				
Interest receivable	**(1,461)**	(1,425)	**(15)**	(14)
Interest payable	**592**	442	**78**	66
Depreciation and amortisation (note 6)	**75**	70	-	-
Profit on sale of land and buildings	**(10)**	(2)	-	-
Loss on revaluation of land and buildings	**10**	-	-	-
Transfer from available for sale reserve	**(4)**	(5)	-	-
Transfer from cash flow hedge reserve	**(1)**	4	-	-
Loss on sale of AFS investments	**3**	-	**-**	-
Derivative financial instruments fair value movements	**(9)**	30	-	-
Impairment losses on credit exposures (note 15)	**737**	297	-	-
Impairment losses on goodwill (note 6)	**141**	-	-	-
Impairment losses on software (note 6)	**36**	-	**-**	-
Dividends received from subsidiaries	**-**	-	**(60)**	(75)
Adjustment to carrying value of investments	-	(1)	**1,181**	-
Movement in share option reserve	**(9)**	15	-	-
	100	(575)	**1,184**	(23)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	**(2)**	1	**-**	-
Due from other banks	**(2)**	(1)	**-**	-
Derivative financial instruments	**429**	153	**-**	-
Financial assets at fair value through profit or loss	**2,055**	46	**-**	-
Loans and advances to customers	**3,155**	(1,554)	**-**	-
Due from customers on acceptances	**-**	1	**-**	-
Other assets	**47**	51	**-**	-
Assets held for sale (note 24)	**(5,225)**	-	**-**	-
	457	(1,303)	**-**	-
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	**(783)**	148	**-**	-
Derivative financial instruments	**21**	(36)	**-**	-
Financial liabilities at fair value through profit or loss	**(8)**	109	**-**	-
Due to customers	**(1,789)**	(264)	**-**	-
Liabilities on acceptances	**-**	(1)	**-**	-
Provisions (note 27)	**181**	82	**(2)**	2
Defined benefit pension obligations	**(223)**	(82)	**-**	-
Other liabilities	**274**	84	**-**	-
Liabilities associated with assets held for sale (note 24)	**142**	-	**-**	-
	(2,185)	40	**(2)**	2

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group		Company	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Cash and balances with central banks (note 9)	**7,896**	6,023	**3**	35
Other assets	**153**	152	**-**	-
Due to other banks	**(9)**	(174)	**-**	-
Due to related entities	**(13)**	(12)	**-**	-
Other liabilities	**(74)**	(115)	**-**	-
	7,953	5,874	**3**	35

35. Employees

The average number of full time equivalent employees of the Group during the year was made up as follows:

	2012 Number	2011 Number
Managers	**2,588**	2,713
Clerical staff	**5,078**	5,415
	7,666	8,128

36. Equity based compensation

Share incentive plans, share offers, performance options and performance rights in NAB are used to provide short-term and long-term incentives to employees. These incentives are an integral part of the Group's remuneration strategy in rewarding employees' current and future contribution to the Group's performance.

The plans described below involve the provision of shares in NAB to employees of the Group and to Directors of the Company, and performance options and performance rights to senior employees of the Group. The Group reimburses NAB for the cost of these shares and the value of the performance options and performance rights.

Short term incentive (STI)

The STI plan has an element of deferral to provide an appropriate level of reward aligned with sound risk management principles. STI deferral encourages longer term sustainable decision making and assurance of individual and business performance. Deferral applies to all levels of performance across the organisation. Deferral is in the form of NAB shares, restricted for at least one year. The deferred equity is subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet Compliance Gateway requirements. A reduction or forfeiture of deferred amounts can also be determined by the Principal Board, at its absolute discretion. Such a determination may be made in relation to the NAB Group, a business unit, executive committee, role or individual.

Recognition shares

These shares enable retention and recognition awards to be provided in the form of shares, rather than in cash. Such awards are made on a very limited basis with NAB Group executive general manager approval, to individuals in significant key roles where retention is critical over a medium-term timeframe (two to three years). Awards under the programme may also be provided to individuals accepting significant project leadership or additional responsibilities for a limited period of time with no related increase in their fixed remuneration. The provision of shares under this plan is desired over the use of cash payments, as it provides a stronger retention and shareholder value link to the reward. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, or retirement or failure to meet Compliance Gateway requirements. The minimum restriction period is until the final key date or milestone has been achieved.

Commencement shares

These shares enable 'buyout' of evidenced equity from previous employment for significant new hires. Shares are provided under this programme or commencement performance options and performance rights if more appropriate. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet Compliance Gateway requirements.

UK National Share Incentive Plan

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year through the National Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

36. Equity based compensation (continued)

General employee shares

Up to a target value of A$1,000 of NAB shares are offered to each eligible employee when the NAB Group's performance is on target, measured against a scorecard of objectives for the financial year. These shares are held in trust restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Long term incentives (LTI)

LTIs help to drive management decisions focussed on the long-term prosperity of NAB Group through the use of challenging performance hurdles. The Executive LTI programme is awarded to senior executives across the NAB Group and is provided wholly as performance rights. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. External and/or internal performance hurdles are measured at the end of a three year restriction period and during the restriction period an executive will forfeit their performance rights for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

Performance options and performance rights

These are used to provide long-term incentives in recognition of executive potential and talent in the Group. Performance rights are also being used for STI and LTI.

A variety of performance measures are used for different grants of long-term incentives (taking the form of shares, performance options, or performance rights) including Total Shareholder Return (TSR) compared against peer companies, and regional or NAB Group ROE and cash earnings. The measures used depend on the level and impact of the participant's role, the business or region in which they work, and the relevant programme. Vesting generally occurs to the extent that the relevant performance hurdle is satisfied (as determined by the NAB Board Remuneration Committee). The performance options and performance rights generally have an expiry date between three and eight years from the effective date if unexercised.

Each performance option or performance right is exchanged for one fully paid ordinary share in NAB upon exercise, subject to standard adjustments for capital actions. The exercise price for performance options is generally the market price for NAB's fully paid ordinary shares as at the date the performance option was granted or such other relevant date determined by the NAB Board Remuneration Committee. No exercise price is payable by the holder on exercise of performance rights.

Performance options are predominantly offered only to key senior executives of the Group and generally lapse after a specified number of days after cessation of employment as determined by the NAB Board.

The movement in share options and performance rights granted and exercised during the year was as follows:

Share options	**2012**		2011	
	Number	**Weighted average exercise price A$**	Number	Weighted average exercise price A$
Outstanding at 1 October	**3,432,798**	**36.65**	5,135,858	35.41
Forfeited and expired during the year	**(3,095,354)**	**37.92**	(1,703,060)	32.89
Exercised during the year	**(58,498)**	**19.89**	-	-
Outstanding at 30 September	**278,946**	**26.12**	3,432,798	36.65
Exercisable at 30 September	**65,343**		2,388,925	

36. Equity based compensation (continued)

For share options outstanding at 30 September 2012, the weighted average remaining contractual life is 1.27 years (2011: 0.87 years). The range of exercise prices for options outstanding at the end of the year was A$19.89 – A$31.70 (2011: A$19.89 - A$43.43).

Performance rights	2012 Number	2011 Number
Outstanding at 1 October	**745,984**	1,271,959
Forfeited and expired during the year	**(717,699)**	(508,629)
Granted during the year	**145,729**	-
Exercised during the year	**(28,285)**	(17,346)
Outstanding at 30 September	**145,729**	745,984
Exercisable at 30 September	-	561,257

For share rights outstanding at 30 September 2012, the weighted average remaining contractual life is 3.21 years (2011: 0.70 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

A fair value of goods or services to the value of £1.4m was measured indirectly by reference to the fair value on the performance rights granted during the year (2011: £Nil).

37. Directors' emoluments

2012 £'000			**Performance related pay**				
			Short term incentive schemes (4)			**Long term incentive schemes(7)**	
	Salary and fees (1)	**Benefits and allowances (3)**	**Annual (cash)**	**Deferred (shares)**	**Total short term (PRP)**	**Shares**	**Total emoluments**
Executive Directors							
Cameron Clyne (5) (6)	-	-	-	-	-	-	-
John Hooper	703	214	-	-	-	1	918
Mark Joiner (5) (6)	-	-	-	-	-	-	-
Richard Sawers (5) (6)	-	-	-	-	-	-	-
David Thorburn	400	109	-	-	-	1	510
Total Executive	**1,103**	**323**	**-**	**-**	**-**	**2**	**1,428**
Non-Executive Directors							
David Allvey (5)	25	-	-	-	-	-	25
David Browne (5)	25	-	-	-	-	-	25
Jonathan Dawson (5)	50	-	-	-	-	-	50
Sir David Fell (5)	85	-	-	-	-	-	85
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson (5)	69	-	-	-	-	-	69
Elizabeth Padmore (5)	55	-	-	-	-	-	55
James Pettigrew (5)	-	-	-	-	-	-	-
Barbara Ridpath (5)	25	-	-	-	-	-	25
Alexander Shapland (5)	25	-	-	-	-	-	25
Sir Malcolm Williamson (2) (5)	156	-	-	-	-	-	105
Peter Wood (5)	4	-	-	-	-	-	4
Total Non-Executive	**612**	**-**	**-**	**-**	**-**	**-**	**612**
	1,715	**323**	**-**	**-**	**-**	**2**	**2,040**

2011 £'000			Performance related pay				
			Short term incentive schemes (4)			Long term incentive schemes(7)	
	Salary and fees (1)	Benefits and allowances (3)	Annual (cash)	Deferred (shares)	Total short term (PRP)	Shares	Total emoluments
Executive Directors							
Cameron Clyne	-	-	-	-	-	-	-
John Hooper	627	144	103	412	515	194	1,480
Lynne Peacock	854	197	459	-	459	-	1,510
David Thorburn	389	113	64	256	320	341	1,163
Total Executive	1,870	454	626	668	1,294	535	4,153
Non-Executive Directors							
Jonathan Dawson	75	-	-	-	-	-	75
Sir David Fell	78	-	-	-	-	-	78
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson	75	-	-	-	-	-	75
Elizabeth Padmore	60	-	-	-	-	-	60
Sir Malcolm Williamson	140	-	-	-	-	-	140
Peter Wood	68	-	-	-	-	-	68
Total Non-Executive	589	-	-	-	-	-	589
Total Directors	2,459	454	626	668	1,294	535	4,742

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for Directors amounting to £430,000 (2011: £777,000) and in respect of emoluments for the Highest Paid Director of £178,000 (2011: £383,000).

37. Directors' emoluments (continued)

Notes

(1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors.

(2) Sir Malcolm Williamson's Directorship fees exclude NAB Board and Risk Committee fees of AUD $171,627 (2011: AUD $250,000).

(3) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to one Director (2011: One) under a defined benefit pension plan. Pension contributions amounting to £18,000 (2011: £38,000) were paid during the year of which contributions for the highest paid Director amounts to £Nil (2011: £Nil).

(4) Performance related pay relates to the respective financial year. The cash element will be paid in the forthcoming year and the deferred amount represents shares deferred for one and two years. The Remuneration Report disclosed in the NAB Annual Financial Report details the actual remuneration received in the year, for certain of the Directors, including cash paid and the value of equity that vested and lapsed without providing any value. The highest paid Director received 165,132 shares (2011: 127,394) that vested during the year, with a fair value of £960,372 (2011: £1,408,870). Certain historical awards (deferred STI) have been forfeited during the year ended 30 September 2012.

(5) Mark Joiner and Richard Sawers were appointed as Executive Directors of the Company on 14 June 2012. Peter Wood, retired as a Non-executive Director of the Company on 21 October 2011. Elizabeth Padmore, Jonathan Dawson and Roy Nicolson retired as Non-executive Directors of the Company on 31 May 2012 and Sir David Fell retired on 23 July 2012. David Browne, Barbara Ridpath, David Allvey, Alexander Shapland and James Pettigrew were appointed as Non-executive Directors of the Company on 2 May 2012, 9 May 2012, 18 May 2012, 23 May 2012 and 25 September 2012 respectively. Sir Malcolm Williamson retired as Chairman and Non-executive Director on 23 July 2012 and Cameron Clyne was appointed as Executive Chairman on Sir Malcolm Williamson's retirement.

(6) Cameron Clyne, Mark Joiner and Richard Sawers are remunerated as employees of NAB, and do not receive incremental remuneration in respect of their duties as Directors of the Company. The Directors believe it would be appropriate to apportion A$510,000 of their remuneration as being in respect of their duties to the Company.

(7) The long term incentive scheme amounts principally represent share options, performance rights and deferred shares for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. Typically, the performance period is three years. The value attributed is the fair value of the shares at the date of granting. No Directors (2011: Two) received benefits under an executive long term incentive scheme. One Director exercised share options during the year (2011: Nil). In 2012, the amounts disclosed relate solely to the general employee shares described in note 36.

(8) The table below shows, for the highest paid Director in the given year, the number of shares in respect of share options, performance rights, short term incentive, long term incentive and other employee share plans (including free shares, commencement shares, recognition shares).

2012 Number	**Share options**	**Share rights**	**Short term incentive shares**	**Long term incentive shares**	**Other employee share plans**
Outstanding at 1 October 2011	**430,238**	**28,390**	**48,091**	**60,155**	**26,348**
Granted during the year	**-**	**21,146**	**19,636**	**-**	**3,182**
Forfeited during the year	**-**	**-**	**(12,714)**	**-**	**-**
Exercised during the year	**(48,022)**	**(8,760)**	**-**	**-**	**-**
Expired during the year	**(136,500)**	**(19,630)**	**-**	**-**	**-**
Restrictions ceased	**-**	**-**	**(37,211)**	**(30,365)**	**(21,311)**
Net (obligation)/asset	**245,716**	**21,146**	**17,802**	**29,790**	**8,219**

2011 Number	Share options	Share rights	Short term incentive shares	Long term incentive shares	Other employee share plans
Outstanding at 1 October 2010	838,209	119,055	57,451	101,733	125,377
Granted during the year	-	-	12,322	42,177	46
Forfeited during the year	(181,769)	(45,442)	-	(28,705)	-
Exercised during the year	-	(6,982)	(25,000)	-	(25,000)
Expired during the year	(50,000)	(12,500)	-	-	-
Restrictions ceased	-	-	(32,451)	(27,298)	(100,377)
Net (obligation)/asset	606,440	54,131	12,322	87,947	46

38. Fair value of financial instruments

Financial instruments include both financial assets and financial liabilities and also derivatives. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. For the purposes of this note, carrying value refers to amounts reflected in the Consolidated Balance Sheet.

Group		**2012**		2011	
	Footnote	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m As restated
Financial assets					
Cash and balances with central banks	(a)	**7,927**	**7,927**	6,052	6,052
Due from related entities	(b)	**1,256**	**1,256**	4,952	4,953
Due from other banks	(c)	**14**	**14**	12	12
Investments – available for sale	(d)	**1,039**	**1,039**	1,117	1,117
Other financial assets at fair value	(e)	**2,791**	**2,791**	4,846	4,846
Derivative financial assets	(f)	**600**	**600**	1,018	1,018
Loans and advances to customers	(g)	**24,346**	**24,420**	28,238	28,343
Due from customers on acceptances	(a)	**7**	**7**	7	7
Other assets	(h)	**232**	**232**	380	380
Assets held for sale	(i)	**5,225**	**5,225**	-	-
Financial liabilities					
Due to other banks*	(g)	**557**	**557**	1,507	1,514
Other financial liabilities at fair value	(e)	**147**	**147**	155	155
Derivative financial liabilities	(f)	**952**	**952**	931	931
Due to customers*	(g)	**26,381**	**26,460**	28,170	28,200
Liabilities on acceptances	(a)	**7**	**7**	7	7
Due to related entities	(b)	**7,716**	**7,716**	7,962	7,962
Bonds, notes and subordinated debt*	(g)	**3,163**	**3,164**	3,553	3,562
Other liabilities	(j)	**1,929**	**1,929**	1,785	1,785
Liabilities associated with assets held for sale	(i)	**142**	**142**	-	-

The fair value estimates are based on the following methodologies and assumptions:

(a) The carrying amounts of these financial assets and financial liabilities approximate fair value.

(b) The carrying value of amounts due from and due to related entities is considered to approximate fair value. Amounts due from related entities are repayable on demand or within twelve months. Amounts due to related entities are repayable up to five years and over but are materially repriced every 3-6 months relative to market rates. As a result, the carrying value approximates the fair value.

(c) The carrying value of amounts due from other banks is net of allowances for impairment losses and unearned income. The fair value of amounts due from other banks equates to the carrying value at 30 September 2012.

(d) The fair values of investments are based on quoted closing market prices. Where investments are unlisted and quoted market prices are not available, the Group obtains fair value by means of other valuation techniques that are commonly used by market participants.

(e) The fair value of assets and liabilities designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based upon observable market data as appropriate to the nature and type of the underlying instrument. Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as derivative financial instruments (note 12).

(f) The fair value of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from quoted closing market prices as at the balance sheet date, discounted cash flow models or option pricing models as appropriate.

(g) The fair value of these financial assets and financial liabilities are obtained from discounted cash flow models.

(h) Other assets include accrued interest receivable and other short term receivables whose carrying values approximate fair value.

* The prior year comparative figures have been restated to conform to current year presentation.

38. Fair value of financial instruments (continued)

(i) The fair value of assets held for sale and associated liabilities is estimated in accordance with the methodologies and assumptions applied to the classifications that were applicable for the underlying assets before classification as held for sale. The breakdown of the assets held for sale and associated liabilities is shown in note 24. The assets were transferred on 5 October 2012.

(j) Other liabilities include accrued interest payable and notes in circulation whose carrying values approximate fair value.

Fair value hierarchy

For financial instruments carried at fair value on the balance sheet the fair value measurement is in accordance with the following hierarchy as defined by IFRS 7:

- Level 1: Financial instruments with quoted prices for identical instruments in active markets;
- Level 2: Financial instruments with quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable; and
- Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The classification of assets and liabilities into the fair value hierarchy is outlined for each class of financial instrument within the relevant notes for those assets and liabilities.

Level 3 movements analysis

	Group		
	Investments – available for sale £m	**Other financial assets at fair value £m**	**Other financial liabilities at fair value £m**
At 1 October 2010	6	-	-
Gains/(losses) recorded in equity	1	-	-
At 30 September 2011	**7**	**-**	**-**
Gains/(losses) recorded in the income statement	1	-	-
Gains/(losses) recorded in equity	(1)	-	-
Purchases	-	-	-
Sales	-	-	-
Settlements	-	-	-
Transfers into level 3 from level 2	-	4,266	147
At 30 September 2012	**7**	**4,266**	**147**

Other financial assets at fair value incorporate a suite of loan products which were removed from sale with effect from 30 April 2012. Alternative products are now offered for future advances and these are accounted for within Loans and Advances to Customers. The removal from sale added uncertainty to the level of early repayments within the residual portfolio and led to a reduction in the level of observable inputs. This resulted in the loans being reclassified from level 2 to level 3 at 30 September 2012. The balance includes £1,475m classified as assets held for sale.

A sensitivity analysis of the valuation of the level 3 other financial assets at fair value is included in note 3. Reasonable changes in the assumptions used in valuing the level 3 available for sale investments would not result in material changes in the valuation.

39. Financial risk management

Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates for various periods, and seeks to earn interest margins by investing these funds in high-quality assets. The Group seeks to improve these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

Fair value hedges

The Group hedges part of its existing interest rate and foreign currency risk from any decrease in the fair value of fixed rate assets or increase in fair value of fixed rate liabilities using interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 13. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate risk arising from variable interest rate assets and liabilities using interest rate swaps, forward rate agreements and futures contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives entered into is disclosed in note 13.

Credit risk

Credit risk is inherent within any transaction that creates an actual or potential obligation for a borrower to pay the Group. Credit risk is the risk that a borrower will fail to meet its obligations to the Group in accordance with agreed terms.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees where appropriate.

Derivatives

The Group maintains control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Credit-related commitments

Credit-related commitments are facilities where the Group is under a legal obligation to extend credit unless some event occurs, which gives the Group the right, in terms of the commitment letter of offer or other documentation, to withdraw or suspend the facilities. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry similar credit risk to loans.

39. Financial risk management (continued)

Credit risk (continued)

Credit-related commitments

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss of an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Forbearance

Forbearance primarily refers to the support options granted by the Group to its retail home loan and commercial customers when they experience financial difficulty or distress. The Group utilises a number of potential impairment indicators ("PII") to try and identify those customers in need of assistance including forbearance at the earliest possible opportunity. These PIIs and the data that underpins them are under continuous development and refinement to ensure they continue to capture and reflect the current customer behaviours and market conditions.

Forbearance is considered to take place where the Group grants a concession to provide a customer with more affordable terms and conditions than those originally contracted for. It is a consequence of concerns about the customer's ability to meet the contracted repayments when due and specifically relates to such instances where the changes to the arrangement have been made on terms that the Group would not ordinarily consider on a commercial basis.

The Group is committed to ensuring that any forbearance strategy implemented is on sustainable terms to the customer with the ultimate aim of minimising the risk of losses for the Group and its customers.

The Group exercises forbearance in two distinct areas: retail and non-retail.

Retail forbearance

The Group considers providing forbearance to its retail (primarily mortgage) customers when they have been identified as experiencing financial difficulties or distress. The Group makes every effort to follow its principles of treating customers fairly by working with customers in times of distress in order to find a solution that enables the Group to continue its relationship with the customer but with the ultimate aim of minimising the risk of the customer losing their home where this is in the interest of the customer.

Forbearance is exercised on retail customers in a number of different ways and is specific to the individual customer and their circumstances with the primary aim of ensuring that a sustainable solution can be found. These sustainable solutions can take a variety of forms and customers can be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action.

The principal forbearance facilities operated by the Group are:

- Formal arrangements: this includes arrangements with the customer to repay any arrears over a shorter period than capitalisation would involve, or may include the capitalisation of arrears, which are added to the remaining capital balance of the loan to be repaid over the remaining term.
- Short-term or temporary measures: these allow for a period of relief for customers to facilitate their anticipated return to the previous terms or completion of the sale of the property which would lead to a full recovery by the Group. This will usually take the form of agreeing with the customer to either temporarily suspend or reduce their monthly payments to less than they would have been on a fully commercial basis.
- Conversion to interest only repayments: this allows the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term through the sale of the property or by some other repayment vehicle.

39. Financial risk management (continued)

Credit risk (continued)

Retail forbearance (continued)

- Extensions to the loan term: this allows the customer to make lower repayments whilst still repaying the outstanding balance in full.

At an operational level, forbearance measures that either extend the loan term or relate to a conversion to interest only repayments are undertaken within a dedicated Financial Solutions Unit, which was established in 2009 with the aim of helping our retail customers in financial difficulty to manage their finances more effectively. All other forbearance measures are exercised within Mortgage Collections.

Retail home loans subject to forbearance are of low significance in the context of the Group's overall lending operations. The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance.

2012	**Number**	**£m**	**% of total portfolio %**	**Impairment allowance £m**	**% coverage %**
Temporary forbearance	210	17	0.11	1	5.88
Interest only conversion	27	2	0.01	-	0.00
Term extension	15	1	0.00	-	0.00
Capitalisation of arrears	673	52	0.34	2	3.85
Other arrangements	9	-	0.00	-	0.00
	934	**72**	**0.46**	**3**	**4.17**

2011	Number	£m	% of total portfolio %	Impairment allowance £m	% coverage %
Temporary forbearance	298	21	0.15	-	0.00
Interest only conversion	60	5	0.04	-	0.00
Term extension	19	1	0.01	-	0.00
Capitalisation of arrears	1,227	94	0.68	3	3.19
Other arrangements	28	1	0.01	-	0.00
	1,632	122	0.89	3	2.46

A further forbearance provision of £4m (2011: £5m) is presently held within the overall collective provision to cover any potential understatement of arrears (and hence provision) as a result of retail forbearance that cannot be allocated to any specific forbearance measure exercised by the Group. The effect of this on the above tables would be to increase the impairment provision to £7m (2011: £8m) and to increase overall coverage to 9.72% (2011: 6.56%). The overall reduction in the volume of customers who are subject to forbearance measures as at 30 September 2012 can be attributed to a number of factors including, but not limited to, some customers returning to a stable position following a short period of successful forbearance and other customer circumstances where forbearance is no longer suitable.

Examples of short-term or temporary forbearance measures included in the category "temporary forbearance" above are:

- Arrangement or short term promise to pay.
- Payment of fees/charges on behalf of the customer to protect security of the property.
- Reduced payment concession.
- Temporary transfer to interest only terms.
- Non-contractual payment holidays/redraw of previous overpayments.

39. Financial risk management (continued)

Credit risk (continued)

Retail forbearance (continued)

The above list of short-term forbearance or temporary solutions is not exhaustive and is applied on a case-by-case basis where appropriate.

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2012 there were 200 repossessions including 50 voluntary (2011: 161 including 55 voluntary).

The Group also currently exercises limited forbearance strategies in relation to unsecured loans and credit cards which mainly consist of term extensions (subject to negotiations with the customer) for the former and reduced payment arrangements for the latter. Forbearance strategies implemented on unsecured loans and credit cards are of low financial significance in the context of the Group's overall lending operations.

Non-retail forbearance

The Group identifies commercial customers where a forbearance strategy may be appropriate on a case by case basis. Commercial customer relationships are individually managed with lending tailored to the specific requirements of the business.

Commercial customer terms can be renegotiated or modified for a variety of reasons, not all of which will be as a direct result of the introduction of a non-retail forbearance strategy.

Non-retail forbearance is undertaken selectively where the Group has identified that repayment difficulties against the originally approved terms already have, or are very likely to materialise. Where the changes are made on terms that the Group would not ordinarily consider on a commercial basis, such cases are treated as impaired facilities in accordance with the Bank Credit Policy on Restructured Obligations. Terms renegotiated or modified on a commercial basis would not be treated as non-retail forbearance, reflecting the Bank Credit Policy on Re-contracted Obligations.

Where loans have been renegotiated on a non-commercial basis and concessions have been granted, non-retail forbearance would be considered to be in place until such time as there is evidence to show a significant reduction in the risk of non-payment from future cash flows consistent with the Bank Credit Policy on Cured Default.

For the purposes of determining whether non-retail forbearance is evident the following types of modification are considered as concessionary:

- extending of facility payment term;
- deferral of contracted capital repayments (i.e. capital repayment holiday or rescheduling);
- reduction in the contracted interest rate, including a reduction in the level of accrued interest, or amendment to the original fee structure;
- debt forgiveness; and
- use of alternative forms of payment, including debt for equity and asset transfer.

Modification of facilities which do not affect payment terms, including restructuring of security arrangements or waiver of rights under documented covenants are not considered as sufficient to indicate non-retail forbearance. In isolation such amendments do not necessarily constitute evidence of financial difficulty.

39. Financial risk management (continued)

Credit risk (continued)

Non retail forbearance (continued)

Covenants are frequently documented to give the Bank rights of repricing or other action at the early stages of credit deterioration where payment capacity is yet to be affected. Where covenant breaches have occurred which could imply financial difficulty normal impaired asset review procedures are followed in line with Bank Credit Policy.

If the Group has made a demand for repayment, such facilities are not considered to evidence non-retail forbearance as the facilities are withdrawn and a debt repayment process, through realisation of security or otherwise, is instigated.

The tables below summarise the number of arrangements in place and the loan and impairment allowances associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance.

2012	**Number**	**£m**	**% of total portfolio %**	**Impairment allowance £m**	**% coverage %**
Term extension	1,059	1,078	6.52	168	15.59
Deferral of contracted capital payments	296	234	1.41	21	8.97
Reduction in contracted interest rate	24	22	0.13	4	18.18
Debt forgiveness	36	53	0.32	11	20.75
Alternative forms of payment	31	86	0.52	4	4.65
	1,446	**1,473**	**8.90**	**208**	**14.12**

The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements for assets that are classified as being held for sale as described in note 24. These amounts are included within the table above summarising the total number of arrangements in place.

2012 – Assets classified as held for sale	**Number**	**£m**	**% of total of held for sale portfolio %**	**Impairment allowance £m**	**% coverage %**
Term extension	645	979	17.32	164	16.75
Deferral of contracted capital payments	54	78	1.38	6	7.69
Reduction in contracted interest rate	11	13	0.23	4	30.77
Debt forgiveness	10	15	0.26	1	6.67
Alternative forms of payment	13	34	0.60	2	5.88
	733	**1,119**	**19.79**	**177**	**15.82**

Maximum exposure to credit risk

The Group's credit exposure has been determined in accordance with capital adequacy guidelines. The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at reporting date is the carrying value of the financial asset.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

39. Financial risk management (continued)

Credit risk (continued)

Maximum credit risk exposure	**Group**	
	2012	2011
	£m	£m
Cash and balances with central banks	**7,927**	6,052
Due from related entities (note 10)	**1,256**	4,952
Due from other banks	**14**	12
Investments – available for sale (note 11)	**1,039**	1,117
Other financial assets at fair value (note 12)	**2,791**	4,846
Derivative financial assets (note 13)	**600**	1,018
Loans and advances to customers (note 14)	**24,346**	28,238
Due from customers on acceptances	**7**	7
Assets held for sale (note 24)	**5,225**	-
	43,205	46,242
Contingent liabilities (note 33)	**286**	285
Commitments (note 33)	**9,290**	10,568
Commitments relating to assets held for sale (note 33)	**140**	-
Maximum credit risk exposure	**52,921**	57,095

The commitments balance includes sale and option to repurchase transactions and other commitments.

Credit quality of financial assets

Notes 14 and 24 contain an assessment of the credit quality of loans and advances to customers including assets held for sale. Note 11 contains an assessment of the credit quality of investments.

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Risk concentration

Concentration of risk is managed by client / counterparty, by product, by geographical region and by industry sector. In addition single name exposure limits exist to limit exposure to a single entity / counterparty.

39. Financial risk management (continued)

Credit risk (continued)

Eurozone risk

The Group and Company have no material operations outside the UK and have no direct sovereign exposure to the peripheral Eurozone countries (Greece, Ireland, Italy, Portugal and Spain) (2011: Nil). The Group had an exposure to the European Investment Bank of £100m at 30 September 2012 (2011: £100m).

Industry concentration of credit risk

The following tables show the levels of industry concentration of credit risk as at 30 September:

Loans and advances to customers including loans designated at fair value through profit or loss and assets held for sale	**Group**	
	2012	2011
	£m	£m
Government and public authorities	**39**	34
Agriculture, forestry, fishing and mining	**1,913**	1,864
Financial, investment and insurance	**886**	1,110
Property – construction	**3,722**	4,436
Manufacturing	**922**	1,047
Instalment loans to individuals and other personal lending (including credit cards)	**2,372**	2,553
Property – mortgage	**15,369**	13,981
Asset and lease financing	**694**	901
Other commercial and industrial	**7,303**	7,751
	33,220	33,677

Contingent liabilities and credit related commitments	**Group**	
	2012	2011
	£m	£m
Agriculture, forestry, fishing and mining	**753**	745
Financial, investment and insurance	**66**	187
Property – construction	**543**	827
Manufacturing	**211**	242
Instalment loans to individuals and other personal lending (including credit cards)	**3,674**	4,022
Property – mortgage	**1,724**	1,581
Other commercial and industrial	**2,745**	3,249
	9,716	10,853

Available for sale investments and held to maturity investments	**Group**	
	2012	2011
	£m	£m
Financial, investment and insurance	**1,039**	1,110

The industry categories used in the above tables include assets that are designated as held for sale at the balance sheet date.

39. Financial risk management (continued)

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Group's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

Interest rate risk in the banking book (IRRBB)

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with NAB IRRBB policy. Risk measurement techniques include: Value at Risk (VaR), Earnings at Risk (EaR), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model:

- Historical simulation approach utilising instantaneous interest rate shocks.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a consistent basis.
- 99% confidence level.
- Three month holding period.
- EaR utilises a twelve month forecast period.
- 8 years of business day historical data.
- Rate changes are proportional rather than absolute.
- Investment term for capital is modelled with an established benchmark term of between 1 and 5 years.
- Investment term for core “non-interest” bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between 1 to 5 years.

Model parameters and assumptions are reviewed and updated on at least an annual basis by Non-Traded Market Risk, in consultation with Treasury. Material changes require the approval of the UK ALCO.

Interest rate risk	**Value at risk**		**Earnings at risk**	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
As at 30 September	**31**	41	**4**	14
Average value during the year	**37**	31	**6**	9
Minimum value during the year	**31**	26	**2**	2
Maximum value during the year	**45**	41	**13**	14

Prepayment risk

Early repayment charges on fixed rate business loans are calculated on an economic cost basis, fully recompensing the Company for any loss on the unwinding of the underlying hedge. Early repayment charges on fixed rate mortgages are calculated on a sliding scale basis, whereby an agreed percentage of the balance is charged dependent upon the residual time to maturity of the loan.

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39. Financial risk management (continued)

Market risk (continued)

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Group 2012	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Assets							
Cash and balances with central banks	6,800	-	-	-	-	1,127	**7,927**
Due from related entities	1,223	-	-	-	33	-	**1,256**
Due from other banks	-	14	-	-	-	-	**14**
Investments – available for sale	-	-	-	100	932	7	**1,039**
Other financial assets at fair value	1	45	165	1,006	1,574	-	**2,791**
Derivative financial assets	-	37	50	314	199	-	**600**
Loans and advances to customers	4,132	488	796	3,799	14,695	436	**24,346**
Due from customers on acceptances	-	7	-	-	-	-	**7**
All other assets	153	315	78	-	-	713	**1,259**
Assets held for sale	587	135	723	2,462	1,298	20	**5,225**
Total assets	**12,896**	**1,041**	**1,812**	**7,681**	**18,731**	**2,303**	**44,464**
Liabilities							
Due to other banks	-	521	36	-	-	-	**557**
Other financial liabilities at fair value	-	-	5	74	68	-	**147**
Derivative financial liabilities	7	87	51	236	571	-	**952**
Due to customers	15,599	3,527	3,453	3,802	-	-	**26,381**
Liabilities on acceptances	-	7	-	-	-	-	**7**
Due to related entities	735	25	4,350	1,006	1,600	-	**7,716**
Bonds, notes and subordinated debt	-	-	590	1,370	1,203	-	**3,163**
All other liabilities	1,641	455	59	-	-	625	**2,780**
Liabilities associated with assets held for sale	-	-	6	48	88	-	**142**
Total liabilities	**17,982**	**4,622**	**8,550**	**6,536**	**3,530**	**625**	**41,845**

39. Financial risk management (continued)

Market risk (continued)

Maturity analysis of assets and liabilities (continued)

Group 2011 As restated	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,101	-	-	-	-	951	6,052
Due from related entities	801	2,724	1,427	-	-	-	4,952
Due from other banks	-	12	-	-	-	-	12
Investments – available for sale	-	-	66	100	944	7	1,117
Other financial assets at fair value	-	113	386	1,933	2,414	-	4,846
Derivative financial assets	-	59	444	349	166	-	1,018
Loans and advances to customers	4,979	652	1,143	5,969	15,012	483	28,238
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	-	628	46	-	-	769	1,443
Total assets	10,881	4,195	3,512	8,351	18,536	2,210	47,685
Liabilities							
Due to other banks	238	655	614	-	-	-	1,507
Other financial liabilities at fair value	-	-	-	33	122	-	155
Derivative financial liabilities	-	30	75	248	578	-	931
Due to customers	16,672	5,838	4,044	1,616	-	-	28,170
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	192	1,150	2,415	2,151	2,054	-	7,962
Bonds, notes and subordinated debt	-	1,255	1,504	590	204	-	3,553
All other liabilities	1,335	584	61	-	-	363	2,343
Total liabilities	18,437	9,519	8,713	4,638	2,958	363	44,628

Comparative disclosures have been restated to conform with current year presentation. The reclassification of derivative balances from other financial assets and liabilities at fair value to derivative financial assets and liabilities is referred to in note 12. The maturity profile of all other assets and all other liabilities has been adjusted in line with the presentation in the NAB Annual Financial Report.

39. Financial risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

Group 2012	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	-	522	36	-	-	-	**558**
Other financial liabilities at fair value	-	2	9	103	81	-	**195**
Derivative financial liabilities	-	2	4	-	-	-	**6**
Due to customers	15,599	3,549	3,492	3,873	-	-	**26,513**
Liabilities on acceptances	-	7	-	-	-	-	**7**
Bonds, notes and subordinated debt	-	20	647	1,598	1,313	-	**3,578**
All other liabilities	1,567	-	-	-	-	-	**1,567**
Risk management derivatives							
Contractual amounts payable	-	2	1	-	-	-	**3**
Contractual amounts receivable	-	-	(4)	-	-	-	**(4)**
Total liabilities	**17,166**	**4,104**	**4,185**	**5,574**	**1,394**	**-**	**32,423**

Group 2011	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	238	662	617	-	-	-	1,517
Other financial liabilities at fair value	-	2	5	59	130	-	196
Derivative financial liabilities	-	-	-	-	-	44	44
Due to customers	16,688	5,862	4,069	1,667	-	-	28,286
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	1,270	1,526	640	210	-	3,646
All other liabilities	1,335	-	-	-	-	-	1,335
Risk management derivatives							
Contractual amounts payable	-	11	18	1	-	-	30
Contractual amounts receivable	-	(2)	(4)	-	-	-	(6)
Total liabilities	18,261	7,812	6,231	2,367	340	44	35,055

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. The balances for other financial liabilities at fair value and derivative financial liabilities are less than shown on the consolidated balance sheet as they exclude cash flows on related party balances.

The Group all other liabilities balance for 2011 has been reclassified from no specified maturity to call to align with the presentation in the NAB Annual Financial Report.

40. Management of risk

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy, as well as that of its parent entity NAB Group. A key component of the Group's risk management strategy is the establishment by the Board of a formal 'Risk Appetite Statement'.

This places an overall limit on the total amount of risk that the Group is prepared to take. This is set with respect to the returns that the Group is seeking to provide to its shareholder, the credit rating that the Group is seeking to maintain and the Group's capital position and desired capital ratios.

This informs the Group's risk, capital and business limits and policies. It is regularly reviewed by the Board as a part of the strategic planning process, or as the commercial circumstances of the Group change.

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the businesses' front-line teams to be effective. This overriding principle embodies the following concepts:

- all business decisions proactively consider risk and the impact on the Group's customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components;
- all employees are responsible for risk management in their day-to-day activities; and
- risk management is a core competency for all employees.

Within this context, the Group manages risk within a three lines of defence framework. Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are accountable for establishing risk policy, standards and the oversight of risk management effectiveness within the business. The third line of defence is Internal Audit who are responsible for independently reviewing, monitoring, and testing business unit compliance and regularly assessing the overall effectiveness of the Risk Management Framework.

The NAB Group Risk and Reward Management Committee, chaired by the Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance on the performance of the overall Risk Management Framework. This Committee is supported by three sub-committees - the NAB Group Credit Risk Committee, the NAB Group Asset and Liability Committee (NAB Group ALCO), and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated through the European Boards' Risk Committee, which enables Board members to challenge Executives on the profile and management of risk. This is supplemented by the annual ICAAP Board submission, which is completed alongside the Capital Plan, Strategic Plan, the Internal Liquidity Adequacy Assessment (ILAA), Recovery and Resolution Plan and the Risk Appetite Statement. There is also a UK Risk Committee, chaired by the Chief Executive Officer UK, and comprised of senior Company executives, which serves to provide leadership focus on key risk issues from a Group perspective. The Committee is supported by the following UK Governance Committees: UK Asset & Liability Committee (UK ALCO), Pension Management Committee and Model Oversight Committee. First line responsibility for risk management resides with the Management Assurance Committees in each of the Group's principal operating divisions: Retail, Business & Private Bank and Operations & Information Technology. Each of the Management Assurance Committees provide reports to the UK Risk Committee and European Board Risk Committee.

The UK Risk Management team independently monitors and systematically assesses the risk profile within the Group against established risk appetite parameters. They also assist the front line business units in the design and implementation of appropriate risk management policies / strategies and work with the business units to promote awareness of the need to manage risk.

40. Management of risk (continued)

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality.

The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities within the Group are clearly defined.

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Group Credit Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the Group Chief Credit Officer (and associated teams) provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management within the UK, with appropriate oversight through the UK executive management governance committees.

The Group's credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

Single large exposure policies are in place within the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems or from external events. This includes legal risks as well as operational risk components associated with other risks categories (e.g. credit, traded market, non-traded market).

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.

These risk categories are defined as follows:

- Customer, Products and Sales Practices – the treatment of customers and the management of customers impacts on all the Group's core activities. This is a principal focus of the Board, Senior Management and the regulators and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, that customer expectations are met and complaints are dealt with effectively. Consideration of customer outcomes is embedded within the Group's operating processes and metrics are regularly monitored to ensure outcomes are appropriate.
- Regulatory Environment and Market Practices – the Group is required to comply with a large volume of laws and regulations and the regulatory environment has also been subject to substantial change in recent years. This is likely to continue and represents an on-going focus of the Group's management in ensuring the Group continues to operate within prudential parameters and that the conduct of the Group's activities meets the expectations of the Group's customers, shareholders and regulators. The Group operates a zero tolerance for regulatory breaches and organises its activities to ensure controls over regulatory risk are maintained in addition to maintaining a strong, open and trusted relationship with its regulators.
- Monitoring, Reporting and Oversight – effective controls over business operations are essential for the protection of the Group's customers and shareholders and is a key responsibility of all employees and managers. The Group continues to reinforce frameworks, standards and oversight arrangements to enhance the quality of risk management in the organisation. Each business unit maintains a risk profile with embedded controls and actions to manage inherent risks.

40. Management of risk (continued)

Operational risk (continued)

- Payments and Process Management – the Group processes a large volume of transactions for customers every day and manages the risks in this and other operations to ensure these activities are conducted safely and efficiently. However, in all operational activity there is a potential risk of established procedures not being followed, a failure to detect errors or that inadequate controls are in place.
- External Fraud and Criminal Activities – the Group takes seriously its responsibilities to protect customers against financial crime. This includes preventing fraud activities in all channels through which customers transact; the prevention of money laundering; and compliance with legal sanctions requirements. Fraud management is an ongoing challenge for the financial services industry and presents a constant risk to the Group as criminal activities evolve on a national and global basis. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Internal Fraud and Criminal Activities – The Group recognises the risk of internal fraud associated with internal acts intended to defraud, misappropriate funds, information and physical assets, and circumvent policy. The Group has no tolerance for internal fraud and has a strong control framework in place to mitigate this risk.
- Workplace Practices and Environment – providing a safe environment for customers and colleagues is important for the success of the business and the Group seeks to ensure adequate safeguards are in place and are operating effectively.
- Systems and Infrastructure – There is a risk of service interruption due to failure of the Group’s systems leading to a period of service disruption. The Group has a strong framework of controls over the continuity of service provision for all critical processes including recovery procedures in the event of unplanned service interruption.
- Third Party Providers - Failure to manage third party providers effectively may also impact on the level of service available to customers. The Group’s controls to mitigate this risk include regular oversight of third party processes and assurance testing of the effectiveness of relationship management.

Responsibility for the management of operational risk rests with the business managers with oversight from the Risk Management function and independent assurance activities undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. This is based on a set of core principles and defines the Group's standards for Operational Risk Management and compliance. Its design recognises the importance of embedding the management of operational risk into business activities. It has particular focus on defining and implementing the right behaviour and incorporating risk considerations into the Group's systems and processes.

The Operational Risk Framework is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes. It includes:

- an established governance structure that is used to ensure consistent application, control and reporting of the Operational Risk Management process. This element also includes the establishment and communication of the Group's operational risk appetite; and
- a structured process to facilitate the identification, quantification and management of risks underpinned by clear policies and guidelines. Material risks are reported monthly to the Management Assurance Committees and the UK Risk Committee, and to each European Boards’ Risk Committee to provide visibility and understanding of the Group's overall risk profile.

40. Management of risk (continued)

Non-traded market risk

Non-traded market risks include liquidity and funding risk, structural interest rate risk, foreign exchange risk and risks associated with the Group's defined benefit pension scheme. The primary objective for the management and oversight of non-traded market risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

Policies relating to non-traded market risks are approved by the Board of the NAB Group. The consistent application of NAB Group polices across the Group is the responsibility of the Company's Board with the support of executive management governance committees. In relation to non-traded market risks, the primary management committee is the UK ALCO.

Risk appetite and limits are approved for non-traded market risk by the Company's Board, with authority delegated to the UK ALCO for their subsequent implementation and monitoring.

UK ALCO oversees the management of non-traded market risks. UK ALCO meets monthly and reports to the UK Risk Committee. The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from the Non-Traded Market Risk team.

Liquidity and funding risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on-demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Liquidity within the Group is managed in accordance with the Group's Individual Liquidity Adequacy Assessment (ILAA) that is approved by the Board. The ILAA includes the manner in which the Group meets all regulatory requirements of the FSA and includes the Group's policy for the management of liquidity risk. Oversight of liquidity risk is undertaken by the UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group, including the Group, is monitored by the NAB Group ALCO in accordance with the NAB Group Non-Traded Market Risk Policy. To meet the requirements of local regulatory authorities the liquidity of the Group is managed on a daily basis as a stand-alone undertaking. UK ALCO delegates daily management responsibilities to the Group's Treasury division.

The ILAA encompasses the requirements of local regulatory authorities and those of the NAB Group. This results in liquidity being managed through a combination of positive cash flow management, including under a series of assumptions to simulate stressed market conditions, the maintenance of portfolios of high quality liquid assets and diversification of the funding base.

A contingency plan has also been established for management of an escalated liquidity requirement where the Group or the NAB Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

There are three major contributors to interest rate risk:

- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities; and
- the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets i.e. basis risk.

40. Management of risk (continued)

Non-traded market risk (continued)

Structural interest rate risk (continued)

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and NAB Group ALCO.

Interest rate risk management across the Group is directed by UK ALCO with delegation for day-to-day management to the Group's Treasury division. The UK Risk Committee, through UK ALCO oversight, monitors risk to ensure it remains within approved policy and Board approved risk appetite.

Basis risk is managed through a combination of wholesale market basis risk products, pricing strategies and product innovation.

A key feature of the risk management and oversight framework is the use of Value at Risk (VaR) as a measure of interest rate risk, along with Earnings at Risk (EaR) to measure the impact on future net interest income. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group's Risk Management team that is independent of the Treasury division.

Foreign exchange risk

Exposures arise if future cash flows can only be converted to Sterling at less favourable rates than at the time of the original transaction. The Group's policy is to fully hedge these exposures at the time of commitment for all exposures that are considered to be of a marketable size.

The transactional currency exposures principally arise from dealings with customers and the Group maintains a matched position through transactions with a range of counterparties including the NAB Group in order to comply with the Group's Trading Policy Statement.

Pension risk

Pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. The operation of a pension scheme gives rise to a number of risks, e.g. movements in equity valuations, changes in bond yields and life expectancy of scheme members. The Scheme is managed by independent Trustees however the impact of the Scheme on the Group is subject to management by the Bank and corresponding risk oversight. The Group's Pension Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

The Group is governed by NAB Group's Capital Management Policy. The objectives of the NAB Group's Capital Management Policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators requirements and managing the ratings agencies assessment of the Group.

The Group implemented Basel II requirements from 1 January 2008 in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Group calculates its minimum capital requirements based on 8% of RWAs. The FSA then adjusts this requirement to cover risks under Pillar II of Basel II and generate an Individual Capital Guidance (ICG) and a Capital Planning Buffer (CPB). The CPB is designed to be available to absorb losses and / or to cover increased capital requirements in adverse circumstances that are outside the firm's normal and direct control.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The UK ALCO, which consists of the Chief Executive Officer, Executive Director, the Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Group actively manages its capital position and reports this on a regular basis to senior management via UK ALCO and other governance committees. Capital requirements are included within an annual capital management plan presented to and approved by the Board of Directors.

42. Basel II Capital Requirements Directive Pillar 3 disclosure

The FSA has granted the Bank a waiver direction under BIPRU 11.2.5: (Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a non EEA state).

The waiver direction can be found on the FSA website: http://www.fsa.gov.uk/register/pdf/A1375943P.pdf

In line with the FSA waiver direction, the Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure.

National Australia Bank Limited 2012 Full Year Risk and Capital Report: http://www.nabgroup.com/0,,32863,00.html

National Australia Bank Limited 2012 Full Year Financial Results, Section 6 (Supplementary Information): http://www.nab.com.au/vgnmedia/downld/asx-2012-supplementary-information.pdf

National Australia Bank Limited 2012 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html

The first published disclosure was based on the financial position of the Group and NAB as at 30 September 2008. After due consideration by the Group Directors, subsequent Pillar 3 disclosures will be made annually by way of the National Australia Bank Limited Risk and Capital Report. These disclosures will be in line with the FSA Waiver direction as outlined above.

The information contained in these qualitative disclosures has not been audited by the Group's external auditors except to the extent that they are equivalent to those made under accounting requirements and is limited to those required by BIPRU 11.

43. FSA Remuneration Pillar 3 disclosure

In December 2010, the FSA issued Policy Statement 10/21 'Implementing CRD3 requirements on the disclosure of remuneration'. The Pillar 3 disclosures required are specified within BIPRU 11.5.18R to BIPRU 11.5.21G. The Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosures plus additional aggregate disclosures for UK Code Staff to satisfy the Pillar 3 disclosure obligations.

National Australia Bank Limited 2012 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html

The remuneration report is held within the Report of the Directors on pages 15 - 40 of the National Australia Bank Limited 2012 Annual Financial Report.

44. Events after the balance sheet date

On 5 October 2012, the Group successfully completed the transfer of the majority of its commercial real estate lending portfolio and associated assets and liabilities to NAB at their carrying value. The results of this element of the Group's business are accordingly excluded from future financial performance from 6 October 2012.

The balance transferred reflected those amounts disclosed in note 24 adjusted for transactions between 30 September 2012 and the date of transfer.

Glossary

Term	Description
APRA	Australian Prudential Regulatory Authority.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
ATM	Automated teller machine.
Average assets	Represents the average of assets over the period adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the "International Convergence of Capital Measurement and Capital Standards".
Basel III	In December 2010, the Basel Committee issued final rules "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring". Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2013 with full implementation by 1 January 2019.
Cash earnings	A non Generally Accepted Accounting Principles (GAAP) key performance measure that excludes certain items within the calculation of net profit attributable to owners of the Group. It is also a key performance measure used by the Australian peers of the ultimate parent with a similar business portfolio. These specified items are excluded in order to better reflect what is considered to be the underlying performance of the Group. Net profit attributable to owners of the Group Adjusted for: Distributions Treasury shares Fair value and hedge ineffectiveness Payment Protection Insurance provision charge Efficiency, quality and service initiatives ("EQS") Restructure costs Litigation expense Property revaluation Goodwill impairment Software impairment
CFI	Customer funding index.
Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Company	National Australia Group Europe Limited.
Contractual maturities	The date on which the final payment (principal or interest) of any financial instrument is due to be paid, at which point all the remaining outstanding principal and interest have been repaid.

Glossary (continued)

Core Tier 1 capital	The highest quality form of regulatory capital that comprises total shareholders' equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
CRE	Commercial real estate.
Credit enhancements	Facilities used to enhance the creditworthiness of financial obligations and cover losses due to asset default.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of over the counter (OTC) derivative contracts to reflect the creditworthiness of OTC derivative counterparties. Can also be known as a credit value adjustment (CVA).
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities.
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Delinquency	See "Arrears".
Derivative	A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
EaR	Earnings at risk. A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Efficiency, quality and service initiatives	Represent those costs that the Group accelerated in response to the economic downturn to bring forward efficiency gains that would otherwise have been realised in subsequent periods.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (level 2 and level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
Fair value and hedge ineffectiveness	Represents volatility attributable to the Group's application of the fair value option, ineffectiveness from designated accounting and economic hedge relationships and economic hedges of significant approved funding activities where hedge accounting has not been applied.
Forbearance	The term generally applied to the facilities provided to assist borrowers, both retail and non-retail, who are experiencing a period of financial stress and can take a variety of forms such as negotiating an arrangement or short term promise to pay, transfer to interest only terms, or term extensions.
FSA	Financial Services Authority.

Glossary (continued)

FSCS	Financial Services Compensation Scheme.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	National Australia Group Europe Limited and its controlled entities.
IFRS	International Financial Reporting Standards.
Impaired loans	Retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
Impaired losses	Where an asset's recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This may be assessed at either the individual level or collectively.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
Indexed LTV	Outstanding balance divided by indexed property valuation.
Indexed property valuation	Based upon the movement in the seasonally adjusted Halifax House Price Index between the latest valuation date of the property and the current date, which is then applied to the latest property valuation.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach ("IRB")	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investments - AFS	Investments - available for sale.
Investments - HTM	Investments - held to maturity.
Investment grade	A rating that indicates that a municipal or corporate bond has a relatively low risk of default. Bond rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade.
IRB advanced approach	A method of calculating credit risk capital requirements using internal PD (probability of default), LGD (loss given default) and EAD (exposure at default) models.
IRB foundation approach	A method of calculating credit risk capital requirements using internal PD models but with supervisory estimates of LGD and conversion factors for the calculation of EAD.
IRRBB	Interest rate risk in the banking book.
Key management personnel	Directors of the Group, members of the UK Executive Committee and FSA approved persons with a controlled function 1 – 29 (as defined in the FSA handbook available at www.fsahandbook.info/FSA/html/handbook/).

Glossary (continued)

Level 1	Financial instruments with quoted prices for identical instruments in active markets.
Level 2	Financial instruments with quoted prices for similar instruments in active and financial instruments valued using models where all significant inputs are observable.
Level 3	Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.
LIBOR	London Interbank Offered Rate.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
LTV	Loan to value. A mathematical calculation that expresses the amount of the loan as a percentage of the value of security. A high LTV indicates that there is less cushion to protect the lender against asset price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
Medium term notes (“MTNs”)	Notes issued by corporates including financial institutions across a range of maturities. MTNs are frequently issued by corporates under MTN Programmes whereby notes are offered on a regular and continuous basis to investors.
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of National Australia Group Europe Limited.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net interest margin	Net interest income as a percentage of average interest earning assets.
Net profit attributable to owners of the Group	Represents the Group's statutory profit after tax and reflects the amount of net profit that is attributable to owners.
Non-impaired assets 90+ days past due	Non-impaired assets 90+ days past due consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Non-retail deposits and other borrowings	Comprises other wholesale deposits, certificates of deposits, securities sold under agreements to repurchase and borrowings.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Past due loans and advances	Loans and advances on which repayments are overdue.
PPI	Payment Protection Insurance.
Probability of default (“PD”)	The probability that an obligor will default within a one-year time horizon.
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.

Glossary (continued)

Regulatory capital	The capital which the Group holds, determined in accordance with rules established by APRA for the consolidated NAB Group and by local regulators (in the UK the FSA) for individual Group companies.
Residential mortgage-backed securities (“RMBSs”)	Securities that represent interests in groups of mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: - the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non market extension of principal repayment period); - the Group has previously made a specific provision for the customer/obligor and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. See also forbearance.
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as residential mortgages, overdrafts and credit card balances.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed.
Risk weighted assets	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Sale and repurchase agreement (“repo”)	A repo is a short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	Structured finance transaction which involves pooling and packaging cash flow converting financial assets into securities that can be sold to investors. It provides a mechanism that assists the Group in reducing funding costs by providing the investor with access to security / collateral.
Scheme	The Yorkshire and Clydesdale Bank Pension Scheme.
SFI	Stable funding index.
SME	Small and medium enterprises.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.

Glossary (continued)

Special Purpose Entity ("SPE")	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SPE may take the form of a corporation, trust, partnership or unincorporated entity. SPEs are often created with legal arrangements that impose strict limits on the activities of the SPE. These can also be known as Special Purpose Vehicles ("SPVs").
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ("ECAI") ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Strategic Review	A review of the business model and operations as a result of prevailing and expected economic and market conditions.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Tier 1 capital	A component of regulatory capital, comprising core Tier 1 and other Tier 1 capital. Other Tier 1 capital includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 2 capital	A component of regulatory capital, comprising qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.
Tier 1 ratio	Tier 1 capital, as defined by the FSA, divided by risk weighted assets.
Tier 2 ratio	Tier 2 capital, as defined by the FSA, divided by risk weighted assets.
UK	United Kingdom of Great Britain and Northern Ireland.
UK ALCO	UK Asset and Liability Committee.
VaR	Value at risk. A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	Reduction in the carrying value of an asset due to impairment or fair value movements.

Other information

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National Australia Bank	NAB Group results are available from www.nabgroup.com.au