

Virgin Money Group
Annual Report
and Accounts
2012



At Virgin Money we have a very simple ambition:
to make everyone better off.

Customers, colleagues, communities, corporate partners
and our company.

Highlights in 2012 include:

Customers

Over
1.2 million

new products were bought by customers during the year, while our customer Lounges won the Banking category at the UK Customer Experience Awards.

Colleagues

Over
99.7%

of our colleagues signed up to new terms and conditions after the integration of Virgin Money and Northern Rock.

Communities

Over
£72 million

was donated to charities in 2012 through Virgin Money Giving, our not-for-profit online donation service.

Corporate partners

Over
4,000

of our intermediary partners said they were “very likely to recommend” us when considering their client’s mortgage.

Company

Our net interest margin grew by
54%

from 0.35% to 0.54% as we grew both our mortgage and deposit books, and undertook two successful RMBS issues.



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An introduction to Virgin Money

On 1 January 2012, Virgin Money acquired Northern Rock plc. The two businesses were complementary, and their combination has created a retail bank with a wide product range and a broad distribution capability.

As a challenger bank that is aiming to do things better for customers:

- › we believe in simple, honest, transparent products that treat customers fairly
- › we believe that customers should be able to deal with us through the channel of their choice
- › we believe in creating a culture where customer service is the priority
- › we believe that we have a responsibility to build and support the communities we serve.

The ambition to make everyone better off sits at the heart of our business and underpins the way we go about doing business today, as well as the approach we are taking to creating products and services for the future.

We believe that by building a bank that aims to make everyone better off, we can deliver superior returns to our shareholders.

Our product range

We offer a broad range of products to our customers across five key categories:

Savings

- › Easy access
- › Fixed term
- › Cash ISAs
- › Charity
- › Business
- › Children's

Mortgages

- › Residential
- › Buy-to-let

Cards

- › Credit
- › Prepaid

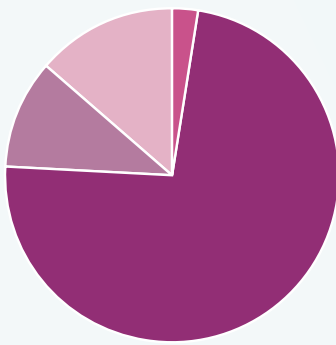
Insurance

- › Travel
- › Home
- › Motor
- › Pet

Investments

- › Stocks and shares ISAs
- › Unit trusts
- › Personal pensions
- › Pension annuity service (with The Partnership Group)
- › Financial planning service (with Legal & General)





Our distribution mix

- Online
- Telephone
- Store
- Corporate partner

Based on 2012 sales

Our distribution capability

We aim to make it easy for our customers to deal with us through the channel of their choice.

Our simple and straightforward internet site is the most popular channel for customers when purchasing our products. Virginmoney.com now receives over 14 million visits per year, 25% of which are made using mobile devices or tablets.

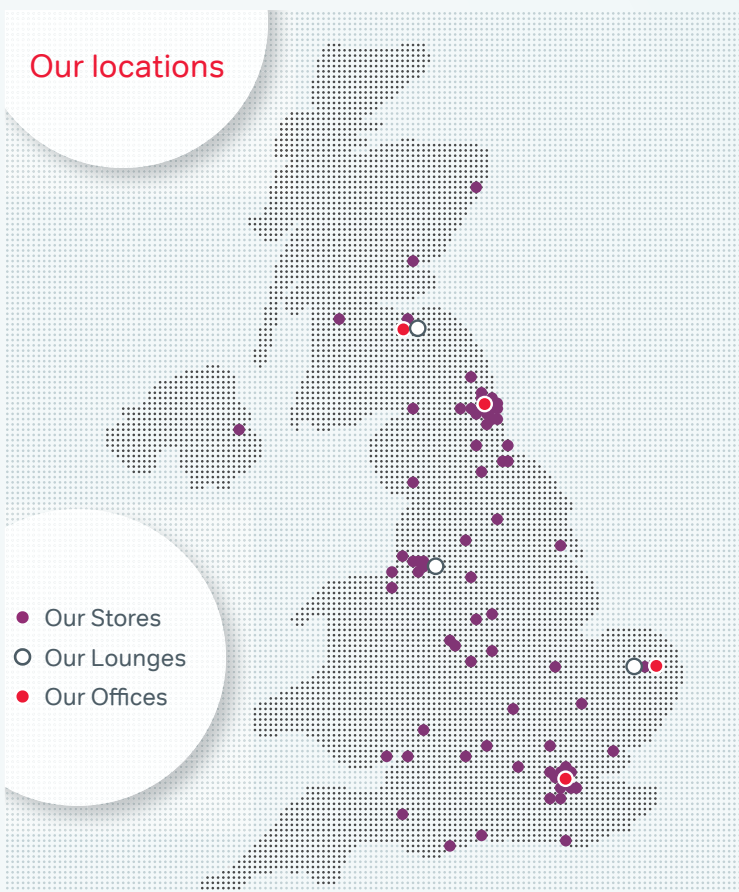
All our products are also available on the telephone for customers looking for additional support when making their purchase decisions. Our call centres handle over 5 million calls per year.

Many of our mortgage customers seek advice when making such a significant financial decision, and we are proud to work with over 8,000 intermediary partners nationally.

For those customers that prefer to deal with us face to face, we have 75 Virgin Money Stores nationally. Our Stores are warm and welcoming places, designed to make it easy for our customers to sort out their money quickly and easily.

We also have Virgin Money Lounges in Edinburgh, Manchester and Norwich. Our Lounges are designed to be places where our customers and our communities can come together. They are free to use and offer tea, coffee and snacks as well as newspapers and wi-fi. Special customer-only events are held in our Lounges, and community groups can use them in the support of the work they do. Lounges are an important part of our proposition, as they serve to highlight our differentiation and create an opportunity for both customer retention and customer recommendation, reducing our new customer acquisition cost.

Our locations



Chairman's statement



Sir David Clementi
Chairman

“

2012 was a transformational year for Virgin Money, during which we completed the acquisition of Northern Rock, delivered its integration smoothly and successfully, achieved good growth in deposits and mortgages and planned for the future of our credit card business.

”

Results for 2012

As a result of the growth in deposits and in mortgages and the reduction in costs across the combined business, Virgin Money reduced the loss on the combined business, before tax and before exceptional items, from £59.1 million in 2011 to £8.4 million in 2012. We traded profitably in each of the last four months of the year.

After exceptional items, the statutory profit before tax was £150.6 million in 2012, compared to Virgin Money Holding's profit before tax of £23.5 million in 2011. At the end of 2012, our core Tier 1 capital ratio was 16.4% and our Tier 1 capital ratio was 19.9%. Our liquidity position remained strong, and comfortably above our regulatory requirements.

Vision and strategy

Our vision for the combined business is to be an effective challenger bank and a credible alternative to the large incumbent banks, whilst holding true to our philosophy of making 'everyone better off' under which we aim to offer fair value to all stakeholders.

Our strategy is intended to deliver growth that is stable and sustainable. Our business strategy is simple: we aim to offer a broad range of retail financial products, with fair and transparent pricing and with good customer service, through the channels our customers prefer to use. In doing this, we aim to build on the pro-consumer and pro-competition credentials of the Virgin brand. Our financial strategy is low-risk: we give priority to responsible management of our balance sheet, with a conservative approach to capital and liquidity.

There are two significant strategic developments to report for the business: the acquisition of Northern Rock plc at the beginning of the year and the acquisition of a Virgin credit card portfolio from MBNA shortly after the end of the year. Both are important steps forward towards achieving our vision.

The acquisition of Northern Rock plc

The acquisition of Northern Rock plc was completed on 1 January 2012. There was an excellent fit between the two businesses: Northern Rock had strong positions in retail deposits and mortgages, a national network of 75 branches and excellent relationships with mortgage intermediaries, while Virgin Money was strong in credit products, savings and investment products and protection products, and had good capabilities in internet and telephone distribution.

During 2012 our primary focus was to deliver a smooth and successful integration of the acquired business. All elements of the integration were completed successfully during the year. At the same time, a comprehensive review of costs was carried out across the combined business and significant cost savings delivered. We do not believe that these cost savings will reduce our ability to support future growth.

The acquisition of a Virgin credit card portfolio from MBNA

In August, we agreed in principle to acquire from MBNA a portfolio of £1.04 billion of Virgin credit cards which MBNA had managed for us since 2002. This acquisition was completed on 18 January 2013 and so is not reflected in our results for 2012. This transaction arose from Bank of America's announcement, in August 2011, that it was considering disposing of its European card businesses. While we are grateful for the support which MBNA has given us over the last decade, we are confident that we now have sufficient scale and experience to manage our own future in this market, where Virgin Money has already been successful.

Regulatory developments

Virgin Money's aspiration to compete effectively in retail banking is entirely consistent with regulatory developments in 2012. During the year the Government issued a White Paper and then a draft Bill to implement the recommendations of the Independent Commission on Banking (ICB). The ICB's recommendations to improve transparency in personal current accounts and to make it easier for customers to switch banks will support greater competition in retail banking. The ICB also made recommendations about subsidiarisation and ring-fencing to improve financial stability. While this will require structural changes in large universal banks in the UK, Virgin Money in its current form already complies fully with the proposed requirements for a ring-fenced retail bank.

Further support for a more competitive environment in retail banking will come from the Government's decision to give a competition objective to the Financial Conduct Authority, which will be established in April 2013. We fully support the Parliamentary Commission on Banking Standards, with its focus on improving banking standards and trust in banking and we agree with the view, implicit in questions asked by the Commission, that greater competition can make a contribution to improving standards to the benefit of all stakeholders.

Colleagues

On behalf of the Board, I would like to thank Management and all Staff for their commitment and hard work during this transformational year, particularly those who delivered the successful integration programme.

Outlook

Following the acquisitions of Northern Rock and the credit card portfolio, we believe that we have laid the foundations for a bank which, under the Virgin Money brand, will be positively different from the large incumbent banks and able to compete effectively with them, and able to respond positively to regulatory developments supporting greater competition and better standards in banking.



Sir David Clementi
Chairman
20 March 2013

Chief Executive's Review



Jayne-Anne Gadhia
Chief Executive Officer

“After completion of the acquisition of Northern Rock on 1 January 2012 our principal initiatives were an integration programme to bring the two former businesses together under the Virgin Money brand and a cost management programme to reduce costs across the combined business. Both of these programmes were completed successfully during 2012.

During the year, our success in growing mortgages and deposits demonstrated the strength of the Virgin Money brand in banking.

The acquisition of a Virgin credit card portfolio, after the year end, further enhanced our ability to meet the needs of consumers across a broad range of retail financial products and to offer an attractive alternative to the large incumbent banks.”

Integration programme

After completion of the acquisition of Northern Rock, we moved quickly to establish the leadership team and governance framework for the combined business. Sir David Clementi was appointed as Chairman of Northern Rock plc, and appointments were also made to the Virgin Money Executive Team and to other senior management positions to ensure clear leadership was evident in the business from the outset.

A dedicated integration programme team was established to plan and deliver integration during the remainder of the year. A key priority for early 2012 was the refinement and approval of detailed plans within the integration programme.

Over the summer months an extensive programme of customer and employee communications was undertaken. During this period, we opened our first Virgin Money store, in Guildford, rebranded all the other 74 Northern Rock branches as Virgin Money stores, and improved the facilities at the former Northern Rock site in Gosforth. These changes were well-received by customers and employees.

After months of preparation, the full rebranding from Northern Rock to Virgin Money was completed successfully in October.

The final element of integration was the alignment of employee terms and conditions across the combined business. In October, new terms and conditions were offered to all employees. By the deadline in early November, 99.7% of employees had accepted the new terms and conditions. The small balance included people about to leave or retire.

Cost management programme

The cost income ratio of the acquired Northern Rock business was 223% in 2011. This reflected relatively low income, because of the low-risk nature of the mortgage book and the high level of excess liquidity held on the balance sheet.

A cost management programme was established to identify and eliminate costs not necessary for the combined business. Cost savings were achieved in all areas except marketing and advertising in which we invested further in order to increase awareness of the expanded Virgin Money business. As a result of this programme, our operating expenses fell from £252.9 million in 2011 to £228.3 million in 2012.

We delivered this cost reduction whilst keeping our promise that there would be no compulsory redundancies in Gosforth as a result of the acquisition.

Business performance in 2012

The net interest income of the combined business increased from €69.2 million in 2011 to €105.3 million in 2012. This increase reflects our success in growing our mortgage book by €2.7 billion and our retail deposit book by €1.8 billion across the year, and in making two issues of residential mortgage-backed securities (RMBS) for a total of €1.7 billion. Over 2012, our net interest margin increased from 0.35% to 0.54%.

Mortgage lending

The acquired business of Northern Rock serviced mortgages amounting to €14.0 billion at 1 January 2012. During 2012, we grew our mortgage book by €2.3 billion, excluding acquisitions, and provided 31% of net mortgage lending in the UK. Our gross mortgage lending was €4.9 billion, and our share of gross mortgage lending was 3.4%, higher than that achieved by Northern Rock in any year since 2008. In growing our mortgage book, we maintained quality in terms of distribution by LTV band, while increasing our overall book margin.

In July, we bought from Northern Rock (Asset Management) plc a further €466.4 million of mortgages of equivalent quality to the mortgages acquired on 1 January. This acquisition enabled us to deploy some of the excess liquidity that came with the Northern Rock acquisition.

Retail deposits and funding

The acquired business of Northern Rock had retail deposits amounting to €16.2 billion at 1 January 2012 (excluding the Irish retail book which was sold on 3 January 2012). During the year, despite strong competition, we increased our retail deposits by €1.8 billion, which was greater than the amount raised by Northern Rock in any year since 2008. The strong inflow in the early months of the year confirmed the appeal of a Virgin Money branded deposit product, but we held back from further acquisition later in 2012 because of the substantial amount of excess deposits we had already attracted.

Non-interest income

The non-interest income of the combined business was €117.6 million in 2012, compared with €129.5 million in 2011. Our non-interest income was impacted by the requirement of our credit card partner MBNA, a subsidiary of Bank of America, to limit the volume of new credit card sales during the period that they considered the sale of their European cards business.

In January 2013, we announced that we had agreed to buy a Virgin credit card portfolio of €1.04 billion from our card partner MBNA. The portfolio acquisition represents a proportion of the book previously managed for us by MBNA under a Strategic Partnership Agreement ("SPA"). The remainder of the portfolio operated under the SPA is now wholly owned by MBNA. Under the agreement the Group takes the economic benefit of the book immediately with operational transfer of our customers to Virgin Money in the first half of 2014. This is an important step in broadening the product set we can offer to consumers and it allows us to grow further in a market we know well.

Giving and community

Virgin Money Giving makes it easy for people to give money online to charities of their choice. By the end of 2012, almost 4 million donations totalling almost €160 million (including Gift Aid) had been made to the more than 6,500 charities registered with us since Virgin Money Giving's launch in 2009.

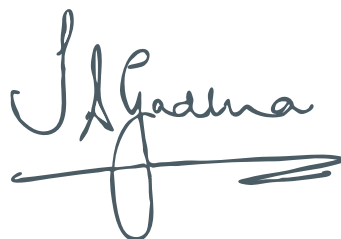
Virgin Money Giving deducts a fee of 2% of the amount donated to cover the costs involved in card processing and the collection of Gift Aid, but because Virgin Money Giving is a not-for-profit organisation, it charges significantly lower fees than its major competitor meaning charities receive more money. We estimate that the cumulative benefit to charities from these lower fees, up to the end of 2012, was €5.1 million. Virgin Money Giving is an excellent example of our ambition to make everyone better off.

In February, we added a third Virgin Money Lounge, in Manchester, to our existing Lounges in Norwich and Edinburgh. On average, about 500 customers visit our three Lounges each day and, during 2012, nearly 100 community, charity and customer events were held in them.

During the year, we continued our sponsorships of the London Marathon, and in Edinburgh, the Fringe on the High Street, which supports free street performances on the Royal Mile during the Fringe Festival, and the Fireworks Concert in Princes Street Gardens, the grande finale of the Edinburgh International Festival.

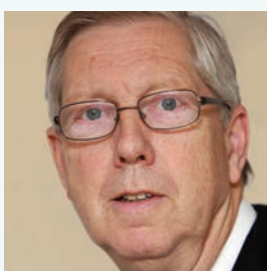
Outlook

During 2012, through our acquisition of Northern Rock, and our agreement to buy the credit card portfolio, we have made good progress on building a retail-only bank with broad and deep capabilities. Our objective, however, is not simply to build a bigger bank, but to build a better kind of bank, offering straightforward, no-nonsense products that consumers can trust, supported by good customer service and high standards. In the enlarged Virgin Money we will continue to pursue our ambition to make everyone better off. This means continuing to offer good value products for consumers, providing employees with a great place to work, being a good partner with suppliers, and making a contribution to the communities in which we operate, while delivering an appropriate return for our shareholders.



Jayne-Anne Gadhia
Chief Executive Officer
20 March 2013

Virgin Money Board



Sir David Clementi
MA, MBA
Chairman

Sir David was Chairman of Prudential plc from 2002 to 2008. Before joining the Prudential, Sir David was Deputy Governor of the Bank of England from 1997 to 2002. In addition to his membership of the Monetary Policy Committee, Sir David was responsible for the day-to-day management of the Bank and had specific responsibility for the Bank's work on Financial Stability. During this period, he was also a non-executive director of the Financial Services Authority. Prior to this, Sir David worked at Kleinwort Benson for 22 years including as Chief Executive and subsequently Vice Chairman.



Gordon McCallum MA, MBA
Non-Executive
Director

Gordon is a senior partner at the Virgin Group. He is Chairman of Virgin Enterprises Limited and is a Director of Virgin Group Holdings. He led the strategic development of the Virgin Group from 1998 to 2012, first as Group Strategy Director and then as CEO of Virgin Management Limited. Gordon currently sits on the Boards of Virgin Media and Virgin Mobile in France. Gordon has been involved in the development of Virgin Money since 1998. Prior to joining Virgin Management, Gordon was a Management Consultant at McKinsey.



Colin Keogh MA, MBA
Independent
Non-Executive
Director

Colin is Chairman of the Risk Committee and of the Remuneration Committee. He also sits on the Audit Committee. A qualified Barrister, Colin spent 24 years working at Close Brothers Group plc, including 8 years as Group Chief Executive from 2002 to 2009. He was previously Chief Executive of the Asset Management Division from 1998 to 2002, and before that Chief Executive and then Chairman of the Corporate Finance Division between 1995 and 1998.



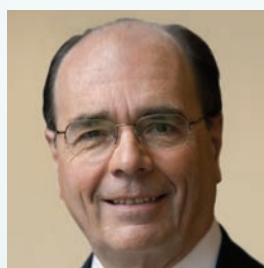
Patrick McCall BSc Econ
Non-Executive
Director

Patrick is a senior partner at the Virgin Group. He has worked for the Group for over 10 years. He is the Co-Chairman of Virgin Rail and Chairman of Virgin Galactic. He is also a Director of Virgin Active and Virgin Care and Chair of Trustees for Virgin Unite, Virgin Group's not-for-profit foundation. Prior to joining the Virgin Group, Patrick was Deputy Chief Executive Officer of Vine Telecom and before that was an investment banker at SG Warburg and then at SBC Warburg.



Norman McLuskie CA
Independent
Non-Executive
Director

Norman is Chairman of the Audit Committee and of the Balance Sheet Committee. A Chartered Accountant, Norman retired from the Board of the RBS Group in 2004. During his career of more than 25 years at RBS, he was Deputy Chief Executive prior to its takeover of NatWest, and after the acquisition he became Chief Executive of Retail Direct which comprised Tesco Personal Finance, Virgin One account and Direct Line Financial Services, as well as the RBS Credit Card business. Norman has also served as Chairman of the Board of MasterCard Europe.



James B. Lockhart III
BA, MBA, FCT
Non-Executive
Director

Jim has been Vice Chairman of WL Ross & Co since 2009 where, as a member of the Investment Committee, he oversees \$9 billion in private equity investments. Prior to his appointment, Jim was CEO and Chairman of the US Federal Housing Finance Agency, and Deputy Commissioner and Chief Operating Officer of the Social Security Administration Agency. He also served as Executive Director (CEO) of the US Pension Benefit Guaranty Corporation. In the private sector Jim has held senior positions in major investment banking, insurance and oil companies.

Virgin Money Executive Team



Jayne-Anne Gadhia
BA, MBA, FCA
Chief Executive
Officer and
Board Member

Jayne-Anne is a Chartered Accountant and qualified whilst at Ernst and Young. She then spent 7 years in management roles in Norwich Union (now Aviva) before becoming one of the three founders of Virgin Direct in 1995. Jayne-Anne launched the market-leading Virgin One account in 1998. That business was acquired by RBS in 2001 after which Jayne-Anne went on to lead a number of RBS business units, ultimately joining the RBS Retail Executive Board where she was responsible for the Group's mortgage business. Jayne-Anne returned to lead Virgin Money in 2007.



Finlay Williamson
BCom (Hons), CA
Chief Financial
Officer and
Board Member

Finlay is a Chartered Accountant and qualified whilst at Grant Thornton. He then spent 18 years at RBS in various Group and Divisional finance roles. Finlay served as Head of Group Corporate Finance during the time of the RBS takeover of NatWest and, after the acquisition, became Finance Director of the RBS Retail Direct division which comprised the Virgin One account, Direct Line Financial Services and Tesco Personal Finance. In 2006, Finlay became Finance Director of RBS's Manufacturing division. Finlay joined Virgin Money in 2009.



Marian Watson
BSc (Hons), CA
Chief Risk Officer

Marian is a Chartered Accountant and qualified whilst at Ernst and Young. She joined the Britannia Building Society where she was Internal Audit Manager, before spending 4 years at the Britannic Group where she was Head of Group Audit and then Head of Group Risk. Marian joined RBS in 2004 and served as the Risk Director of the Group's consumer finance businesses and of its mortgage business and then of Tesco Personal Finance. Marian joined Virgin Money in 2007.



Mark Parker
Chief Operating
Officer

Mark's early career allowed him to gain experience in IT and Operations before he took on his first IT Director roles at British Sugar and then at PepsiCo's snack foods business, Frito-lay. In 2000, Mark joined the HBOS Group, now part of Lloyds Banking Group, as Group Services Director and Chief Information Officer, and then became Managing Director of Intelligent Finance. Mark was then Chief Operating Officer at Northern Rock and joined Virgin Money in January 2012.



Pete Ball
Product and
Commercial Director

Pete's early career was spent at Bank of Scotland and Marks & Spencer Financial Services, where he specialised in IT and project management. In 1993, he moved to MBNA to lead development of their core business systems and in 1997, moved to Iceland Foods before, in 2001, becoming Regional Managing Director of Valtech, an e-commerce business. Pete returned to MBNA in 2003 and served as Director of Partnerships, leading their affinity card business. He joined Virgin Money in 2010.



Brian Brodie MBA
Customer and
Distribution Director

Brian has over 30 years of experience in banking. He spent his early career at Bank of Scotland where he was Sales Director for the branch channel before becoming Regional Sales Manager for HBOS. In 2001, Brian moved to RBS where he became a Regional Managing Director, Director of Mortgage Operations and then Director of Retail Service Operations, responsible for 7,800 staff across 17 operational centres. In 2008 he joined financial outsourcer, HML, as Chief Executive Officer. He joined Virgin Money in 2011.



Matt Elliott MA, MSc, CIPD
HR Director

Matt's early career was at RBS, where he worked on HR policy and employment issues, before working on the HR transformation programme following the acquisition of NatWest. Matt then held senior HR roles in several operating businesses including the Consumer Finance division and Tesco Personal Finance. In 2007, Matt moved to BP as Senior Manager for Corporate and Functions before becoming HR Vice President for BP in North Africa in 2010. He joined Virgin Money in 2011.



Stephen Pearson LLB
General Counsel and
Company Secretary

Stephen qualified as a lawyer in 1985 and has nearly 30 years' experience in both private practice and corporations. He spent his early career at Dorman Jeffrey (now Dundas and Wilson) before moving to Linklaters where he specialised in commercial litigation and insolvency. He then moved to Travers Smith as a partner where he specialised in banking litigation and insolvency. He joined RBS in 2001 as Head of Litigation before moving to the role of General Counsel, Specialist Services. Stephen joined Virgin Money in 2010.

Group Performance

Combined business results

Key highlights

Virgin Money Holdings (UK) Limited completed the acquisition of Northern Rock plc on 1 January 2012. These key highlights show the results of the combined business in 2012, and to allow comparison, the results that would have been achieved in 2011 had Virgin Money Holdings (UK) Limited completed the acquisition of Northern Rock plc on 1 January 2011.

- During 2012, we grew our mortgage book by £2.7 billion. This included the purchase of a mortgage portfolio of £466.4 million from Northern Rock (Asset Management) plc.
- During 2012, we grew our retail deposits by £1.8 billion. We also made two issues of residential mortgage-backed securities for a total of £1.7 billion.
- We expanded our net interest margin from 0.35% in 2011 to 0.54% in 2012.
- We increased our net interest income from £69.2 million in 2011 to £105.3 million in 2012, and our total income from £198.7 million in 2011 to £222.9 million in 2012.
- We reduced our operating expenses from £252.9 million in 2011 to £228.3 million in 2012.
- The charge for impairments declined from £4.9 million in 2011 to £3.0 million in 2012.
- We reduced the loss before tax of the combined business, before exceptional items, from £59.1 million in 2011 to £8.4 million in 2012.
- Exceptional items added £82.6 million to profits in 2011 and £159.0 million in 2012. In 2012, the largest exceptional item was a negative goodwill credit of £139.1 million, arising from the acquisition of Northern Rock plc.
- Including these exceptional items, the statutory profit of the combined business reached £150.6 million in 2012.
- At the end of 2012, our core Tier 1 capital ratio was 16.4% and our Tier 1 capital ratio was 19.9%.
- At the end of 2012, our liquidity position remained strong, and comfortably above our regulatory requirements.
- During 2012, the integration of Northern Rock plc (now known as Virgin Money plc) was completed successfully.
- After the end of the year, on 18 January 2013, we completed the acquisition from MBNA of a £1.04 billion portfolio of Virgin credit cards for a consideration of £1.02 billion. Details can be found in note 44 to the accounts.

Virgin Money Holdings (UK) Limited (“the Company” or “Parent Company”), is a company registered in England and Wales. It is the parent company of the Virgin Money (“VM”) group of companies (“Virgin Money Group” or “Group”).

Group Performance

Combined business results

	Note	2012	2011
		£m	£m
Combined business results summary			
Net interest income		105.3	69.2
Other income		117.6	129.5
Total income		222.9	198.7
Operating expenses		(228.3)	(252.9)
Impairment		(3.0)	(4.9)
Loss before tax – combined business		(8.4)	(59.1)
Reconciliation of combined businesses loss before tax to statutory profit before tax			
Loss before tax – combined business		(8.4)	(59.1)
Integration costs	a	(8.7)	(2.2)
Negative goodwill credit	b	139.1	-
Fair value unwind and acquisition related adjustments	c	27.5	-
Contingent consideration	d	13.0	-
Restructuring costs	e	(0.8)	(12.6)
Proceeds from credit card debt sale		-	20.3
Gains on sale of investment securities	f	-	63.5
Deal costs	g	(13.0)	(16.0)
Net impact of services provided to Northern Rock (Asset Management) plc (“NRAM”) and Bradford & Bingley plc (“B&B”)		1.6	3.7
Profit of disposal group	see note 14	0.3	-
Adjustment for 2011 statutory loss before taxation of Northern Rock plc	h	-	25.9
Profit before tax – statutory	i	150.6	23.5

Basis for the preparation of the combined business results

In order to provide results for 2011 and 2012 that are comparable and better present the underlying business performance, the results of the Group are presented on a ‘combined business’ basis and non-recurring items are included as exceptional items.

The key principles adopted in the preparation of the combined business results are described below.

In order to reflect the acquisition of Northern Rock plc on 1 January 2012, the following adjustments have been made to the Group’s results:

- the 2011 results include the results of Northern Rock plc as if it had been acquired on 1 January 2011
- the unwind of acquisition-related fair value adjustments, which is explained in note (c) on page 12, has been included as an exceptional item in 2012, but has not been backdated to 2011
- the negative goodwill credit on the acquisition of Northern Rock plc and the amortisation of purchased intangible assets have been included as exceptional items in 2012.

In order to show the underlying performance of the combined business, the following items which are not related to the acquisition of Northern Rock plc, have also been included as exceptional items:

- integration costs.

Group Performance

Combined business results

Notes to the combined business results

a Integration costs

The costs of integrating Virgin Money Holdings (UK) Limited and Northern Rock plc amounted to £8.7 million in 2012, after £2.2 million in 2011. The costs relate principally to the “rebrand” of Northern Rock plc to Virgin Money plc.

b Negative goodwill credit

Following completion of its acquisition of Northern Rock plc on 1 January 2012, Virgin Money Holdings (UK) Limited recognised an accounting credit of £139.1 million, after fair value adjustments of £23.3 million, in respect of negative goodwill. This was because when Virgin Money Holdings (UK) Limited acquired Northern Rock plc, the amount of the consideration paid was less than the accounting value (‘fair value’) of the net assets acquired, reflecting the depressed value of banks in general, with many of them trading well below their accounting values, and the fact that the business was loss making.

c Fair value unwind and acquisition related adjustments

After completing its acquisition of Northern Rock plc, Virgin Money Holdings (UK) Limited was required under accounting standards to review the assets and liabilities acquired and recognise their current accounting value (fair value). Due to changes in the economic environment since some of the assets and liabilities were written to the balance sheet, including low economic growth and the continuation of a low interest rate environment, fair value adjustments were made.

Mortgage assets were adjusted downwards by £59.7 million, and deposit liabilities were adjusted downwards by £28.9 million. Other fair value movements of £7.5 million were made, resulting in an overall reduction in net assets of £23.3 million, (£32.7 million before tax). Detail of the assessment of fair value adjustments is given in note 1.31 (xi) and more detail of the adjustment is found in note 21. Under accounting rules, this fair value adjustment will unwind over the expected behavioural life of the assets and liabilities. As a result, the 2012 results include a fair value unwind, as well as other acquisition related adjustments, of £27.5 million before tax.

d Contingent consideration

As a result of the acquisition of Northern Rock plc on 1 January 2012, a contingent consideration of up to £80 million is payable to HM Treasury upon a future profitable IPO or sale of the business between 2012 and 2016. The amount payable varies on a sliding scale depending on the date of completion of any IPO or sale within the time window. The consideration payable starts at £80 million in 2012 and falls to £50 million in 2016 and nil the year after. In accordance with accounting standards the liability has been measured throughout the period since acquisition and is largely influenced by the macro-economic environment both in the UK and wider euro-zone region. As the date to crystallise the 2012 liability of £80 million has now passed the estimate has been updated to reflect both this and continued low growth in the UK economy. Accordingly the estimate of the liability has reduced by £13 million to £5 million at the end of the year.

e Restructuring costs

Restructuring costs relate primarily to the costs of relocating key colleagues to our operational headquarters in Newcastle. The 2011 figure comprises redundancy costs due to the restructure of the business.

f Gain on sale of investment securities

In 2011, Northern Rock plc realised gains of £63.5 million by selling its portfolio of UK Government securities (‘gilts’) which had risen in value because of the fall in UK interest rates. While this gain was included, as an exceptional item, in the 2011 accounts of Northern Rock plc, the £63.5 million was transferred to HM Treasury as part of the acquisition of Northern Rock plc by Virgin Money Holdings (UK) Limited.

Group Performance

Combined business results

g Deal costs

Deal costs associated with the acquisition of Northern Rock plc by Virgin Money Holdings (UK) Limited and costs relating to the acquisition of a credit card portfolio from MBNA amounted to £13.0 million in 2012. The principal elements of these deal costs include £5.2 million of stamp duty costs relating to the acquisition of Northern Rock plc and £6.3 million of costs relating to the acquisition of the credit card portfolio from MBNA. Deal costs of £16 million were incurred in relation to the acquisition of Northern Rock plc in 2011.

h Adjustment for 2011 statutory loss before taxation of Northern Rock plc

The 2011 loss before taxation of Northern Rock plc is added back to reconcile the profit before tax on a statutory basis to the 2011 financial statements of Virgin Money Holdings (UK) Limited.

i Profit before tax – statutory

The £23.5 million profit for 2011 is for Virgin Money Holdings (UK) Limited only and does not include Northern Rock plc.

Corporate Governance Report

Governance Structure

Since the acquisition of Northern Rock plc (now Virgin Money plc) on 1 January 2012, the Company's Board structure and corporate governance have been regulated principally in accordance with the terms of a shareholders' agreement (the "Shareholders' Agreement") agreed between the Company and certain majority shareholders. In accordance with the Shareholders' Agreement, the Company operates a corporate governance structure which voluntarily takes into account the principles of the UK Corporate Governance Code (the "Code") so far as practicable. Only publicly traded and listed companies are required to report on how they have applied the main principles of the Code. However, as the Code sets out best corporate governance practices, the Company adheres to it as far as possible.

The Board

In 2012, the Board comprised Sir David Clementi (Chairman and Chair of the Nomination Committee), Colin Keogh (Independent Non-Executive Director – Chair of the Risk Committee and Remuneration Committee), Norman McLuskie (Independent Non-Executive Director – Chair of the Balance Sheet Committee and Audit Committee), Gordon McCallum (Non-Executive Director and Virgin shareholder representative), James Lockhart III (Non-Executive Director and WL Ross & Co LLC shareholder representative), Patrick McCall (Non-Executive Director and Virgin shareholder representative), Jayne-Anne Gadhia (Executive Director – Chief Executive Officer) and Finlay Williamson (Executive Director – Chief Financial Officer).

In accordance with the Shareholders' Agreement, there are certain matters reserved for the Board to determine and other matters for the Company shareholders to determine.

Induction and Training

It is the Group's policy that every Director should receive appropriate training when appointed to the Board, and subsequently as necessary. The Group's induction process is designed to ensure that every new Director understands their responsibilities as a Director of the Company. The High Level Controls Manual supports this process. The process also enables Directors to build an understanding of the Group, its business and the market in which it operates.

Corporate Governance Report

Board Committees

In accordance with best practice outlined in the Code, various powers and authorities have been delegated to Committees of the Board. The Board currently operates the following main Committees:

- › Audit Committee
- › Risk Committee
- › Balance Sheet Committee
- › Nomination Committee
- › Remuneration Committee
- › Strategy Committee

The Chairman and membership of each Committee is set out below. Each Committee has detailed Terms of Reference clearly setting out its remit and authority. The Terms of Reference are regularly reviewed by the Board and any amendments are recommended by the respective Committees for approval by the Board.

The following paragraphs set out details of the Committees and the particular work that they undertake.

Audit Committee

The Audit Committee currently comprises Norman McLuskie (Chairman) and Colin Keogh.

The Audit Committee considers and, where appropriate, advises the Board on all matters relating to regulatory and accounting requirements that affect the Group, and has delegated authority for reviewing the effectiveness of the Group's system of internal controls. It reports to the Board on both financial and non-financial controls and monitors the integrity of the financial statements of the Group and any formal announcements relating to the Group's financial performance. As part of its remit it oversees the adequacy, security, independence and appropriateness of the whistle-blowing arrangements.

An important aspect of its role is to ensure that an objective and professional relationship is maintained with the external auditors. The Audit Committee has responsibility for recommending the appointment, re-appointment and removal of the external auditors.

The Audit Committee reviews the scope and results of the annual external audit, its cost effectiveness and the independence and objectivity of the external auditors. It also reviews the nature and extent of any non-audit services provided by the external auditors. The external auditors can attend all meetings of the Audit Committee, have direct access to the Committee and its Chairman at all times and are invited at least annually to meet with the Committee in the absence of Management.

The Head of Internal Audit provides further assurance that the significant risks identified by the business are properly managed through attendance at key Committees and delivery of the risk based audit plan. The Head of Internal Audit also has direct access to the Audit Committee and its Chairman. The Committee regularly receives reports of reviews conducted throughout the Group by the Internal Audit function.

Corporate Governance Report

Risk Committee

The Risk Committee currently comprises Colin Keogh (Chairman), Norman McLuskie and Finlay Williamson.

The main role of the Risk Committee is to recommend to the Board the appropriate risk appetite for the Group and then to review on behalf of the Board:

- (i) the key risks inherent in the business
- (ii) the systems of control that are necessary to manage such risks within the agreed risk appetite limits
- (iii) to present its findings to the Board.

This responsibility requires the Risk Committee to keep under review the effectiveness of the Group's risk management frameworks and systems of internal control (which include financial, operational, compliance and risk management controls), and to foster a culture that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of the Group. The Risk Committee fulfils this remit by reinforcing Management's risk management awareness and making appropriate recommendations to the Board on all significant matters relating to the Group's risk appetite, strategy and policies. It is also responsible for considering the current and prospective macroeconomic and financial environment.

Other responsibilities of the Risk Committee include keeping under review the effectiveness of the Group's risk management infrastructure. This involves an assessment of risk management procedures (for the identification, measurement and control of key risk exposures) in accordance with changes in the operating environment. It is also primarily responsible for considering any major findings of the FSA and Management's response to any risk management review undertaken by Internal Audit or the external auditors.

The Risk Committee is responsible for approving the annual risk assurance plan. It receives regular updates from the Chief Risk Officer on progress with the plan and significant issues uncovered. To assist the Board in discharging its responsibilities for the setting of risk policy, the Risk Committee periodically reviews the Group's credit risk, interest rate risk, liquidity risk and operational risk exposures in relation to the Board approved risk appetite and the Group's capital adequacy.

As part of the implementation of the International Convergence of Capital Measurement and Capital Standards: Revised Framework (commonly known as Basel II), the Risk Committee has responsibility for monitoring the performance of the relevant company's Basel credit rating systems and reviewing reports prepared by the Group's Basel designated Committees.

The Risk Committee also ensures that the public disclosure of information regarding the Group's risk management policies and key risk exposures is in accordance with statutory requirements and financial reporting standards. The Committee also considers the reports made by the Money Laundering Reporting Officer.

Corporate Governance Report

Balance Sheet Committee

The Balance Sheet Committee currently comprises Norman McLuskie (Chairman), Colin Keogh, Sir David Clementi and Finlay Williamson.

The Balance Sheet Committee reviews and monitors, on behalf of the Board, the Group's balance sheet financial exposures and advises and makes recommendations to the Board on the management of the balance sheet, particularly with respect to liquidity adequacy, capital management and interest rate risk.

The Board provides defined control parameters within which the Balance Sheet Committee ensures proper oversight of the Group's net interest income and its structural exposure to movements in market rates and other changes in the external environment.

The Balance Sheet Committee is responsible for reviewing information on the Group's net interest margin performance and for overseeing the transfer charging of capital, funding, liquidity and risk costs in order to optimise value taking into account interest rate forecasts.

With regard to capital management, the Balance Sheet Committee is required to monitor, review and make recommendations concerning the quality of the capital base and the forecast capital surplus and consider the projected capital resources. In particular, the Balance Sheet Committee is responsible for considering any proposed dividend distribution with reference to the Group dividend policy and ensuring that there is an ongoing robust capital base.

The Balance Sheet Committee has a number of responsibilities in managing the Group's liquidity. This involves approving the strategic funding and liquidity plan, ensuring cash and treasury assets are held with approved counterparties, reviewing the Market Conduct Source Book and proposing capital, liquidity and interest rate risk stress scenarios. Managing the Group's liquidity also requires the Balance Sheet Committee to produce aggregate regional and global stress tests and approve the transfer pricing framework for funding and liquidity in order to ensure a risk adjusted return framework.

The Balance Sheet Committee is also accountable for monitoring and reviewing the effectiveness of resourcing of the Treasury function. This involves approving as appropriate the Treasury organisation structure for the management of asset and liability risks, and an oversight of the work and reports of the Asset and Liability Committee.

Nomination Committee

The Nomination Committee currently comprises Sir David Clementi (Chairman), Colin Keogh, Norman McLuskie, Gordon McCallum and James Lockhart III.

The purpose of the Nomination Committee is to develop and maintain a formal, rigorous and transparent procedure for making appointments and re-appointments to the Group Company Boards.

Subject to compliance with the requirements of the Shareholders' Agreement, the Committee monitors and reviews the membership of, and succession to, the Board of Directors and the Committee makes recommendations to the Group Company Board in this regard. One of its functions is to identify potential Executive and Non-Executive Directors taking into account the requirements for members of the Board to have an appropriate range of skills and experience.

Corporate Governance Report

Remuneration Committee

The Remuneration Committee currently comprises Colin Keogh (Chairman), Norman McLuskie and Sir David Clementi.

Subject to compliance with the requirements of the Shareholders' Agreement, the Committee is responsible for considering and advising the Board on the remuneration policy for Executive Directors and the Chairman, and for determining their remuneration packages. The Remuneration Committee also develops and maintains formal and transparent procedures for a remuneration framework, and reviews bonus and other reward programmes in order to ensure they support effective risk management. In carrying out its function, the Remuneration Committee has due regard to the FSA's Remuneration Code and other relevant requirements.

In discharging its responsibilities, the Remuneration Committee can take professional advice from within and outside the Group.

In 2012, the Executive Directors of the Company were remunerated by Virgin Money Management Services Limited, a subsidiary of the Company and the Company determined the remuneration policy for the Non-Executive Directors, within the limits set out in the Shareholders' Agreement. The Remuneration Committee also determines the level of remuneration of the Group Company's Executive Committee (comprising management at the level immediately below the Board) and has an oversight role of the Remuneration Policy of the Group as it applies to all employees.

Strategy Committee

The Strategy Committee currently comprises Sir David Clementi (Chairman), Colin Keogh, Norman McLuskie, James Lockhart, Gordon McCallum and Jayne-Anne Gadhia.

The Committee considers and, where appropriate, advises the Board on all matters relating to strategic issues for the Group, within the parameters agreed by the Board from time to time, including changes to the Group's retail-focused banking strategy, potential capital raising, potential acquisitions and disposals, discussions with regulators and rating agencies and involvement in the wider Virgin Group's international strategy and assignments.

The Committee meets at such times as its Chairman determines.

Executive Committee

The Board delegates authority to the Executive Committee to oversee the prudent day to day management of the Company's affairs.

The Executive Committee is led by Jayne-Anne Gadhia (Chief Executive Officer) and comprises of members of the Virgin Money Executive Team (VMET). There is a range of Executive sub-Committees which cover all the key aspects of the Group's business.



Stephen Pearson
Company Secretary
20 March 2013

Directors' Report

For the year ended 31 December 2012

The Directors present their report and the audited consolidated financial statements for the Virgin Money Group for the year ended 31 December 2012.

Principal Activities

The principal activity of Virgin Money Holdings (UK) Limited and its subsidiaries is the provision of retail banking services to UK consumers.

Virgin Money offers a broad range of products to customers across five key categories:

- › Savings
- › Mortgages
- › Cards
- › Insurance
- › Investments.

Virgin Money operates through a nationwide network of 75 Stores and 3 Lounges, and also distributes products online, by post and telephone and through corporate partners. It also operates Virgin Money Giving, a not-for-profit online fundraising website designed to help people to raise more money for charity.

Review of Business and Future Developments

The Group's performance in 2012 is outlined in the Chief Executive's Review. The underlying performance of the Group, allowing for its acquisition of Northern Rock plc on 1 January 2012 and for exceptional items in 2011 and 2012, is set out in the Combined Business Results section on page 10.

Key Performance Indicators

The key performance indicators reviewed by Management to monitor the business include gross mortgage lending, mortgage balances, customer deposit balances and funds under management. These are shown in the table below:

	2012	2011*
Gross mortgage lending (£bn)	4.9	-
Mortgage balances (£m)	16,761.1	17.6
Customer deposit balances (£m)	18,006.7	110.7
Funds under management (£bn)	2.6	2.4
Total assets (£m)	21,831.4	980.3
Statutory profit before tax (£m)	150.6	23.5

* Based on 2011 statutory accounts, not on a combined business basis.

Non-financial KPIs are disclosed in the Highlights for 2012 section on the inside cover of this report.

Directors' Report

For the year ended 31 December 2012

Principal Risks and Uncertainties

The Group is exposed to a variety of risks through its normal operations. The following paragraphs explain the most significant risks and how they are managed. More detail is disclosed in note 38 to the accounts.

- **Credit risk:** the risk that a borrower or counterparty fails to pay the interest, or to repay the capital, on a loan or other financial instrument. All lending is carefully underwritten, and the performance of individual loans is monitored on an ongoing basis by Management and reported regularly to the Board.
- **Market risk:** the risk that the value of, or net income arising from, the Group's assets and liabilities changes as a result of changes to interest rates or exchange rates. Market risk is managed and monitored on an ongoing basis against Board approved risk appetite and policy.
- **Liquidity risk:** the risk that the Group is unable to meet its obligations as they fall due. The Group's position is monitored by Management on a daily basis and liquidity is supported by intercompany facilities if required. The Group's liquidity position is regularly reported to the Board.
- **Operational risk:** the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. A range of indicators covering the Group's operations is reviewed by Management and the Board regularly throughout the year. All key business processes are subject to periodic reviews by the Group's Risk and Internal Audit teams to ensure that appropriate controls are in place and operating effectively.
- **Legal risk:** the risk of legal sanction, material financial loss or loss of reputation that the Group may suffer as a result of its failure to comply with the law, inadequately document its contractual arrangements or inadequately assess and implement changes required by forthcoming legislation or emerging case law. The Virgin Money Group legal department supports the Group in meeting its contractual obligations and assessing legal developments.
- **Regulatory risk:** the risk that the Group fails to comply with its regulatory requirements with the potential that the Group:
 - treats customers unfairly, potentially exposing them to financial or other detriment
 - is subject to legal or regulatory sanction
 - suffers reputational damage
 - is used for the purposes of financial crime.

The Virgin Money Group Risk and Compliance teams support the Group to develop policies, deliver training and perform monitoring checks to ensure compliance with regulatory requirements.

Dividends

No dividends were declared and paid in the year (2011: £Nil).

Directors' Report

For the year ended 31 December 2012

Directors

The current composition of the Board of Directors together with details of appointments and retirements up to the date of this report is as follows:

Executive

Jayne-Anne Gadhia
Finlay Williamson

Company Secretary

Jasan Fitzpatrick
(resigned 23 May 2012)
Stephen Pearson
(appointed 23 May 2012)

Non-Executive

Sir David Clementi
Colin Keogh
James Lockhart
Patrick McCall (appointed 26 June 2012)
Gordon McCallum
Norman McLuskie

As at the date of this report, specific indemnities are in force under which the Company has agreed to indemnify each Director individually, to the extent permitted by law and the Company's articles of association, in respect of all losses arising out of, or in connection with, the execution of their powers, duties and responsibilities, as directors of the Company.

The Company has also arranged Director's and Officer's Insurance on behalf of the Directors in accordance with the provisions of the Companies Act 2006.

Employees

The Group believes that colleagues are fundamental to our success and that capitalising on what is unique about individuals and drawing on their different perspectives and experiences will add value to the way the Group does business.

Using fair, objective and innovative employment practices, the Group's aim is to ensure that:

- all colleagues and potential colleagues are treated fairly and with dignity and respect at all times
- all colleagues have the right to be free from harassment, victimisation and bullying of any description, or any other form of unwanted behaviour, whether based on age, colour of skin, disability, ethnic origin/race, gender/trans-gender status, marital/civil partnership status, sexual orientation, religion or belief
- all colleagues have an equal opportunity to achieve their potential, irrespective of any defining feature that may give rise to unfair discrimination.

Shares

Details of the structure of the Company's authorised and issued share capital as at the year end, as well as any movements in and changes to the authorised and issued share capital during the year, are provided in note 32 to the accounts.

Directors' Report

For the year ended 31 December 2012

The ordinary shareholder base of the Company is set out in the table below:

	Number of ordinary shares held	% of voting class held
Virgin Financial Services UK Holdings Limited	18,028,552	46.53
WL Ross & Co LLC ¹	17,392,752	44.90
Stanhope Investments	2,285,545	5.90
Directors and Management	538,700	1.39
Employee Benefit Trust	268,625	0.69
Other	228,555	0.59
Total		100.00

¹ WL Ross & Co LLC shareholdings are held by WLR IV VM LLC and WLR IV VM II LLC

Details of the Employee Share Schemes are provided in note 7.

Further details regarding the rights and obligations attaching to the current share classes are contained in the Company's Articles of Association.

Creditor Payment Policy

The Group's policy in relation to all of its suppliers is to agree the terms of payment at the outset of our relationship. The average creditor payment period at 31 December 2012 was 30 days.

Going Concern

The Directors are satisfied at the time of approval of the financial statements that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts. The Group's use of the going concern basis for the preparation of the accounts is discussed in note 1.

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the group and parent company financial statements in accordance with applicable law and regulations.

Company Law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law the Directors have elected to prepare the group and the parent company financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law.

Directors' Report

For the year ended 31 December 2012

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 parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates that are reasonable and prudent
- state whether they have been prepared in accordance with IFRS as adopted by the EU
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its Financial Statements comply with the Companies Act 2006. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

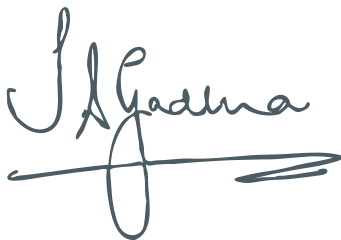
The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Auditor and Disclosure of Information to the Auditor

So far as every Director is aware at the date of this report, there is no relevant audit information needed in preparation of the auditor's report of which the auditor is not aware. The Directors have taken the steps they need to have taken as Directors to make themselves aware of any relevant audit information and to establish that the auditor is also aware of that information.

Under section 487(2) of the Companies Act 2006, KPMG LLP will be deemed to have been reappointed as auditor 28 days after these financial statements were sent to members or 28 days after the latest date prescribed for filing the accounts with the registrar, whichever is earlier.

This report was approved by the Board on 20 March 2013 and signed on its behalf by:



Jayne-Anne Gadhia
Chief Executive Officer

Independent Auditor's Report to the Members of Virgin Money Holdings (UK) Limited

We have audited the financial statements of Virgin Money Holdings (UK) Limited for the year ended 31 December 2012 as set out on pages 26 to 101. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

The 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 22, 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 (APB's) Ethical Standards for Auditors.

Scope of the Audit of the Financial Statements

A description of the scope of an audit of financial statements is provided on the APB's website at: www.frc.org.uk/auditscopeukprivate

Opinion on Financial Statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2012 and of the Group's profit for the year then ended
- the Group's financial statements have been properly prepared in accordance with IFRS as adopted by the EU
- the parent company financial statements have been properly prepared in accordance with IFRS as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on Other Matters 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.

Independent Auditor's Report to the Members of Virgin Money Holdings (UK) Limited

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 parent company, or returns adequate for our audit have not been received from branches not visited by us
- the parent company financial statements are not in agreement with the accounting records and returns
- certain disclosures of Directors' remuneration specified by law are not made
- we have not received all the information and explanations we require for our audit.

Michael Peck (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
15 Canada Square
London
E14 5GL

20 March 2013

Consolidated Income Statement

For the year ended 31 December 2012

	Note	2012	2011
		£m	£m
Interest income	2	633.3	3.8
Interest expense	3	(498.0)	(2.1)
Net interest income		135.3	1.7
Fee and commission income		17.5	-
Fee and commission expense		(17.6)	-
Other operating income	4	110.1	136.2
Gain on sale of property, plant and equipment		0.1	-
Gains on sale of investment securities	18	16.9	-
Fair value gains on financial instruments		0.8	-
Total other income		127.8	136.2
Total income		263.1	137.9
Administrative expenses		(232.2)	(90.5)
Depreciation and amortisation	5,23,24	(16.7)	(7.9)
Acquisition costs	5	(13.0)	(16.0)
Total operating expenses	5	(261.9)	(114.4)
Impairment losses on loans and advances	9	(3.0)	-
Contingent consideration	36	13.0	-
Negative goodwill credit	21	139.1	-
Profit for the year by the disposal group		0.3	-
Profit before taxation		150.6	23.5
Taxation	10	67.8	(10.5)
Profit for the year attributable to owners		218.4	13.0
Other comprehensive income			
Net movement in available for sale reserve	35	11.8	-
Net movement in cash flow hedge reserve	35	(11.3)	-
Total comprehensive income for the year attributable to owners		218.9	13.0

The notes on pages 33 to 101 form an integral part of these financial statements

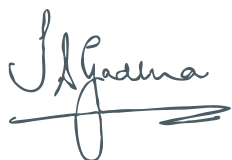
Consolidated Balance Sheet

As at 31 December 2012

	Note	2012	2011
		£m	£m
Assets			
Cash and balances at central banks	13	1,604.5	62.8
Disposal group assets held for sale	14	79.6	-
Loans and advances to banks	15	1,310.2	801.8
Loans and advances to customers	16	16,761.1	17.6
Fair value adjustments of portfolio hedging	16	133.0	-
Investment securities	18	1,534.3	4.6
Derivative financial instruments	20	161.0	0.9
Intangible assets	23	34.8	19.0
Property, plant and equipment	24	77.2	10.8
Prepayments and accrued income		18.7	5.3
Deferred taxation	26	79.8	2.2
Other assets	25	37.2	55.3
Total assets		21,831.4	980.3
Liabilities			
Deposits by banks	27	3.4	253.8
Customer accounts	28	18,006.7	110.7
Disposal group liabilities held for sale	14	54.3	-
Derivative financial instruments	20	285.6	-
Debt securities in issue	17	2,266.6	-
Taxation		-	12.0
Accruals and deferred income	30	242.2	44.9
Provisions for liabilities and charges	31	6.4	-
Other liabilities	29	211.4	23.6
Total liabilities		21,076.6	445.0
Equity			
Share capital	32	-	-
Share premium	33	509.2	509.2
Own shares	34	(6.2)	(2.2)
Other reserves	35	0.3	(4.6)
Retained earnings		251.5	32.9
Total equity		754.8	535.3
Total liabilities and equity		21,831.4	980.3

The notes on pages 33 to 101 form an integral part of these financial statements.

The financial statements were approved and authorised for issue by the Board and were signed on its behalf on 20 March 2013.



Jayne-Anne Gadhia
Chief Executive Officer

Consolidated Statement of Changes in Equity

For the year ended 31 December 2012

	Share capital	Share premium	Other reserves	Own shares	Retained earnings	Total equity
	£m	£m	£m	£m	£m	£m
Balance as at 1 January 2011	-	134.5	(0.2)	-	19.4	153.7
Profit for the year	-	-	-	-	13.0	13.0
Other comprehensive income						
Net movement in available for sale reserve	-	-	-	-	-	-
Net movement in cash flow hedge reserve	-	-	-	-	-	-
Total comprehensive income for the year	-	-	-	-	13.0	13.0
Transactions with equity holders, recognised in equity						
Issuance of shares	-	374.7	-	-	-	374.7
Employee benefit trust	-	-	(4.4)	(2.2)	-	(6.6)
Share-based payments	-	-	-	-	0.5	0.5
Balance as at 31 December 2011	-	509.2	(4.6)	(2.2)	32.9	535.3
Balance as at 1 January 2012	-	509.2	(4.6)	(2.2)	32.9	535.3
Profit for the year	-	-	-	-	218.4	218.4
Other comprehensive income						
Net movement in available for sale reserve	-	-	11.8	-	-	11.8
Net movement in cash flow hedge reserve	-	-	(11.3)	-	-	(11.3)
Total comprehensive income for the year	-	-	0.5	-	218.4	218.9
Transactions with equity holders, recognised in equity						
Issuance of shares	-	-	-	-	-	-
Employee benefit trust	-	-	4.4	(4.0)	-	0.4
Share-based payments	-	-	-	-	0.2	0.2
Balance as at 31 December 2012	-	509.2	0.3	(6.2)	251.5	754.8

Other reserves in 2011 included an amount in relation to put options granted over shares in relation to an Employee Benefit Trust (see note 34).

The notes on pages 33 to 101 form an integral part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2012

	Note	2012	2011
		£m	£m
Net cash inflow from operating activities			
Profit before taxation		150.6	23.5
Adjusted for:			
Depreciation and amortisation		16.7	3.3
Gains on sale of property, plant and equipment		(0.1)	-
Gains on investment securities		(16.9)	-
Income tax paid		(18.0)	(12.4)
Fair value adjustments on financial instruments		(139.4)	-
Impairment of intangible assets		-	4.6
Deemed loss on exercise of warrants		-	0.6
Net increase in deferred tax		-	1.2
Net increase in share based payment reserve		0.2	0.5
Contingent consideration		(13.0)	-
Negative goodwill credit		(139.1)	-
Net cash (outflow)/inflow from operating profit before changes in operating assets and liabilities		(159.0)	21.3
Changes in operating assets and liabilities			
Net increase in deposits held for regulatory or monetary control purposes		2,741.2	-
Net (increase)/decrease in loans and advances to customers		(2,659.8)	3.3
Net increase in derivative financial instruments payable		20.7	-
Net decrease in loans and advances to banks		859.3	162.7
Net increase in prepayments and accrued income		(0.9)	(1.8)
Net increase/(decrease) in other assets		54.2	(18.1)
Net (decrease) in provision for liabilities		(1.4)	(0.1)
Net (increase) in deposits from banks		(94.8)	-
Net increase/(decrease) in customer accounts		1,295.4	(8.8)
Net (increase)/decrease in other liabilities		(24.5)	9.8
Net increase in accruals and deferred income		41.3	7.8
Net cash inflow from operating activities		2,071.7	176.1
Net cash (outflow)/inflow from investing activities			
Net investment in intangible assets		(5.5)	(10.3)
Net investment in property, plant & equipment		(23.6)	(9.5)
Net investment in securities		(3,121.3)	-
Proceeds from sale and redemption of investment securities		2,885.6	75.0
Movement in disposal of group assets and liabilities		(9.6)	-
Acquisition of Virgin Money plc		(825.0)	-
Net cash (outflow)/inflow from investing activities		(1,099.4)	55.2
Net cash (outflow)/inflow from financing activities			
Issuance of ordinary shares		-	363.9
Loan from banks		(253.8)	253.8
Sale/(repurchase) of shares by Employee Benefit Trust		0.6	(2.2)
Net increase in debt securities in issue		1,320.2	-
Net cash (outflow)/inflow from financing activities		1,067.0	615.5
Net increase in cash and cash equivalents		2,039.3	846.8
Cash and cash equivalents at 1 January		857.1	10.3
Cash and cash equivalents at 31 December	12	2,896.4	857.1

The notes on pages 33 to 101 form an integral part of these financial statements.

Company Balance Sheet

As at 31 December 2012

	Note	2012	2011
		£m	£m
Assets			
Loans and advances to banks	15	17.1	772.8
Investment in subsidiary undertakings	19	1,118.4	128.7
Derivative financial instruments	20	0.2	0.9
Other assets	25	59.3	56.8
Prepayments and accrued income		0.1	10.8
Deferred tax	26	0.3	0.4
Total assets		1,195.4	970.4
Liabilities			
Deposits by banks	27	-	253.8
Other liabilities	29	328.4	171.8
Total liabilities		328.4	425.6
Equity			
Share capital	32	-	-
Share premium	33	509.2	509.2
Own shares	34	(6.2)	(2.2)
Other reserves		-	(4.4)
Retained earnings		364.0	42.2
Total equity		867.0	544.8
Total liabilities and equity		1,195.4	970.4

The notes on pages 33 to 101 form an integral part of these financial statements.

The financial statements were approved and authorised for issue by the Board and were signed on its behalf on 20 March 2013.



Jayne-Anne Gadhia
Chief Executive Officer

Company Statement of Changes in Equity

For the year ended 31 December 2012

	Share capital	Share premium	Other reserves	Own shares	Retained earnings	Total equity
	£m	£m	£m	£m	£m	£m
Balance as at 1 January 2011	-	134.5	-	-	64.0	198.5
Loss for the year	-	-	-	-	(22.3)	(22.3)
Total comprehensive income for the year	-	-	-	-	(22.3)	(22.3)
Transactions with equity holders, recognised in equity						
Employee Benefit Trust	-	-	(4.4)	(2.2)	-	(6.6)
Issuance of shares	-	374.7	-	-	-	374.7
Share-based payments	-	-	-	-	0.5	0.5
Balance as at 31 December 2011	-	509.2	(4.4)	(2.2)	42.2	544.8
Balance as at 1 January 2012	-	509.2	(4.4)	(2.2)	42.2	544.8
Profit for the year	-	-	-	-	321.6	321.6
Total comprehensive income for the year	-	-	-	-	321.6	321.6
Transactions with equity holders, recognised in equity						
Employee Benefit Trust	-	-	4.4	(4.0)	-	0.4
Issuance of shares	-	-	-	-	-	-
Share-based payments	-	-	-	-	0.2	0.2
Balance as at 31 December 2012	-	509.2	-	(6.2)	364.0	867.0

Other reserves in 2011 include an amount in relation to put options granted over shares in relation to an Employee Benefit Trust (see note 34).

The notes on pages 33 to 101 form an integral part of these financial statements.

Company Cash Flow Statement

For the year ended 31 December 2012

	Note	2012	2011
		£m	£m
Net cash (outflow)/inflow from operating activities			
Profit/(loss) before taxation		319.4	(28.7)
Adjusted for:			
Income tax paid		6.6	2.7
Unrealised movement on derivatives		0.7	-
Deemed loss on exercise of warrants		-	0.5
Revaluation of subsidiary investment		4.6	-
Contingent consideration		(13.0)	-
Gain on sale of subsidiaries		(320.3)	-
Net cash outflow from operating profits before changes in operating assets and liabilities		(2.0)	(25.5)
Changes in operating assets and liabilities			
Net increase in other assets		0.4	0.1
(Increase)/decrease in amounts due to group undertakings		(51.1)	144.4
Net decrease/(increase) in other liabilities		0.3	(0.3)
Net cash (outflow)/inflow from operating activities		(52.4)	118.7
Net cash outflow from investing activities			
Investment in subsidiary undertakings		-	(15.0)
Purchase of subsidiary undertaking		(825.0)	(10.9)
Sale of subsidiary undertaking		330.0	-
Net cash outflow from investing activities		(495.0)	(25.9)
Net cash (outflow)/inflow from financing activities			
Issuance of ordinary shares		-	363.9
Loan from banks		(253.8)	253.8
Amounts from group undertakings		49.5	(36.1)
Repurchase of shares by Employee Benefit Trust		(4.0)	(2.2)
Net cash (outflow)/inflow from financing activities		(208.3)	579.4
Net (decrease)/increase in cash and cash equivalents		(755.7)	672.2
Opening cash and cash equivalents		772.8	100.6
Closing cash and cash equivalents	12	17.1	772.8

The notes on pages 33 to 101 form an integral part of these financial statements.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies

1.1 Reporting entity

Virgin Money Holdings (UK) Limited is a company incorporated and registered in England and Wales.

1.2 Basis of preparation

The Group and Company financial statements, which should be read in conjunction with the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, IFRIC interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. No individual profit and loss account is presented for the Company, as permitted by Section 408(4) of the Companies Act 2006.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Group and all of its subsidiaries. The Directors are confident that they show that the Group will have sufficient resources to meet its liabilities as they fall due. Accordingly the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

1.3 Basis of consolidation

In these financial statements Virgin Money Holdings (UK) Limited is referred to as the "Company". The "Group" consists of the Company and all its subsidiaries. The subsidiaries are listed in note 19. The consolidated financial statements comprise the financial statements of the Group.

Entities are regarded as subsidiaries where the Group has the power to govern financial and operating policies so as to obtain benefits from their activities. Inter-company transactions and balances are eliminated upon consolidation.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that control ceases. Uniform accounting policies are applied consistently across the Group.

1.4 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments and available for sale assets held at fair value. A summary of the material Group accounting policies is set out below.

The preparation of the financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

1.5 Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

The effective interest rate method calculates the amortised cost of a financial asset or a financial liability, and allocates the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

1.6 Fees and commissions

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan. Insurance commissions are recognised in the period in which they are earned.

1.7 Other operating income

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts.

Income arising from credit card co-branding arrangements is reflected within the pre-tax net income of the total card portfolio and recognised daily. Amounts received over and above the standard mechanism are recorded as revenue when it is considered the performance obligations relating to such amounts have been fulfilled.

In 2009, the Company agreed to vary the terms of its existing contract with the credit card partner extending it for a period of a further 5 years. The substance of the transaction is such that the equivalent revenues to which the Company is entitled during the term of the contract extension are deemed to relate to the entire contract period of 10 years. As such, contracted revenues have been spread over a period of 10 years, discounted at a rate equivalent to an appropriate 10 year bond yield.

Other operating income from sales of units in managed funds is recognised daily based on the average volume of funds under management.

Fees charged to charities for registering with Virgin Money Giving Limited are recognised from the date on which there is no significant uncertainty as to their collectability. The 2% commission charged on donations and event fees is recognised from the date donations and event fees are transacted on the website. Both of these income streams contribute towards costs incurred by Virgin Money Giving which is the Group's not-for-profit subsidiary.

1.8 Financial instruments

Financial assets can be classified in the following categories: loans and receivables, available for sale, held to maturity or financial assets at fair value through profit or loss. Management determines the classification of its financial instruments at initial recognition. The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (see below). Regular way purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on the trade date – the date on which the Group commits to purchase or sell the asset.

Loans and receivables at amortised cost

The Group's loans and advances to banks and customers are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan. Both loans and receivables and financial liabilities are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

Available for sale financial assets

Available for sale financial assets are non-derivative assets that are either designated as available for sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally but not exclusively investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models. Subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in the income statement. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to the income statement.

Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity. They are initially measured at fair value including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. No financial assets were classified as held to maturity during either the current or prior year.

Financial assets at fair value through profit or loss

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in the income statement.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Financial liabilities

Borrowings, including shares, deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

1.9 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

1.10 Derivative financial instruments and hedge accounting

The Group is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest and foreign exchange rates inherent in the Group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and so it is therefore decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially at fair value and subsequently remeasured to fair value. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models. Where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within hedging relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at hedge inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group designates certain derivatives as either:

(i) Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. The fair value gain or loss relating to the ineffective portion is recognised immediately in the income statement.

(ii) Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

If derivatives are not designated as hedges then changes in fair values are recognised immediately in the income statement.

(iii) Embedded derivatives

Certain derivatives are embedded within other non-derivative host instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risk of the host instrument, and where the hybrid instrument is not measured at fair value, the Group separates the embedded derivative from the host instrument and measures it at fair value with the changes in fair value recognised in the income statement.

1.11 Client money

The Group's unit trust management and investment intermediary subsidiaries administer money on behalf of some clients in accordance with the Client Money Rules of the Financial Services Authority. Such monies and the corresponding amounts due to clients are not shown on the face of the balance sheet as the Group is not the beneficial owner.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

1.12 Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest rate method. Securities lent to counterparties are also retained in the financial statements.

1.13 Impairment losses

The Group assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if and only if there is a loss event (or events) that has occurred after initial recognition, and on or before the balance sheet date, that has a reliably measurable impact on the estimated future cash flows of the financial assets or groups of financial assets. Losses that are incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements.

Assets held at amortised cost

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. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events:

- significant financial difficulty of the issuer or obligor
- a breach of contract, such as a default or delinquency in interest or principal repayments
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider
- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation
- the disappearance of an active market for that financial asset because of financial difficulties
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - (i) adverse changes in the payment status of borrowers in the portfolio
 - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an impairment allowance and the amount of the loss is recognised in the income statement. In future periods the unwinding of the discount is recognised within interest income.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in the income statement.

A specific provision is also made in the case of accounts, which may not currently be in arrears, where the Group has exercised forbearance in the conduct of the account. The provision is based on the propensity of the account to realise a loss, had forbearance not been shown. Normal impairment procedures are followed, and as 31 December 2012 the value of such cases of forbearance was not assessed to be material.

Available for sale financial assets

The Group's debt securities and treasury bills are held as available for sale assets. For available for sale financial assets, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets are impaired. The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The amount of the impairment loss is recognised in the income statement. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

1.14 Disposal group

Assets and liabilities of a disposal group are classified as held for sale where the carrying amount will be recovered principally through a sale transaction as opposed to continuing use and they are available for sale in the present condition. This is subject only to the terms that are usual and customary for the sale of such assets and liabilities and the sale being highly probable and expected to complete within one year of being classified as a disposal group. The disposal group is measured at the lower of carrying amount and fair value less costs to sell.

1.15 Derecognition of financial assets and liabilities

Derecognition is the point at which the Group removes an asset or liability from its balance sheet. The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires. The Group also derecognises financial assets that it transfers to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, cancelled or has expired or is transferred to a third party.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

1.16 Securitisation transactions

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers. Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless:

- (i) a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised
- (ii) substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised
- (iii) a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement.

The Group has also entered into self-issuance of securitised debt which may be used as collateral for repurchase or similar transactions. Investments in self-issued debt and the equivalent deemed loan, together with the related income, expense and cash flows, are not recognised in the financial statements.

1.17 Debt and equity securities in issue

Issued securities are classified as liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities.

Financial liabilities are carried at amortised cost using the effective interest rate method (see note 39). Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities.

1.18 Foreign currency translation

The Group's financial statements are presented in sterling, which is the functional currency of the parent Company.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement. Non-monetary items measured at amortised cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss.

1.19 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, including cash and non-restricted balances with central banks.

1.20 Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income.

Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The Group has adopted the Code of Practice on Taxation issued by HM Revenue and Customs.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

1.21 Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50-100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5-30 years
Computer equipment	3-5 years
Office equipment	3-10 years
Motor vehicles	4 years

Assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated. Property, plant and equipment are subject to impairment testing, if deemed appropriate.

1.22 Impairment of property, plant and equipment and intangible assets

Property, plant and equipment and intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on a fixed asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the fixed asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

1.23 Intangible assets and amortisation

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3-5 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 10, purchased goodwill (representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired) arising on business combinations in respect of acquisitions since 1 January 1998 is capitalised.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

Positive goodwill is held on the balance sheet and tested for impairment annually.

Computer software

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 5 years.

Costs associated with maintaining software are expensed as they are incurred.

1.24 Leases

If the lease agreement, in which the Group is a lessee, transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to the income statement on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the income statement in the period in which termination is made.

1.25 Provisions

Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

1.26 Investments in subsidiaries

Investments in subsidiaries are valued at cost less provision for impairment. Investments in subsidiaries are included in the Company's balance sheet, comprising equity investments in subsidiary entities. These are carried at cost less impairment provisions. At each reporting date an assessment is undertaken to determine if there is any indication of impairment. This assessment can include reviewing factors such as the solvency, profitability and cash flows generated by the subsidiary. If there is an indication of impairment, an estimate of the recoverable amount is made. If the carrying value exceeds the recoverable amount then a provision for impairment is made to reduce the carrying value to the recoverable amount.

1.27 Share capital

The financial instruments issued by the Company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

- (a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company
- (b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability.

Share issue costs

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Dividends

Dividends are recognised in equity in the period in which they are approved by the Company's shareholders or paid.

1.28 Employee Benefit Trust

Purchases of shares by the Employee Benefit Trust ("EBT") are accounted for as a purchase of own shares by the Company and are debited to the own shares reserve at cost. Put options granted over the Company's shares are accounted as a financial liability with a corresponding deduction in equity.

1.29 Share based payments

The Group engages in share based payment transactions in respect of services received from certain of its employees. The grant date fair value of share-based payment awards granted is recognised as an employee expense with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards.

The fair value of the shares granted is determined using valuation models, which take into account the terms and conditions upon which the shares were granted, the exercise price of the shares, the risk free interest rate, the expected volatility of the Company's share price and other relevant factors. In the absence of market prices, the fair value of the instruments at the date of the grant is estimated using an appropriate valuation technique.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

For share based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

For cash settled share based payment transactions, the fair value of the amount payable to the employee is recognised as an expense with a corresponding increase in liabilities. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value is measured based on a valuation model taking into account the terms and conditions upon which the instruments were granted. The liability is revalued at each balance sheet date and settlement date with any changes to fair value being recognised in the profit and loss account.

1.30 Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, i.e. when control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

The Group measures goodwill at the acquisition date as the fair value of the consideration transferred less the fair value of the net identifiable assets acquired and liabilities assumed.

When the excess is negative, the negative goodwill is recognised immediately in profit or loss.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

1.31 Accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on Management's best knowledge of the amount, actual results ultimately may differ from those estimates. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed below:

(i) Revenue recognition

During 2012, the Group received income direct from its credit card, payment services and insurance partners on the basis of detailed contractual terms, rather than direct from the customer. This required judgement in both determining whether performance obligations have been delivered, and estimation of the appropriate revenue, and Management have exercised judgement in both these respects.

(ii) Acquisitions

As set out in note 21, a portfolio of mortgage assets was purchased by the Company in 2012. Judgement was necessary to determine whether the acquisition was a business combination or an asset purchase. Management has determined that the acquisition was an asset purchase as the assets were solely purchased without staff contracts or processes or other aspects of the business being transferred with them.

(iii) Acquisition accounting

Acquisition accounting involves a number of estimation techniques, including the determination of the fair value of assets and liabilities at acquisition, the fair value of consideration and the determination of the appropriate depreciation period for non-current assets acquired. Management's estimates of the fair values in relation to the acquisition of Northern Rock plc are contained in note 21. The major judgements and estimates relate to the fair value of the mortgage and deposit books, the fair value of the core deposit intangible and tax asset and the fair value of the contingent consideration.

(iv) Taxation and deferred tax assets

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is based mainly on the premise that the relevant subsidiary will generate sufficient profits in the medium term to realise the deferred tax assets.

This is reviewed at each reporting date by the Directors with a detailed exercise to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise and the deferred tax asset reverse. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax is realised or the deferred tax liability is settled.

Following the acquisition of Northern Rock plc, Management reviewed the unrecognised deferred tax balances within the Company against forecasts of future taxable profits. This exercise demonstrated to the satisfaction of the Directors that a deferred tax asset could be recognised. At 31 December 2012, a total deferred tax asset of £79.8m is recognised. Note 26 provides further information.

(v) Contingent liabilities

Through its partnership agreement with MBNA during the year in respect of personal credit cards, certain obligations payable in cash may arise if business volumes and activity do not reach pre-agreed targets. Management has utilised appropriate estimation and modelling techniques to assess liabilities and exercised judgement in respect of assumptions and estimates used.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

(vi) Contingent consideration

As a result of the acquisition of Northern Rock plc on 1 January 2012, a contingent consideration of up to £80m is payable to HM Treasury upon a future profitable IPO or sale of the business between 2012 and 2016. The amount payable varies on a sliding scale depending on the date of completion of any IPO or sale within the time window. The consideration payable starts at £80m in 2012 and falls to £50m in 2016 and nil the year after. In accordance with accounting standards, the liability has been measured throughout the period since acquisition and is largely influenced by the macro-economic environment both in the UK and wider euro-zone region. As the date to crystallise the 2012 liability of £80m has now passed, the estimate has been updated to reflect both this and continued low growth in the UK economy. Accordingly, the estimate of the liability has reduced by £13m to £5m at the end of the year. The key judgement relates to estimating the timing of any potential payment.

(vii) Non-financial assets

A review of non-financial assets for indications of impairment is undertaken at each reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. Management judgement was necessary in the impairment assessment of the intangible assets, the investment in certain subsidiaries and the assets held in a disposal group. In the year ended 31 December 2011 the acquisition goodwill on Church House Trust Limited was considered to be impaired as set out in note 23.

(viii) Impairment losses on loans and advances

Individual impairment losses on loans and advances are calculated based on an individual valuation of the underlying asset. Collective impairment losses on loans and advances are calculated using a statistical model. The key assumptions used in the model are the probability of any balance entering into default in the next twelve months as a result of an event that had occurred prior to the balance sheet date; the probability of this default resulting in possession or write off; and the subsequent loss incurred. These key assumptions are based on observed data trends and are updated on a monthly basis within the agreed methodology to ensure the impairment allowance is entirely reflective of the current portfolio. The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes. To the extent that the loss given default differs by +/- 10%, the impairment allowance would be an estimated £0.8m (2011: £Nil) higher or £0.8m (2011: £Nil) lower respectively.

(ix) Fair value calculations

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty. For the majority of instruments carried at fair value these are determined by reference to quoted market prices. Where these are not available, fair value is based upon cash flow models, which use wherever possible independently sourced market parameters such as interest rate yield curves, currency rates and option volatilities. Other factors are also considered, such as counterparty credit quality and liquidity. Management must use judgement and estimates where not all necessary data can be externally sourced or where factors specific to the Group's holdings need to be considered. The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions. For example, if management were to use a tightening in the credit spread of 10 basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £16.5m (2011: £Nil).

(x) Average life of secured lending

IAS 39 requires interest earned from mortgage lending to be measured under the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset.

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. The accuracy of the effective interest rate would therefore be affected by unexpected market movements resulting in altered customer behaviour, inaccuracies in the models used compared to actual outcomes and incorrect assumptions. Management have reviewed expected average lives in the period and the catch-up adjustment resulted in an income statement credit in the consolidated financial statements of £15.3m driven by an expectation that, on an overall basis, loan lives are longer. If the estimated average life of secured loans were increased or reduced by one month, the value of such loans on the balance sheet would be increased or decreased by £5.6m (2011: £Nil) and £5.5m (2011: £Nil) respectively.

(xi) Fair value of identifiable net assets of Northern Rock plc

The acquisition of Northern Rock plc on 1 January 2012 has been accounted for in accordance with applicable accounting standards which require the recognition of the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. As part of this process, it is also necessary to identify and recognise certain assets and liabilities which are not included on the acquiree's balance sheet such as a core deposit intangible (note 21).

The exercise to fair value the Northern Rock plc balance sheet was inherently subjective and required management to make a number of assumptions and estimates. Fair values were established using discounted cash flow models.

During 2012, the effects of the fair value adjustments have started to unwind and be recognised in the Group's income statement. The determination of the extent to which the adjustments unwind often requires significant judgement. The unwind of the acquisition-date fair values on both customer lending and customer accounts is based on the estimated average life of the underlying asset or liability.

(xii) Non-Core Tier One Notes

The Non-Core Tier One notes have both debt and equity features and are classified as a compound financial instrument. The equity features include the perpetual life of the notes and the discretionary nature of dividends. The debt feature relates to a conversion mechanism whereby under certain scenarios the notes convert to ordinary equity. This conversion mechanism is a contingent settlement feature. When valuing a debt component such as this, management judgement is required on the probability of the conversion event occurring. Management has estimated the fair value of the debt component to be £150m with no element of the instrument being shown in equity.

(xiii) Disposal group

The assets and liabilities of Church House Trust Limited have been classified as held for sale within a disposal group. Management judgement was required in assessing whether the sale of Church House Trust Limited is highly probable and is expected to complete within one year of being classified as a disposal group.

(xiv) Provisions and Indemnification asset

A provision has been recorded in these accounts in relation to the cost of remediating the interest charged to customers who have been found to have letters and statements which were not in compliance with the Consumer Credit Act. Management judgement was required in recognising the corresponding indemnification asset. Full details of the provision and the corresponding asset are provided in Note 31.

1.32 Accounting developments

The following new standards, amendments to standards or interpretations are mandatory for the first time for financial years during 2012 and have been endorsed for adoption by the EU, but have no material financial impact on the Group. These are applicable from 1 January 2012 unless otherwise stated:

- (i) Amendment to IAS 12, 'Income taxes' on deferred tax.
- (ii) Amendment to IFRS 7, Financial Instruments: Disclosures – Transfers of Financial Assets (effective for annual periods beginning from 1 July 2011).

Notes to the Financial Statements

For the year ended 31 December 2012

1. Accounting Policies (continued)

1.33 Standards, interpretations and amendments to published standards that are not yet effective and the early adoption of standards

The Group has not early adopted any standards or interpretations during 2012.

The following new standards, amendments to standards or interpretations that are relevant to the Group have been issued and have been endorsed by the EU but are not effective for financial years beginning 1 January 2012:

- (i) Amendment to IAS 1, Presentation of financial statements, on other comprehensive income (OCI)
- (ii) Amendment to IFRS 7, Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities
- (iii) IFRS 10, Consolidated financial statements
- (iv) IFRS 11, Joint arrangements
- (v) IFRS 12, Disclosures of interests in other entities
- (vi) IFRS 13, Fair value measurement
- (vii) IAS 19, (revised 2011), Employee benefits.
- (viii) IAS 27, Separate financial statements
- (ix) IAS 28, Investments in associates and joint ventures
- (x) Amendment to IAS 32, Financial Instruments: Presentation on offsetting financial assets and financial liabilities.

The following new standards, amendments to standards or interpretations that are relevant to the Group have been issued but are not effective for financial years beginning 1 January 2012 and have not been endorsed by the EU:

- (i) IFRS 9, Financial instruments

Phase III of IFRS 9 may affect the way a company reports hedging instruments and how the companies treat the ineffective proportion of these instruments. This phase received an exposure draft in December 2011 and has passed. IFRS 9 has an effective date of January 2015.

Notes to the Financial Statements

For the year ended 31 December 2012

2. Interest Income

	2012	2011
	£m	£m
On loans and advances to customers	598.4	1.3
On loans and advances to banks	1.6	0.5
On investment securities	19.0	1.3
On cash and balances with central banks	12.2	-
Other interest	2.1	0.7
Total	633.3	3.8

Interest accrued on individually impaired assets was £0.6m (2011: £0.3m).

3. Interest Expense

	2012	2011
	£m	£m
On retail customer accounts	465.2	1.0
On other customer accounts	0.6	-
On deposits by banks	0.4	-
On debt securities in issue	27.9	-
Other	3.9	1.1
Total	498.0	2.1

Notes to the Financial Statements

For the year ended 31 December 2012

4. Other Operating Income

Total operating income represents net interest income, fees and commission income and other operating income.

Other operating income is attributable to the sale and management of stocks and shares ISAs, pensions, authorised unit trusts, the marketing of credit cards, general insurance and other financial services products.

Total operating income is derived in the United Kingdom and relates to trade with third parties and continuing operations.

	2012	2011
	£m	£m
Gross credit card income	83.5	116.3
Reimbursed marketing costs	(3.8)	(8.3)
Net credit card income	79.7	108.0
Investment and protection income	29.9	26.7
Other*	0.5	1.5
Total	110.1	136.2

* Other includes commission on donations, interest received from related parties and other sundry income.

Notes to the Financial Statements

For the year ended 31 December 2012

5. Total Operating Expenses

	2012	2011
	£m	£m
Wages and salaries	85.8	26.4
Social security costs	11.2	3.4
Other pension costs	8.0	1.9
Employee share option scheme	2.5	1.4
Total employee costs	107.5	33.1
Other operating expenses (see below)	154.4	81.3
Total	261.9	114.4
Other operating expenses includes:		
Hire of equipment	5.4	-
Property rentals	10.0	2.1
Remuneration of auditors (see below)	1.2	0.6
Depreciation of owned fixed assets	8.2	2.4
Amortisation of intangible assets	8.5	0.9
Costs of acquiring businesses	13.0	16.0
Impairment of intangible assets	-	4.6
Marketing costs	29.1	20.5

Total expenses includes exceptional costs of £0.8m (2011: £Nil) related to restructuring the Group.

Employee Information

The monthly average number of persons (including Directors) employed by the Group was as follows:

	2012	2011
Full time	2,300	340
Part time	485	77
Total	2,785	417

The Company did not directly employ any staff during the year.

Notes to the Financial Statements

For the year ended 31 December 2012

5. Total Operating Expenses (continued)

Services provided by the Group's auditor and network firms

During the year the Group obtained the following services from the Group's auditor as detailed below:

	2012	2011
	£m	£m
Fees payable to the Company's auditor for the audit of the Company's accounts	0.1	0.1
Fees payable to the Company's auditor for other services:		
The audit of the Company's subsidiaries pursuant to legislation	0.5	0.2
Audit related assurance services	0.3	-
Tax advisory services	0.2	-
Other assurance services	0.1	-
Corporate finance services	-	0.3
Total	1.2	0.6

All amounts payable to the auditors have been charged to Virgin Money Management Services Limited and Virgin Money plc, subsidiary undertakings of the Company.

6. Retirement Benefit Obligations

The Group operates a defined contribution pension scheme, for its Directors and employees. The assets of the scheme are held separately from those of the Company in an independently administered fund. The Group made contributions of £8.0m (2011: £1.9m) during the year. There were no unpaid contributions outstanding at the year end (2011: £Nil).

7. Employee Share Schemes

The Group puts in place share schemes for employees to reward good business performance and to incentivise growth for the future.

The four existing Group employee share schemes are listed below in chronological order.

Existing Group schemes

On 7 October 2011, an equity based option scheme was set up for a senior individual with a hurdle valuation of £471.5m over a three year vesting period. A valuation model was used to determine the value of the shares which took into account the exercise price of shares, current share price, risk free interest rate and expected share price volatility. An option to subscribe for up to 64,384 shares was issued when the scheme was set up. On 19 June 2012, the scheme was modified by the Board such that the number of option shares would be increased to 65,824. In line with the rules of the scheme, one third of the shares vested in October 2012, however, none of these have yet been exercised.

On 27 January 2012, the 2012 Growth Scheme was introduced primarily targeted at senior executive positions. Shares were granted at a price of £0.001 per share. The scheme is designed to enable participants to share in the continued growth of the Group above an initial valuation of £849m plus an annual increase in the value of the business. Participants do this by subscribing for "A" ordinary shares in the Company. Holders are entitled to receive a return on the shares granted in the event of a prescribed exit event – flotation of the company, share sale or business sale – occurring prior to 1 January 2022. This scheme is governed by the Articles of Association of the Company and is deemed to be an equity settled scheme and has been accounted for as such. Participants have to remain in employment or be deemed a good leaver to continue to qualify for the scheme.

Notes to the Financial Statements

For the year ended 31 December 2012

7. Employee Share Schemes (continued)

Movements in the number of shares outstanding at 31 December 2012:

Shares in existence at 1 January 2012	-
Granted	1,143,833
Forfeited	(81,703)
Outstanding at 31 December 2012	1,062,130
Exercisable at 31 December 2012	-

The fair value of the shares was determined using a valuation model. The significant inputs into the model were net asset value, the hurdle rate specified in the Articles of Association, a discount factor, the probability of a vesting event occurring and the assumed lapse rate of employees.

In late 2012, a notional (phantom) share scheme for senior individuals was established. The scheme is designed to comply with FSA requirements for deferral and clawback on treatment of annual bonuses. The scheme has been accounted for as a cash settled scheme.

A further equity settled scheme for all staff below executive level has also been established. The purpose is to allow employees to share in the future success and growth of the company by granting an award to acquire a number of shares to each relevant employee. The award will vest on the earlier of (i) the Company undertaking a Flotation or Share Sale (as defined in the Company's Articles of Association) or (ii) at such other time as determined at the discretion of the Remuneration Committee.

Scheme maturities

The acquisition of Northern Rock plc by the Company was deemed to be a qualifying investment event under the terms of the Long Term Incentive Scheme, Phantom Cash Schemes and Northern Rock plc LTIPs. As a consequence, all share classes of existing schemes were deemed to be fully vested or lapsed at 31 December 2011.

An amount totalling £0.2m (2011: £0.5m) has been recognised in respect of equity settled schemes and an amount totalling £2.3m (2011: £0.9m) has been recognised in respect of cash settled schemes.

8. Directors' Remuneration

	2012	2011
	£m	£m
Remuneration		
Remuneration paid to Executive Directors	1.2	1.2
Company pension contributions to defined contribution pension schemes	0.1	0.1
Total Remuneration for Executive Directors	1.3	1.3
Remuneration paid to Non-Executive Directors	0.9	0.6
Total Directors' remuneration	2.2	1.9

Notes to the Financial Statements

For the year ended 31 December 2012

8. Directors' Remuneration (continued)

During the year retirement benefits were accruing to two Directors (2011: two) in respect of defined contribution pension schemes.

The highest paid director received remuneration of £0.8m (2011: £0.9m).

The value of the Company's contributions to a defined contribution pension scheme in respect of the highest paid director amounted to less than £0.1m (2011: less than £0.1m).

In 2012, remuneration was paid to six Non-Executive Directors (2011: six).

9. Impairment Losses on Loans and Advances

	On advances secured on residential property	On advances secured on residential buy to let property	On unsecured loans	Total
	£m	£m	£m	£m
2012				
Group				
At 1 January 2012	0.3	-	-	0.3
Acquired through business combinations	6.2	0.3	0.1	6.6
Increase in allowance during the year net of recoveries reflected in the Income Statement	2.7	0.3	-	3.0
Amounts written off during the year	(1.7)	(0.2)	-	(1.9)
Transferred to disposal group	(0.2)	-	-	(0.2)
As at 31 December 2012	7.3	0.4	0.1	7.8

	On advances secured on residential property	On advances secured on residential buy to let property	On unsecured loans	Total
	£m	£m	£m	£m
2011				
Group				
At 1 January 2011	0.5	-	-	0.5
Increase in allowance during the year net of recoveries reflected in the Income Statement	-	-	-	-
Amounts written off during the year	(0.2)	-	-	(0.2)
As at 31 December 2011	0.3	-	-	0.3

Notes to the Financial Statements

For the year ended 31 December 2012

10. Taxation

	2012	2011
	£m	£m
Current tax		
Profits subject to corporation tax	-	10.4
Adjustments in respect of prior periods	-	-
Total current tax	-	10.4
Deferred tax		
Recognition of deferred tax unprovided in prior periods	(73.5)	-
Unwind of deferred tax on fair value adjustments	5.6	-
Effect of change in tax rates	0.1	0.1
Total deferred tax	(67.8)	0.1
Total tax (credit) / charge	(67.8)	10.5
Deferred tax credited to available for sale reserve	(0.5)	-

The deferred tax credited to available for sale reserve of £0.5m is the total tax relating to items in other comprehensive income.

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the standard weighted average rate of UK corporation tax of 24.5% (2011: 26.5%) as follows:

	2012	2011
	£m	£m
Profit for the period	150.6	23.5
Tax at effective corporation tax rate of 24.5% (2011: 26.5%)	36.9	6.2
Effects of:		
Expenses not deductible for tax purposes	4.5	5.3
Income not taxable	(2.8)	(0.2)
Unwind of fair value adjustments not taxable	(1.2)	-
Negative goodwill credit not taxable	(34.1)	-
Unrecognised deferred tax on capital allowances in excess of depreciation	-	(0.5)
Recognition of deferred tax unprovided in prior periods	(74.6)	-
Available for sale adjustments	3.2	-
Effect of change in tax rate	0.3	0.1
Adjustments in respect of prior periods	-	(0.2)
Utilisation of previously unrecognised tax losses brought forward	-	(0.7)
Other timing difference	-	0.5
Total tax (credit)/charge	(67.8)	10.5

The changes announced in HM Government's March 2011 Budget Statement that the corporation tax rate would reduce to 23% by 1 April 2014 was further changed such that from 1 April 2014 the corporation tax rate for large companies will be 21%.

Notes to the Financial Statements

For the year ended 31 December 2012

11. Analysis of Financial Assets and Financial Liabilities by Measurement Basis

Group	Financial liabilities at amortised cost	Loans and receivables	Available for sale securities	Derivatives not in IAS 39 hedges	Derivatives in IAS 39 hedges Fair value hedges	Cash flow hedges	Total
	£m	£m		£m	£m	£m	£m
2012							
Financial assets							
Cash and balances with central banks	-	1,604.5	-	-	-	-	1,604.5
Derivative financial instruments	-	-	-	21.6	136.2	3.2	161.0
Loans and advances to banks	-	1,310.2	-	-	-	-	1,310.2
Loans and advances to customers	-	16,761.1	-	-	-	-	16,761.1
Investment securities	-	37.3	1,497.0	-	-	-	1,534.3
Accrued income	-	1.0	-	-	-	-	1.0
Total financial assets	-	19,714.1	1,497.0	21.6	136.2	3.2	21,372.1
Non financial assets							459.3
Total assets	-	19,714.1	1,497.0	21.6	136.2	3.2	21,831.4
Financial liabilities							
Deposits by banks	3.4	-	-	-	-	-	3.4
Customer accounts	18,006.7	-	-	-	-	-	18,006.7
Debt securities in issue	2,266.6	-	-	-	-	-	2,266.6
Derivative financial instruments	-	-	-	29.7	254.5	1.4	285.6
Accruals	202.0	-	-	-	-	-	202.0
Total financial liabilities	20,478.7	-	-	29.7	254.5	1.4	20,764.3
Non financial liabilities							312.3
Total liabilities	20,478.7	-	-	29.7	254.5	1.4	21,076.6
Equity							754.8
Total liabilities and equity	20,478.7	-	-	29.7	254.5	1.4	21,831.4

Notes to the Financial Statements

For the year ended 31 December 2012

11. Analysis of Financial Assets and Financial Liabilities by Measurement Basis (continued)

Group	Financial liabilities at amortised cost	Loans and receivables	Available for sale securities	Derivatives not in IAS 39 hedges	Derivatives in IAS 39 hedges Fair value hedges	Cash flow hedges	Total
	£m	£m	£m	£m	£m	£m	£m
2011							
Financial assets							
Cash and balances with central banks	-	62.8	-	-	-	-	62.8
Derivative financial instruments	-	-	-	0.9	-	-	0.9
Loans and advances to banks	-	801.8	-	-	-	-	801.8
Loans and advances to customers	-	17.6	-	-	-	-	17.6
Investment securities	-	-	4.6	-	-	-	4.6
Accrued income	-	5.3	-	-	-	-	5.3
Total financial assets	-	887.5	4.6	0.9	-	-	893.0
Non financial assets							87.3
Total assets	-	887.5	4.6	0.9	-	-	980.3
Financial liabilities							
Deposits by banks	253.8	-	-	-	-	-	253.8
Customer accounts	110.7	-	-	-	-	-	110.7
Debt securities in issue	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	-	-	-	-
Accruals	44.9	-	-	-	-	-	44.9
Total financial liabilities	409.4	-	-	-	-	-	409.4
Non financial liabilities							35.6
Total liabilities	409.4	-	-	-	-	-	445.0
Equity							535.3
Total liabilities and equity	409.4	-	-	-	-	-	980.3

12. Cash and Cash Equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition:

	2012	2011
	£m	£m
Cash and balances at central banks	1,586.2	62.8
Loans and advances to banks	1,310.2	794.3
Total	2,896.4	857.1

The Company had £17.1m (2011: £772.8m) of loans and advances to credit institutions repayable on demand at the year end. The 2011 figure of £772.8m includes £747m which relates to the funds to be transferred to HM Treasury on 1 January 2012 in paid consideration for the acquisition of Northern Rock plc.

Notes to the Financial Statements

For the year ended 31 December 2012

13. Cash and Balances with Central Banks

	2012	2011
	£m	£m
Included in cash and cash equivalents	1,586.2	62.8
Mandatory reserve deposits with central banks	18.3	-
Total	1,604.5	62.8

Mandatory reserves with central banks are not available for use in day to day operations.

14. Disposal Group

The assets (£79.6m) and liabilities (£54.3m) of the disposal group comprise those of Church House Trust Limited, a 100% owned subsidiary of the Company at 31 December 2012. In advance of disposal, £46.6m of deposits will be transferred to Virgin Money plc. These liabilities are not included in the disposal group. The Directors consider a sale to be highly probable and that this disposal will occur within twelve months of classification as a disposal group. In accordance with IFRS 5, 'Non-current assets held for sale and discontinued assets', the assets and liabilities are classified as a disposal group.

A breakdown of the assets and liabilities of the disposal group is provided in the table below:

	2012
	£m
Assets	
Loans and advances to banks	9.6
Loans and advances to customers	15.6
Investment securities	54.1
Property, plant and equipment	0.3
Total Assets	79.6
Liabilities	
Customer accounts	53.7
Accruals and deferred income	0.5
Amounts due to group undertakings	0.1
Total Liabilities	54.3

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For the year ended 31 December 2012

15. Loans and Advances to Banks

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Fixed rate	-	-	0.9	772.8
Variable rate	1,310.2	801.8	16.2	-
Total	1,310.2	801.8	17.1	772.8

16. Loans and Advances to Customers

	2012	2011
	£m	£m
Advances secured on residential property not subject to securitisation	9,510.9	17.9
Advances secured on residential property subject to securitisation	5,392.5	-
	14,903.4	17.9
Residential buy to let loans not subject to securitisation	1,865.2	-
Total advances secured on residential property	16,768.6	17.9
Unsecured loans not subject to securitisation	0.3	-
Gross loans and advances to customers	16,768.9	17.9
Impairment allowance (see note 9)	(7.8)	(0.3)
Net loans and advances to customers	16,761.1	17.6
Loans to customers by rate		
Fixed rate	10,759.0	-
Variable rate	6,002.1	17.9
Total	16,761.1	17.6

In addition to the above, fair value adjustments of portfolio hedging amount to £133.0m (2011: £Nil). This amount represents the uplift in loans and advances to customers to fair value under accounting rules where the assets are included in a portfolio hedge relationship. Such relationships are established to protect the Group from interest rate risk on fixed rate products (see note 38) and the fair value of the interest rate swaps which form the other part of the relationship are reflected in derivative financial instruments.

Notes to the Financial Statements

For the year ended 31 December 2012

17. Securitisation

Securitisation is a means used by the Group to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their principal value to Special Purpose Entities ("SPEs") and have been funded through the issue of amortising mortgage backed securities to investors. The transfers do not meet the criteria for asset derecognition in IAS 39 as the Group has retained the risks and rewards of the assets. As a result, 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 31 December 2012 within the Group balance sheet are as follows:

	2012	2011
	£m	£m
Assets		
Cash and cash equivalents	294.5	-
Loans and advances to customers	5,392.5	-
Investments	197.0	-
Deferred tax asset	5.2	-
Total assets	5,889.2	-
Liabilities		
Debt securities in issue	2,266.6	-
Deposits by banks	2.7	-
Derivative financial instruments	5.4	-
Other liabilities	5.1	-
Total liabilities	2,279.8	-

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.

	2012	2011
	£m	£m
Carrying amount of transferred assets	5,392.5	-
Carrying amount of associated liabilities	2,266.6	-
Fair value of transferred assets	5,530.5	-
Fair value of associated liabilities	2,291.0	-

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

Notes to the Financial Statements

For the year ended 31 December 2012

18. Investment Securities

	2012	2011
	£m	£m
Available for sale securities	1,497.0	4.6
Investment securities held as loans and receivables	37.3	-
	1,534.3	4.6

(a) Available for sale securities

	2012	2011
	£m	£m
At fair value		
Listed	1,497.0	4.6
Unlisted	-	-
	1,497.0	4.6
Fixed rate	1,225.0	-
Variable rate	272.0	4.6
	1,497.0	4.6

The movement in available for sale securities was as follows:

	2012	2011
	£m	£m
At 1 January	4.6	79.8
Acquired through business combinations	1,235.4	-
Additions	3,173.8	3.5
Disposals (sales and redemptions)	(2,885.6)	(78.7)
Exchange differences	(0.5)	-
Net gains on changes in fair value	23.4	-
Transferred to disposal group	(54.1)	-
At 31 December	1,497.0	4.6

Notes to the Financial Statements

For the year ended 31 December 2012

18. Investment Securities (continued)

(b) Investment securities held as loans and receivables

	2012		2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	£m	£m	£m	£m
Listed	37.3	35.3	-	-
Unlisted	-	-	-	-
	37.3	35.3	-	-
Fixed rate securities	-	-	-	-
Variable rate securities	37.3	35.3	-	-
	37.3	35.3	-	-

These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership. The corresponding counterparty liability is included within deposits by banks.

Gains on sale of available for sale securities amounted to £16.9m (2011: £Nil) and were predominantly from the sale of UK gilt holdings.

Notes to the Financial Statements

For the year ended 31 December 2012

19. Investments in Subsidiaries

The following were subsidiaries of the Company:

Name	Class of Share	Holding
Direct holdings		
Virgin Money plc (formerly Northern Rock plc)	Ordinary	100%
Church House Trust Limited (formerly Virgin Bank Limited) – held for sale	Ordinary	100%
Virgin Money Personal Financial Service Limited	Ordinary	100%
Virgin Money Unit Trust Managers Limited	Ordinary	100%
Virgin Money Management Services Limited	Ordinary	100%
Virgin Money Giving Limited	Ordinary	100%
Challenger (Norwich) Limited*	Ordinary	100%
Indirect holdings		
Virgin Card Limited*	Ordinary	100%
Virgin Money Nominees Limited*	Ordinary	100%
Virgin Money Cards Limited (formerly Virgin Money Limited)		
– company sold on 18 January 2013 (see note 44)	Ordinary	100%
Northern Rock Limited*	Ordinary	100%
Northern Rock Guernsey Limited	Ordinary	100%

* Indicates dormant company

The following companies are SPEs established in connection with the Group's securitisation programme. Although the Company has no direct or indirect ownership interest in these companies, they are accounted for as subsidiaries in the Group. This is because they are principally engaged in providing a source of long term funding to the Group, which in substance means the Group has the rights to all benefits from the activities of the SPEs. They are therefore effectively controlled by the Group.

Name	Nature of business
Gosforth Funding plc	Issue of securitised notes
Gosforth Funding 2011-1 plc	Issue of securitised notes
Gosforth Funding 2012-1 plc	Issue of securitised notes
Gosforth Funding 2012-2 plc	Issue of securitised notes
Gosforth Mortgages Trustee Limited	Trust
Gosforth Mortgages Trustee 2011-1 Limited	Trust
Gosforth Mortgages Trustee 2012-1 Limited	Trust
Gosforth Mortgages Trustee 2012-2 Limited	Trust
Gosforth Holdings Limited	Holding company
Gosforth Holdings 2011-1 Limited	Holding company
Gosforth Holdings 2012-1 Limited	Holding company
Gosforth Holdings 2012-2 Limited	Holding company

Notes to the Financial Statements

For the year ended 31 December 2012

19. Investments in Subsidiaries (continued)

	Investment in subsidiary companies
	£m
Company	
Cost or valuation	
As at 1 January 2012	128.7
Acquisition of Virgin Money plc (formerly Northern Rock plc)	1,003.8
Sale of Virgin Money Cards Limited	(9.7)
Revaluation of investment in Church House Trust Limited to recoverable amount prior to sale (see note 14)	(4.6)
Capital contribution – share based payment (see note 7)	0.2
At 31 December 2012	1,118.4

On 2 January 2012, subsequent to the acquisition of Virgin Money plc on 1 January 2012, Virgin Money Holdings (UK) Limited sold 100% of its investment in Virgin Money Cards Limited (formerly Virgin Money Limited) to Virgin Money plc.

Both Virgin Money Giving Limited and Virgin Money Management Services Limited have net liabilities as at 31 December 2012. The carrying value of these investments is not considered material to the accounts and as such no impairment has been made. A letter of Group support has been provided.

The carrying value of each investment in Virgin Money Personal Financial Service Limited, Virgin Money Unit Trust Managers Limited and Virgin Money plc are in excess of the net assets as at 31 December 2012. However, the carrying values have been assessed by reference to the discounted value of expected future cash flows. No provision for impairment has been made as a result of this assessment.

20. Derivative Financial Instruments

Strategy in using derivative financial instruments

The Board has authorised the use of derivative instruments for the purpose of supporting the strategic and operational business activities of the Group and reducing the risk of loss arising from changes in interest rates, exchange rates and the FTSE 100 index. All use of derivative instruments within the Group is to hedge risk exposure, and the Group takes no trading positions in derivatives.

The objective, when using any derivative instrument, is to ensure that the risk to reward profile of any transaction is optimised. The intention is to use only derivatives to create economically effective hedges. However, because of the specific requirements of IAS 39 to obtain hedge accounting, not all economic hedges are designated as accounting hedges, either because natural accounting offsets are expected or because complying with hedge accounting rules would be especially onerous.

Hedge Accounting

When transactions meet the criteria specified in IAS 39, the Group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the income statement to offset the fair value movement of the related derivative. To qualify for hedge accounting the hedge relationship must be clearly documented at inception and the derivative must be expected to be highly effective in offsetting the hedged risk. Effectiveness must be tested throughout the life of the hedge relationship.

Hedge accounting may be applied to three types of hedging relationships:

Notes to the Financial Statements

For the year ended 31 December 2012

20. Derivative Financial Instruments (continued)

(a) Fair value hedges

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability that is attributable to a particular risk and could affect profit or loss. The most frequently used fair value hedges are:

- (i) hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages
- (ii) hedging the interest rate risk of a portfolio of fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings
- (iii) hedging the interest rate risk of a single currency portfolio of sterling, US Dollar or Euro non-prepayable fixed rate assets /liabilities on a one-for-one basis or/and many-to-many basis with vanilla fixed/floating or floating/fixed interest rate swaps
- (iv) hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps.

(b) Cash flow hedges

The resulting accounting hedge relationship is to hedge floating rate sterling liabilities.

(c) Net investment hedges

The Group has not designated any derivatives as net investment hedges in 2012 or 2011.

The analysis below splits derivatives between those in accounting hedge relationships and those in economic hedge relationships but not in accounting hedge relationships.

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For the year ended 31 December 2012

20. Derivative Financial Instruments (continued)

Group	2012			2011		
	Contract/ notional amount	Fair values		Contract/ notional amount	Fair values	
		Assets	Liabilities		Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges						
Interest rate swaps	17,080.0	136.2	(254.2)	-	-	-
Cross currency interest rate swaps	21.8	-	(0.3)	-	-	-
Derivatives designated as cashflow hedges						
Interest rate swaps	1,238.0	3.2	(1.4)	-	-	-
		139.4	(255.9)	-	-	-
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives						
Interest rate swaps	4,426.5	21.4	(24.3)	-	-	-
Currency derivatives						
Cross currency interest rate swaps	73.6	-	(5.4)	-	-	-
Options						
Equity FTSE 100 options		0.2	-	-	0.9	-
Total recognised derivative assets/(liabilities)		161.0	(285.6)	-	0.9	-

The Equity FTSE 100 options of £0.2m (2011: £0.9m) are held by the Company.

Cash flow hedges

Periods when cash flows are expected to occur and affect the income statement:

	2012	2011
	£m	£m
Within one year	3.7	-
In one to five years	7.6	-
	11.3	-

Notes to the Financial Statements

For the year ended 31 December 2012

21. Acquisitions

Virgin Money plc (formerly Northern Rock plc)

On 1 January 2012, Virgin Money Holdings (UK) Limited acquired 100% of the ordinary share capital of Northern Rock plc, a savings and mortgage bank. On 12 October 2012 following a rebranding exercise, Northern Rock plc was renamed Virgin Money plc. The acquisition has been an excellent fit with the Group as it brings together entities with complementary product sets and distribution channels.

The purchase consideration included £747m of cash and £150m of non-core tier one notes paid on 1 January 2012. In addition, deferred consideration comprising realised gilt gains and net asset value adjustments of £72.9m was settled on 28 June 2012. In the five years post acquisition, a contingent consideration of up to £80m may be payable should there be a profitable IPO or sale of the Company. The £18m included in the table below represents the initial estimate of the fair value at acquisition date of this contingent consideration based on expectations of such an event taking place in these timescales.

The consideration was as follows:

	£m
Initial cash proceeds	747.0
Non-core tier one notes (NCT1)	150.0
Additional consideration	72.9
Contingent consideration	18.0
Total consideration	987.9

The acquisition of Virgin Money plc ('VM plc') on 1 January 2012 was accounted for in accordance with IFRS 3 'Business Combinations', which required the recognition of the identifiable assets acquired and liabilities assumed at their acquisition date fair values. As part of this process, it was also necessary to identify and recognise certain assets and liabilities which are not included on the acquiree's balance sheet, for example intangible assets. The exercise to fair value the Virgin Money plc balance sheet was subjective and required Management to make a number of assumptions and estimates.

The overall effect was to reduce the book value of the assets acquired by £49.5m, after the recognition of a core deposit intangible asset of £4.8m not previously included on the VM plc balance sheet. This was offset by a reduction in the value of VM plc liabilities of £26.2m, resulting in a net decrease in the value of net assets acquired of £23.3m. In accordance with IFRS 3, the Company had 12 months to finalise the fair value of Virgin Money plc. No further fair value adjustments were identified. Further information on the specific adjustments is provided in the table on the following page.

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For the year ended 31 December 2012

21. Acquisitions (continued)

The finalised valuations and adjustments are provided below:

	Note	Book value at 31 December 2011	Adjustments	Take on balances at 1 January 2012
		£m	£m	£m
Assets				
Cash and balances with central banks		2,752.1	-	2,752.1
Derivative financial instruments		181.0	-	181.0
Loans and advances to banks		859.3	-	859.3
Loans and advances to customers	a	14,159.0	(59.7)	14,099.3
Retirement benefit asset		1.5	-	1.5
Investment securities		1,361.9	(1.8)	1,360.1
Intangible assets		4.6	-	4.6
Core deposit intangible asset	b	-	4.8	4.8
Deferred tax asset on fair value adjustment		-	9.4	9.4
Property, plant and equipment		27.9	(2.2)	25.7
Other assets		34.6	-	34.6
Prepayments and accrued income		12.5	-	12.5
Total assets		19,394.4	(49.5)	19,344.9
Liabilities				
Deposits by banks		98.2	-	98.2
Customer accounts	c	16,287.2	(28.9)	16,258.3
Customer accounts held for sale		396.0	-	396.0
Derivative financial instruments		285.8	-	285.8
Debt securities in issue		943.7	2.7	946.4
Other liabilities		62.4	-	62.4
Accruals and deferred income		156.5	-	156.5
Current income tax liability		6.5	-	6.5
Provisions for liabilities and charges		7.8	-	7.8
Total liabilities		18,244.1	(26.2)	18,217.9
Net assets acquired		1,150.3	(23.3)	1,127.0
Negative goodwill credit				
Fair value of net assets acquired				1,127.0
Total consideration				987.9
Negative goodwill credit	d			139.1

Notes to the Financial Statements

For the year ended 31 December 2012

21. Acquisitions (continued)

Notes and adjustments

- a) Mortgage balances were adjusted to fair value using discounted cash flow models which used benchmark interest rates. The adjustment reflects the movement in credit spreads since the lending was originated.
- b) An intangible asset was recognised in respect of the intrinsic value of the retail savings book. This will be amortised over its remaining useful life.
- c) Deposit balances were adjusted to fair value using discounted cash flow models which used benchmark interest rates.
- d) The negative goodwill credit of £139.1 million was recognised in the income statement. The discount to net asset value paid by the Company and the resultant negative goodwill credit reflects the difficult economic environment in the UK, the loss making nature of Northern Rock plc, and also depressed valuations in general in the UK banking sector.

Mortgage book portfolio

On 20 July 2012 Virgin Money plc (a wholly owned subsidiary) entered into a transaction to acquire a mortgage portfolio of Northern Rock (Asset Management) plc originated loans from Northern Rock (Asset Management) plc ("NRAM") for a purchase consideration of £466.4m, paid in cash.

22. Collateral Pledged and Received

Cash collateral is given and received as part of normal derivative operations. At 31 December 2012, £157.7m (2011: £Nil) had been pledged by the Group and £0.7m (2011: £Nil) had been received as cash collateral by the Group.

The Company has pledged collateral of £0.4m (2011: £Nil).

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For the year ended 31 December 2012

23. Intangible Assets

	Core deposit intangible	Goodwill	Software	Total
Group	£m	£m	£m	£m
Cost				
Balance at 1 January 2012	-	4.6	25.7	30.3
Acquired through business combinations	4.8	-	4.6	9.4
Acquisitions	-	-	14.9	14.9
Disposals	-	-	-	-
At 31 December 2012	4.8	4.6	45.2	54.6
Amortisation and impairment losses				
Balance at 1 January 2012	-	4.6	6.7	11.3
Charge for the year	1.7	-	6.8	8.5
Disposals	-	-	-	-
At 31 December 2012	1.7	4.6	13.5	19.8
Carrying amounts				
At 1 January 2012	-	-	19.0	19.0
At 31 December 2012	3.1	-	31.7	34.8
Cost				
Balance at 1 January 2011	-	4.6	15.4	20.0
Acquisitions	-	-	10.3	10.3
Disposals	-	-	-	-
At 31 December 2011	-	4.6	25.7	30.3
Amortisation and impairment losses				
Balance at 1 January 2011	-	-	5.0	5.0
Charge for the year	-	-	1.7	1.7
Disposals	-	-	-	-
Impairment	-	4.6	-	4.6
At 31 December 2011	-	4.6	6.7	11.3
Carrying amounts				
At 1 January 2011	-	4.6	10.4	15.0
At 31 December 2011	-	-	19.0	19.0

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For the year ended 31 December 2012

24. Property, Plant & Equipment

2012	Land and buildings	Plant, equipment fixtures, fittings and vehicles	Total
	£m	£m	£m
Cost			
At 1 January 2012	8.2	10.9	19.1
Acquired through business combinations	11.0	14.5	25.5
Additions	39.9	11.4	51.3
Disposals	(0.1)	(1.9)	(2.0)
Assets within disposal group	(0.4)	-	(0.4)
At 31 December 2012	58.6	34.9	93.5
Depreciation and impairment losses			
At 1 January 2012	2.2	6.1	8.3
Depreciation for the year	2.2	6.0	8.2
Disposals	-	(0.2)	(0.2)
At 31 December 2012	4.4	11.9	16.3
Carrying amounts			
At 1 January 2012	6.0	4.8	10.8
At 31 December 2012	54.2	23.0	77.2

In June 2012 the Group completed the purchase of its operational headquarters in Newcastle upon Tyne together with buildings at two other sites in the North East of England. The total acquisition cost, including stamp duty, was £39.5m. The acquisition is included within land and buildings additions of £39.9m in the table above.

2011	Land and buildings	Plant, equipment fixtures, fittings and vehicles	Total
	£m	£m	£m
Cost			
At 1 January 2011	2.7	7.0	9.7
Additions	5.5	4.1	9.6
Disposals	-	(0.2)	(0.2)
At 31 December 2011	8.2	10.9	19.1
Depreciation and impairment losses			
At 1 January 2011	1.5	5.4	6.9
Depreciation for the year	0.7	0.9	1.6
Disposals	-	(0.2)	(0.2)
At 31 December 2011	2.2	6.1	8.3
Carrying amounts			
At 1 January 2011	1.2	1.6	2.8
At 31 December 2011	6.0	4.8	10.8

Notes to the Financial Statements

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25. Other Assets

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Trade debtors	17.5	43.1	-	-
Amounts owed from related parties	7.7	11.4	57.2	49.9
Group relief owed from related parties	-	-	2.1	6.4
Indemnification asset	6.0	-	-	-
Other	6.0	0.8	-	0.5
Total	37.2	55.3	59.3	56.8

The Group's exposure to credit risk and impairment losses related to trade and other receivables is disclosed in note 38.

Included within trade debtors is an amount of £Nil (2011: £20.3m) related to the Group's share from the proceeds of a sale of credit card defaulted and non defaulted debt by MBNA, and £8.3m (2011: £12.4m) related to income due from MBNA in respect of revenues spread over a 10 year period (see note 1.7).

Details of the indemnification asset are contained in note 31.

26. Deferred Tax Asset

Based on their interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards, the Directors conclude that deferred tax assets of £79.8m should be recognised at the balance sheet date.

Deferred tax assets were not recognised in respect of gross assets of £26.4m (2011: £34.9m). Deferred tax assets have been recognised at 23% in respect of the following items:

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Asset				
Excess of depreciation over capital allowances	9.8	-	-	-
Unused tax losses	61.1	1.9	-	-
Short term timing differences	10.7	0.3	0.3	0.4
Change in accounting basis on adoption of IFRS	(1.8)	-	-	-
Recognised deferred tax assets	79.8	2.2	0.3	0.4

The judgement required in the assessment of whether to recognise a deferred tax asset is set out in note 1.31(iv) to these accounts. A deferred tax asset in respect of the subsidiary Virgin Money plc was not recognised at acquisition on 1 January 2012 but subsequently recognised because in the period since acquisition, Management have taken certain actions to have greater certainty about the profitability going forward.

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27. Deposits by Banks

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Fixed rate deposits	-	253.8	-	253.8
Variable rate deposits	3.4	-	-	-
Total	3.4	253.8	-	253.8

On 29 December 2011, the Company borrowed £253m (plus arrangement and commitment fees) on a short term loan facility from Royal Bank of Scotland at an interest rate of 0.5%. The loan, together with interest accrued thereon was repaid in full on 3 January 2012.

28. Customer Accounts

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Fixed rate deposits	7,729.8	-	-	-
Variable rate deposits	10,276.9	110.7	-	-
Total	18,006.7	110.7	-	-

29. Other Liabilities

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Non Core Tier 1 Notes	150.0	-	150.0	-
Trade creditors	3.7	11.3	-	-
Other taxes and social security costs	3.7	2.1	-	-
Other creditors	54.0	10.2	5.4	4.4
Amounts owed to subsidiary undertakings	-	-	173.0	167.4
Total	211.4	23.6	328.4	171.8

The Non Core Tier 1 Notes of £150m were issued to HM Treasury on 1 January 2012 as part consideration in the acquisition of Northern Rock plc. The notes have a discretionary coupon of 10.5% per annum, beginning on 1 January 2013.

The Group's exposure to liquidity risk related to trade and other payables is disclosed in note 38.

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For the year ended 31 December 2012

30. Accruals and Deferred Income

	2012	2011
Group	£m	£m
Accrued interest	177.8	-
Deferred income	24.2	18.2
Other accruals	40.2	26.7
Total	242.2	44.9

Deferred income represents income advanced from partners that will be recognised in future periods.

The number above includes £0.8m (2011: £1.2m) relating to the estimated redemption cost of points earned by members of the Credit Cards Rewards Scheme. Reward points ceased to be issued on retail transactions made using the Virgin Credit Card after 1 August 2007. However any existing points that had been accumulated up to that date are still available to redeem, although the timing of the redemption and ultimate payment is entirely dependent on the actions of reward scheme members. The amount included above reflects Management's assessment of likely value of future points redemptions.

31. Provisions for Liabilities and Charges

	Customer redress		Restructuring		Other		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
	£m	£m	£m	£m	£m	£m	£m	£m
The movement in provisions was as follows:								
At 1 January	-	-	-	-	-	-	-	-
Transferred in through business combinations	-	-	0.8	-	7.0	-	7.8	-
Charged in the year	6.0	-	-	-	1.2	-	7.2	-
Utilised in the year	-	-	(0.8)	-	(7.8)	-	(8.6)	-
At 31 December	6.0	-	-	-	0.4	-	6.4	-

On 11 December 2012 the Economic Secretary to the Treasury released a statement regarding customers of Northern Rock (Asset Management) plc (NRAM) who have mortgage loan accounts which are regulated under the Consumer Credit Act (CCA). Following changes to the CCA implemented in 2008 before the separation of NRAM and Northern Rock plc, certain letters and statements have been sent to customers that do not fully comply with the requirements prescribed by the CCA. The NRAM customers affected are entitled to redress by NRAM for interest charged on the relevant loans and NRAM has announced its intention to remediate such customers.

As a result of this announcement, Virgin Money undertook a review of the mortgage loans acquired in its acquisition of Northern Rock plc on 1 January 2012. A number of Virgin Money mortgage customers were found to have CCA elements in their mortgage loans and, due to the same non-compliance error identified by NRAM, those customers have been sent documentation that does not fully comply with the CCA. Virgin Money has taken steps to ensure that all relevant customer documentation now contains the full wording required by the CCA.

The total cost to Virgin Money of remediating the interest charged to the affected customers, on the same basis as NRAM propose, is estimated at £6m, and is reflected in these accounts. The relevant customers do not need to take any action and will be contacted in due course.

Virgin Money has discussed the position with both UKFI and NRAM and is confident that an agreement will be reached with NRAM whereby the cost of refunds of interest due to Virgin Money customers will be met by NRAM. This reflects the intention of all parties that CCA regulated mortgage loans were to be held by NRAM not Northern Rock plc at the point of its acquisition by Virgin Money. Therefore a corresponding asset has been reflected in these accounts (note 25).

The provision for customer redress and for restructuring are both expected to be fully utilised within the next 12 months.

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For the year ended 31 December 2012

32. Share Capital

	2012	2012	2011	2011
	Number	£m	Number	£m
Allotted, called up and fully paid				
Ordinary Shares of £0.001 each	38,742,729	-	38,742,729	-
A Ordinary Shares of £0.001 each	1,102,982	-	-	-
Deferred Shares of £0.001 each	731,113	-	731,113	-
Total	40,576,824	-	39,473,842	-

On 29 February 2012, the Company issued 1,102,982 £0.001 shares for a consideration of £1,103.

In 2011, warrants which had been issued by the Company in 2010, were cancelled in return for 562,268 Ordinary £0.001 shares for a deemed value of £10,833,338 and, as such, a notional loss of £612,808 was recognised in the income statement.

On 31 December 2011, the Company issued a further 16,867,323 Ordinary £0.001 shares for a consideration of £369,000,000. These shares were subscribed in full by WLR IV VM II LLC, Virgin Financial Services UK Limited, and Stanhope Investments. The shares were issued to fund the acquisition of Northern Rock plc which occurred on 1 January 2012 (see note 21 for further details).

33. Share Premium Account

	2012	2011
	£m	£m
At 1 January	509.2	134.5
Premium on shares issued in the year	-	363.9
Premium on shares issued following cancellation of warrants (note 32)	-	10.8
As at 31 December	509.2	509.2

34. Own Shares

	2012	2011
	£m	£m
Employee Benefit Trust	6.2	2.2

All 'A' Ordinary shares granted under the terms of the Long Term Incentive Scheme (see note 7) became fully vested in March 2011. As part of an arrangement to allow holders of these shares an opportunity to access some of the value increase in the Virgin Money Group since the original grant date, the Company established an Employee Benefit Trust ("EBT") in 2011. The Company funded the EBT by means of a cash loan and is therefore considered to be the sponsoring entity. The EBT entered into a put/call option agreement with the employees to acquire shares over a 3 year period and recognised a liability of £4,416,101 with a corresponding deduction in Other Reserves in 2011. In January 2012, the Trust accelerated the option agreements and acquired all shares for value of £4,416,101.

Notes to the Financial Statements

For the year ended 31 December 2012

34. Own Shares (continued)

In April 2012, certain Non-Executive Directors were invited by the Board to participate in an annual acquisition scheme to acquire a number of ordinary shares in April 2012, 2013 and 2014 at the then current market value acquisition price. The cut off date is 15 April each year. The number of shares and market value of the shares available for acquisition will be communicated prior to 1 April annually and is to be payable out of participants' own funds.

In April 2012, some of the shares held by the EBT were sold to Non-Executive Directors of the Group.

35. Other Reserves

(a) Available for sale reserve

	2012	2011
	£m	£m
At 1 January	(0.2)	(0.2)
Net gains from changes in fair value	48.1	-
Net gains on disposal transferred to net income	(27.4)	-
Amounts transferred to net income due to hedge accounting	(11.7)	-
Amortisation of fair value differences in respect of securities transferred to loans and receivables	2.3	-
Deferred tax	0.5	-
At 31 December	11.6	(0.2)

(b) Cash flow hedge reserve

	2012	2011
	£m	£m
At 1 January	-	-
Amounts recognised in equity	(12.7)	-
Amounts transferred to interest payable	1.4	-
At 31 December	(11.3)	-

36. Contingent Consideration

As a result of the acquisition of Northern Rock plc on 1 January 2012, a contingent consideration of up to £80m is payable to UKFI upon a future profitable IPO or sale of the business between 2012 and 2016. The amount payable varies on a sliding scale depending on the date of completion of any IPO or sale within the time window. The consideration payable starts at £80m in 2012 and falls to £50m in 2016 and nil the year after. In accordance with accounting standards, the liability has been measured throughout the period since acquisition and is largely influenced by the macro-economic environment both in the UK and wider euro-zone region. As the date to crystallise the 2012 liability of £80m has now passed the estimate has been updated to reflect both this and continued low growth in the UK economy. Accordingly, the estimate of the liability has reduced by £13m to £5m at the end of the year.

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37. Financial Services Compensation Scheme

The Financial Services Compensation Scheme ("FSCS") is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund the compensation costs associated with institutions that failed in 2008 and will receive the receipts from asset sales, surplus cash flows and other recoveries from these institutions in the future.

The FSCS meets its obligations by raising management expense levies. These include amounts to cover the interest on its borrowings and compensation levies on the industry. Each deposit taking institution contributes in proportion to its share of total protected deposits.

For the year to 31 December 2012 the Group has paid or made provision for levies of £6.2m (2011: £0.4m) covering Scheme Years 2012/2013 and 2013/2014 in relation to its deposit business, and for the Scheme Year 2012/2013 in relation to its investment business. The scheme year 2013/14 is based on the financial year to 31 December 2012.

If the FSCS does not receive sufficient funds from the failed institutions to repay HM Treasury in full, it will raise compensation levies. On 8 March 2012 the FSCS announced that it expects to receive full repayment of the debt in relation to Bradford & Bingley plc and that it expects to raise compensation levies in respect of the other failed banks beginning in 2013/2014 in light of market conditions. In January 2013, the FSCS has estimated the shortfall resulting from the cash flows to be received from the failed institutions as £788m. Accordingly a provision for the Company's estimated share of these compensation levies of £6.1m (2011: £Nil) has been made in these financial statements.

38. Risk Management and Monitoring

Through its normal operations the Group is exposed to a variety of risks. The Board of Directors is responsible for determining strategies and policies for the Group. The Group maintains a risk governance structure that strengthens risk evaluation and management, in addition to positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

The principal risks that the Group manages are as follows:

Credit risk: the risk that a borrower or counterparty fails to pay the interest, or to repay the capital, on a loan or other financial instrument. All lending is carefully underwritten, and the performance of individual loans is monitored on an ongoing basis

Market risk: the risk that the value of, or net income arising from, the Company's assets and liabilities changes as a result of changes to interest rates or exchange rates. Market risk is managed and monitored on an ongoing basis against Board approved risk appetite and policy

Liquidity risk: the risk that the Group is unable to meet its obligations as they fall due. The Company's position is monitored by Management on a regular basis and liquidity is supported by intercompany facilities if required

Operational risk (Unaudited ¹): the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. A range of indicators covering the Company's operations is reviewed by Management and the Board regularly throughout the year. All key business processes are subject to periodic reviews by the Group's Risk and Internal Audit teams to ensure that appropriate controls are in place and operating effectively

Legal risk (Unaudited ¹): the risk of legal sanction, material financial loss or loss of reputation that the Company may suffer as a result of its failure to comply with the law, inadequately document its contractual arrangements or inadequately assess and implement changes required by forthcoming legislation or emerging case law. The Virgin Money Group legal department supports the Company in meeting its contractual obligations and assessing legal developments

¹These notes are presented within the audited financial statements but contain supplementary information not required by the applicable financial framework. Consequently they are highlighted as unaudited.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

Regulatory risk (Unaudited ¹): the risk that the Company fails to comply with its regulatory requirements with the potential that the Company:

- treats customers unfairly, potentially exposing them to financial or other detriment
- is subject to legal or regulatory sanction
- suffers reputational damage
- is used for the purposes of financial crime.

1. Credit risk

Credit risk comprises both retail and wholesale credit risk within the Group. Retail credit risk arises from secured (mortgages) and unsecured lending (current accounts). Wholesale credit risk arises through the placement of funds and investments by Treasury.

1.1 Retail Credit Risk

The following sections outline our approach to management of credit risk through the setting of appetite and policy and an overview of the measurement of credit risk in the Group

1.1.1 Retail Credit Risk Appetite

Credit risk appetite is an expression of boundaries that provide clear guidance on the level of risk exposure that the Board considers acceptable and in line with corporate strategy. A revised credit risk appetite aligned to the current business strategy and external environment was approved by the Board in March 2012. Risk appetite is subject to an annual review process and limits are regularly monitored and reported to the Risk Management Committee.

The Board's high level expression of a desired credit risk appetite is also translated into specific maximum risk limits in relation to new product and new lending policy parameters within which Management must operate. In addition there are whole book parameters reflecting the inherent risks of previous lending, with trigger levels above which specific control actions may be initiated. Monitoring and reporting against the risk appetite and the associated limits and triggers were in place for both new lending and the whole book during 2012.

1.1.2 Retail Lending Policy Criteria

New lending is tightly controlled using an appropriate mix of statistical analysis and judgement. New business quality is monitored and controlled by the New Business Strategy team using scoring techniques and a number of other core control components as follows:

- Credit scoring. Automated statistically-based credit scoring methods are used in the decision making process for new and existing customers. These are subject to regular monitoring, review and approval.
- Affordability, underwriting and mandates. To lend responsibly, the Group employs affordability models based upon customers' income and outgoings, and experienced underwriters to determine the overall financial situation of customers and their ability to repay credit. The ability to agree a credit agreement with a customer is prescribed in Board delegated authority levels to specific individuals who have the requisite credit skills.
- Valuations. Property assets are independently valued at mortgage inception. Where a revaluation is required, this is led by specialist Property Risk personnel using a range of valuation methods.

In addition to the control of new lending the retail lending policy has key control components for the existing portfolio, including:

- Monitoring and performance. The credit portfolios are monitored regularly, with a range of prescribed reports distributed to key stakeholders. Detailed management information is provided to the Credit Risk Committee, Business Performance Committee and Risk Committee.

¹These notes are presented within the audited financial statements but contain supplementary information not required by the applicable financial framework. Consequently they are highlighted as unaudited.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

- Collections and recoveries. The Group's debt management process is led by the Chief Operating Officer. A team of specialists manage all aspects of collections and recoveries with the aim of helping customers who encounter financial difficulties to achieve a positive outcome for the customer and the Group.
- Stress testing and scenario analysis, to simulate a range of outcomes and calculate the risk impact of adverse macroeconomic conditions.

1.1.3 Retail Credit Risk Measurement

Internal rating based models are used to assess customers' probability of default, exposure at default and loss given default. The rating models use statistical analysis and are subject to internal monitoring and change control.

These credit risk models are used throughout the Group to support the analytical elements of the credit risk management framework, in particular the quantitative risk assessment part of the credit approval process, ongoing credit monitoring as well as portfolio level analysis and reporting.

Models used for credit risk measurement by the Group fall into three broad categories:

- Probability of Default (PD)/customer credit grade – these models assess the probability that a customer will fail to make full and timely repayment of credit obligations over a time horizon. There are a number of different credit rating models in use across the Group, each of which considers particular customer characteristics. The credit rating models use a combination of quantitative inputs, such as transaction characteristics, recent financial performance, credit bureau data and customer behaviour
- Exposure At Default (EAD) – these models estimate an account's exposure, were it to default
- Loss Given Default (LGD) – these models estimate the expected loss that may be suffered by the Group on a credit facility in the event of default. The Group's LGD models take into account the type of borrower and any security held.

1.2 Wholesale Credit Risk

Wholesale credit counterparty risk arises through Treasury hedging and investment activities and related balance sheet management requirements.

Wholesale credit risk can be broken down into two elements:

- the risk of default or rating migration of derivative counterparties
- the risk of default or rating migration of issuers in the Treasury investment portfolio.

The Board has approved a framework for maximum credit counterparty limits against which total exposures are continually monitored and controlled. The credit limit structure adopts a risk based matrix whereby lower rated counterparties are offered lower limits. Single counterparties are assigned maximum limits in accordance with the ratings matrix, based on the lowest rating afforded to any part of the counterparty group.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

1.3 Breakdown of Credit Risk Exposures

The following tables provide a breakdown of the retail and wholesale credit portfolios.

Maximum credit risk exposure at 31 December before provisions for impairment and before collateral and other credit enhancements:

	2012	2011
	£m	£m
On balance sheet		
Cash and balances with central banks	1,604.5	62.8
Investment securities	1,534.3	4.6
Loans and advances to banks	1,310.2	801.8
Derivative financial instruments	161.0	0.9
Loans and advances to customers	16,768.9	17.9
	21,378.9	888.0
Off balance sheet		
Loan commitments	1,385.5	-

2012

Gross loans and advances to customers by credit quality:

	Loans and advances to banks	Residential mortgage loans	Unsecured personal loans
	£m	£m	£m
Neither past due nor impaired	1,310.2	16,563.8	0.3
Past due but not impaired	-	193.6	-
Impaired	-	11.2	-
Total	1,310.2	16,768.6	0.3

2011

Gross loans and advances to customers by credit quality:

	Loans and advances to banks	Residential mortgage loans	Unsecured personal loans
	£m	£m	£m
Neither past due nor impaired	801.8	14.3	-
Past due but not impaired	-	2.9	-
Impaired	-	0.7	-
Total	801.8	17.9	-

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

The credit quality of loans neither past due nor impaired may be assessed by reference to credit ratings and to probability default bandings allocated to loans by the Group's internal credit assessment models as set out in the tables below:

Loans and advances to banks

	2012	2011
	£m	£m
AA	-	792.6
AA-	15.7	-
A+	75.2	9.2
A	1,203.8	-
A-	15.5	-
Total	1,310.2	801.8

Loans and advances by credit quality for retail secured and unsecured lending

	2012		2011	
	Residential mortgage loans	Unsecured personal loans	Residential mortgage loans	Unsecured personal loans
Neither past due nor impaired				
PD by internal banding	£m	£m	£m	£m
Very low risk	14,901.6	0.3	4.3	-
Low risk	1,043.5	-	6.3	-
Medium risk	516.3	-	3.3	-
Higher risk	102.4	-	0.4	-
Total	16,563.8	0.3	14.3	-

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

Past due not impaired loans¹:

2012

	Loans and advances to banks	Residential mortgage loans	Unsecured personal loans
	£m	£m	£m
Up to one month	-	-	-
In one to three months	-	117.9	-
In three to six months	-	48.5	-
Over six months	-	27.2	-
Total	-	193.6	-

2011

	Loans and advances to banks	Residential mortgage loans	Unsecured personal loans
	£m	£m	£m
Up to one month	-	0.9	-
In one to three months	-	1.0	-
In three to six months	-	0.9	-
Over six months	-	0.1	-
Total	-	2.9	-

¹An asset is impaired when its carrying amount exceeds its recoverable amount.

Investment securities by credit quality:

	2012		2011	
	Available for sale securities	Investment securities held as loans and receivables	Available for sale securities	Investment securities held as loans and receivables
	£m	£m	£m	£m
Neither past due nor impaired	1,497.0	37.3	4.6	-
Past due but not impaired	-	-	-	-
Impaired	-	-	-	-
Total	1,497.0	37.3	4.6	-

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

The credit quality of investment securities by reference to credit ratings is set out in the table below.

Credit quality for investment securities

	2012		2011	
	Investment securities		Investment securities	
	Available for sale securities	held as loans and receivables	Available for sale securities	held as loans and receivables
	£m	£m	£m	£m
AAA	1,292.5	28.3	3.9	-
AA	33.5	5.0	-	-
AA-	83.0	4.0	-	-
A+	26.4	-	0.3	-
A	61.6	-	0.4	-
Total	1,497.0	37.3	4.6	-

1.4 Retail and Wholesale Credit Risk Collateral

Due to the nature of the Group's exposures (comprising primarily residential mortgages), collateral held against credit risk as at 31 December 2012 was as follows:

- Residential lending in the form of mortgage charges over residential property amounted to £32,217.3m (2011: £43.6m). Valuations on residential property are carried out on a quarterly basis.
- Counterparty credit risk on derivative transactions (in the form of cash) and in respect of cash collateral held against counterparty credit risk at 31 December 2012 amounted to £3.8m (2011: £Nil).

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

The table below shows an estimate of the fair value of collateral held against financial assets:

2012

	Loans and advances to banks	Residential mortgage loans	Derivative financial instruments
	£m	£m	£m
Neither past due nor impaired			
Property	-	31,898.6	-
Cash	-	-	3.8
Past due but not impaired			
Property	-	303.3	-
Cash	-	-	-
Impaired			
Property	-	15.4	-
Cash	-	-	-
Total	-	32,217.3	3.8

2011

	Loans and advances to banks	Residential mortgage loans	Derivative financial instruments
	£m	£m	£m
Neither past due nor impaired			
Property	-	37.2	-
Cash	-	-	-
Past due but not impaired			
Property	-	5.1	-
Cash	-	-	-
Impaired			
Property	-	1.3	-
Cash	-	-	-
Total	-	43.6	-

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

1.5 Credit Impairment

All credit portfolios are regularly reviewed to assess for impairment. A loan or portfolio of loans is considered to be impaired if there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows or their timings. This will include identification of:

- Significant financial difficulty of the customer
- Default or delinquency in interest or principal payments
- The borrower entering bankruptcy or other financial reorganisation
- Adverse changes in the payment status of borrowers.

In the retail mortgage portfolio, individual impairments may occur where the Group has taken possession of the property or where specific circumstances indicate that a loss is likely to be incurred. In addition, collective impairment allowances across the retail credit portfolios are calculated on a portfolio basis using formulae which take into account the probability of default, the roll to possession and write-off and the loss given default, less the value of any security held. These parameters are kept under regular review to ensure that they reflect current economic circumstances and risk profile.

In addition the Group provides a number of forbearance tools to enable mortgage customers who are in temporary financial difficulty to remain in their property. The key forbearance tools used by the Group are as follows:

- Arrangement to pay less than the contractual payment
- Transfer to an interest only method of repayment
- Extension to the original mortgage term
- Capitalisation of arrears
- Arrangements with customers where the agreed mortgage term has expired and the mortgage loan is not repaid in full.

At 31 December 2012 residential mortgage loans of £534.8m (2011: £Nil) that are neither past due nor impaired had benefited from a forbearance tool. The provisioning methodology recognises the use of forbearance tools and these mortgage loans attract a higher level of provision when compared to rest of the up to date portfolio.

1.6 Credit Concentration Risk

Credit concentration risk is managed for retail and wholesale credit risk at portfolio, product, and counterparty levels. This is carried out through the application of limits relating to geographical spread, the size of loan relative to property value (at counterparty and portfolio levels) and the concentration of borrowers in each risk band.

The Group has maintained its conservative approach to European sovereign debt. As at 31 December 2012 there are no outstanding exposures to Portugal, Ireland, Italy, Greece and Spain, either from a direct sovereign exposure or from institutions domiciled in that country. The only direct European sovereign debt exposure as at 31 December 2012 is a Finnish government bond with a carrying value of £100.1m (2011: £Nil)

The following table breaks down the Group's main credit exposures by geographical region at their carrying amounts. Exposures are allocated to regions based on the country of domicile of the counterparty.

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For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

Credit Concentrations: Geographic Regions

2012	UK	Europe	US	Other countries	Total
	£m	£m	£m	£m	£m
Derivative financial instruments	104.4	7.8	22.8	26.0	161.0
Loans and advances to banks	1,310.2	-	-	-	1,310.2
Loans and advances to customers					
Residential mortgage lending	16,760.9	-	-	-	16,760.9
Unsecured lending	0.2	-	-	-	0.2
Available for sale securities	700.8	595.1	93.0	108.1	1,497.0
Investment securities held as loans and receivables	32.8	-	-	4.5	37.3
As at 31 December 2012	18,909.3	602.9	115.8	138.6	19,766.6

2011	UK	Europe	US	Other countries	Total
	£m	£m	£m	£m	£m
Derivative financial instruments	0.9	-	-	-	0.9
Loans and advances to banks	801.8	-	-	-	801.8
Loans and advances to customers					
Residential mortgage lending	17.6	-	-	-	17.6
Unsecured lending	-	-	-	-	-
Available for sale securities	4.6	-	-	-	4.6
Investment securities held as loans and receivables	-	-	-	-	-
As at 31 December 2011	824.9	-	-	-	824.9

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

An analysis of the mortgage book by loan to value (LTV) ratios is as follows:

Credit concentration: LTV bands	Residential mortgage loans	
	2012	2011
LTV (%) – indexed value as at financial year end	£m	£m
0% - 70%	9,898.6	11.5
70% - 80%	3,997.0	3.0
80% - 90%	2,387.6	1.0
90% - 100%	422.7	0.6
>100%	62.7	1.8
Total	16,768.6	17.9

Credit concentrations loan size bandings	Residential mortgage loans	
	2012	2011
Outstanding balance	£m	£m
0 - £100k	4,226.8	13.8
£100k - £250k	8,156.1	1.3
£250k - £500k	3,044.4	2.8
£500k - £1m	1,147.6	-
£1m - £2.5m	182.1	-
>£2.5m	11.6	-
Total	16,768.6	17.9

2. Market Risk

Market risk is the risk that the value of, or net income arising from, the Groups assets and liabilities changes as a result of changes to interest rates or exchange rates. Market risk is managed and monitored on an ongoing basis against Board approved risk appetite and policy. The Group does not trade or make markets in any areas and market risk arises only as a consequence of carrying out and supporting core business activities. The only material risk that the Group is exposed to is Interest Rate Risk.

2.1 Interest Rate Risk

Interest rate sensitivity arises from the relationship between interest rates and net interest income resulting from the periodic repricing of assets and liabilities. The Group offers fixed rate residential mortgages and savings products on which the interest rate paid by or to the customer is fixed for an agreed period of time at the start of the contract. The Group closely monitors mortgage redemption and repayment patterns and reduces the mismatch of the expected maturity profiles of its interest earning assets and interest bearing liabilities through the use of hedging strategies.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

Interest Rate Risk within the Group can be subdivided into the following risks:

- **Mismatch:** The effect that variations in the relationship between different points on the yield curve have on the value of fixed rate assets and liabilities
- **Optionality:** The effect that variations in early repayment or mortgage drawdowns have on expected run off profiles of fixed rate loans and therefore on the effectiveness of hedging transactions
- **Basis:** Created where balance sheet assets and liabilities are sensitive to different underlying base reference measures e.g. indices or rates. Basis risk arises for example where mortgage interest rates are linked to the Bank of England Base rate but the liabilities funding them are linked to LIBOR
- **Reset:** Exposure to the timing of repricing of asset and liabilities or to a sudden spike in a key underlying base reference measure
- **Foreign Exchange (FX):** Volatility in earnings resulting from movements in exchange rates altering the sterling value of unmatched foreign currency income streams, assets and liabilities
- **Pipeline:** Created by the uncertainty around the actual volume of fixed rate products sold versus the volume forecast
- **Asset/Swap Spread:** The risk caused by the rate used to value an asset being different to the derivative used to hedge the interest rate risk of the asset.

Risk exposures are controlled using position limits which require the Group's Treasury function to manage exposure to movements in the market.

The Group uses a number of measures to monitor and control interest rate risk and sensitivity. One such measure evaluates the difference in principal value between assets and liabilities repricing in various gap periods.

The following table gives an analysis of the repricing periods of assets and liabilities on the balance sheet at 31 December 2012.

Items are allocated to time bands in the table below by reference to the earlier of the next contractual interest rate repricing date and the residual maturity date.

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For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

Assets and Liabilities by Tenor

2012	Within 3 months	After 3 months but within 6 months	After 6 months but within 1 year	After 1 year but within 5 years	After 5 years	Non interest bearing funds	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances with central banks	1,578.8	-	-	-	-	25.7	1,604.5
Disposal group assets	79.6	-	-	-	-	-	79.6
Loans and advances to banks	1,321.8	-	-	-	-	(11.6)	1,310.2
Loans and advances to customers	6,444.0	689.3	2,498.7	6,950.1	90.1	88.9	16,761.1
Investment securities	550.7	-	27.7	449.3	455.0	51.6	1,534.3
Other assets	-	-	-	-	-	541.7	541.7
Total assets	9,974.9	689.3	2,526.4	7,399.4	545.1	696.3	21,831.4
Liabilities							
Deposits by banks	3.4	-	-	-	-	-	3.4
Disposal group liabilities	54.3	-	-	-	-	-	54.3
Customer accounts	10,621.2	1,555.4	3,146.8	2,437.2	-	246.1	18,006.7
Debt securities in issue	2,265.4	-	-	-	-	1.2	2,266.6
Other liabilities	-	-	-	-	-	745.6	745.6
Equity	-	-	-	-	-	754.8	754.8
Total liabilities and equity	12,944.3	1,555.4	3,146.8	2,437.2	-	1,747.7	21,831.4
Notional values of derivatives affecting interest rate sensitivity	3,855.4	943.2	872.7	(4,683.5)	(986.4)	(1.4)	-
Total interest rate sensitivity gap	886.0	77.1	252.3	278.7	(441.3)	(1,052.8)	-
Cumulative interest rate sensitivity gap	886.0	963.1	1,215.4	1,494.1	1,052.8	-	-

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

	Within 3 months	After 3 months but within 6 months	After 6 months but within 1 year	After 1 year but within 5 years	Non interest bearing funds	Total
2011	£m	£m	£m	£m	£m	£m
Assets						
Cash and balances with central banks	62.8	-	-	-	-	62.8
Loans and advances to banks	801.8	-	-	-	-	801.8
Loans and advances to customers	17.6	-	-	-	-	17.6
Investment securities	4.6	-	-	-	-	4.6
Other assets	-	-	-	-	92.6	92.6
Total assets	886.8	-	-	-	92.6	979.4
Liabilities						
Deposits by banks	253.8	-	-	-	-	253.8
Customer accounts	110.7	-	-	-	-	110.7
Debt securities in issue	-	-	-	-	-	-
Other liabilities	-	-	-	-	80.5	80.5
Equity	-	-	-	-	535.3	535.3
Total liabilities and equity	364.5	-	-	-	615.8	980.3
Notional values of derivatives affecting interest rate sensitivity	-	-	-	-	0.9	0.9
Total interest rate sensitivity gap	522.3	-	-	-	(522.3)	-
Cumulative interest rate sensitivity gap	522.3	522.3	522.3	522.3	-	-

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

2.2 Currency Risk

Currency risk arises as a result of the Group having assets, liabilities and derivative items that are denominated in currencies other than sterling as a result of normal banking activities, including wholesale funding.

The Group has a minimal appetite for foreign exchange risk but allows the purchase of both USD and EUR denominated assets that fall within the Funding & Liquidity and Wholesale Credit Risk policies. The Group minimises exchange rate exposures by using cross currency swaps and forward foreign exchange contracts, or by matching exposures with assets denominated in the same currency.

At 31 December 2012, assets exceeded liabilities denominated in € by €0.1m, or £0.1m after taking into account foreign currency derivatives. (2011: £Nil/£Nil).

Assets and liabilities at sterling carrying values denominated in Euros at the balance sheet date

	2012	2011
	€	€
	£m	£m
Assets		
Loans and advances to banks	0.1	-
Investment securities	20.3	-
Other assets	0.1	-
Total assets	20.5	-
Total liabilities	-	-
Notional value of derivatives affecting currency exposures	20.4	-
Net position	0.1	-

3. Liquidity Risk

Liquidity risk represents the risk of being unable to pay liabilities as they fall due and arises from the mismatch in cash flows generated from current and expected assets, liabilities and derivatives. The Group has a liquidity management framework, with a liquidity risk appetite based on maintaining sufficient liquid resources to survive a variety of stress events.

Under the framework:

- The Group aims to ensure that there is adequate liquidity within the Group by operating within a clear and well defined risk appetite. The risk appetite statement directly reflects the overall liquidity adequacy rule to “at all times maintain liquidity resources which are adequate, both in amount and quality, to ensure there is no significant risk that its liabilities cannot be met as they fall due”. We assess the amount of liquidity we need to hold by running potential stress scenarios and measuring these outcomes against the quality and quantity of our liquidity portfolios. The liquidity portfolio is held predominantly in regulatory eligible buffer liquidity as defined by the FSA.
- The minimum level of liquidity held in buffer liquid assets is defined by our Internal Liquidity Requirement (ILR). This is sufficient to meet our core liquidity stress test. We hold additional liquidity over and above this and have arranged contingent liquidity capacity to provide additional prudence over our ILR level.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

- The Company has made use of the Funding for Lending Scheme ("FLS"), a scheme launched by the Bank of England and HM Treasury in July 2012 which provides loans to banks and building societies with the aim of stimulating lending within the economy. The Company has retained £3,075.1 million of notes issued by securitisation Special Purpose Entities ("SPEs") in the Residential Mortgage Backed Securitisation programme. These notes are available for use as collateral for funding and liquidity purposes. This includes the Company's participation in the FLS. At 31 December 2012 the Company had FLS drawings of £510.0 million.

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. Amounts shown in respect of loans and advances to customers include fair value adjustments of portfolio hedging.

2012

	Within 3 months	3 - 12 months	1 - 5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	1,586.2	-	-	18.3	1,604.5
Disposal group assets	-	79.6	-	-	79.6
Investment securities	196.6	74.6	740.7	522.4	1,534.3
Derivatives financial assets	13.4	42.4	92.5	12.7	161.0
Loans and advances to banks	1,310.2	-	-	-	1,310.2
Loans and advances to customers	160.2	459.5	2,695.3	13,579.1	16,894.1
Other assets	45.6	9.3	91.6	101.2	247.7
Total assets	3,312.2	665.4	3,620.1	14,233.7	21,831.4
Liabilities					
Customer accounts	13,805.6	2,716.0	1,485.1	-	18,006.7
Deposits by banks	3.4	-	-	-	3.4
Disposal group liabilities	-	54.3	-	-	54.3
Debt securities in issue	-	-	-	2,266.6	2,266.6
Derivative financial instruments	5.4	17.2	188.9	74.1	285.6
Other liabilities	219.7	59.6	25.5	155.2	460.0
Total liabilities	14,034.1	2,847.1	1,699.5	2,495.9	21,076.6
Net liquidity gap	(10,721.9)	(2,181.7)	1,920.6	11,737.8	754.8

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

2011

	Within 3 months	3 - 12 months	1 - 5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	62.8	-	-	-	62.8
Investment securities	0.4	0.7	3.5	-	4.6
Derivative financial assets	0.5	0.4	-	-	0.9
Loans and advances to banks	801.8	-	-	-	801.8
Loans and advances to customers	0.1	0.5	3.1	14.2	17.9
Other assets	60.6	-	2.3	29.7	92.6
Total assets	926.2	1.6	8.9	43.9	980.6
Liabilities					
Customer accounts	76.4	24.9	8.6	0.8	110.7
Deposits by banks	253.8	-	-	-	253.8
Other liabilities	49.0	13.3	18.2	-	80.5
Total liabilities	379.2	38.2	26.8	0.8	445.0
Net liquidity gap	547.0	(36.6)	(17.9)	43.1	535.6

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

3.1 Non-derivative cash outflows

The table below analyses the Group's non-derivative cash outflows into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

2012

	Within 3 months	3-6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits by banks	0.7	-	-	-	-	0.7
Customer accounts	11,969.6	802.5	1,552.5	2,657.6	0.8	16,983.0
	11,970.3	802.5	1,552.5	2,657.6	0.8	16,983.7

2011

	Within 3 months	3-6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits by banks	253.8	-	-	-	-	253.8
Customer accounts	110.7	-	-	-	-	110.7
	364.5	-	-	-	-	364.5

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

3.2 Derivative cash flows

The following table analyses cash flows for the Group's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. Derivatives included within this analysis are single currency interest rate swaps.

2012

	Within 3 months	3-6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Derivatives in economic but not accounting hedges	(3.5)	(2.2)	(4.0)	(10.6)	(4.6)	(24.9)
Derivatives in accounting hedge relationships	(28.4)	(25.8)	(55.0)	(144.9)	0.6	(253.5)
	(31.9)	(28.0)	(59.0)	(155.5)	(4.0)	(278.4)

2011 Derivative liability cashflows: £Nil

The following table analyses cash flows for the Group's derivative financial liabilities that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. Derivatives included within this analysis are cross currency interest rate swaps and forward currency contracts.

2012

	Within 3 months	3-6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Derivatives in economic but not accounting hedges						
Outflows	(39.5)	(29.7)	(6.1)	(4.4)	(31.1)	(110.8)
Inflows	36.6	27.6	4.8	2.2	22.5	93.7
	(2.9)	(2.1)	(1.3)	(2.2)	(8.6)	(17.1)

2011 Derivative liability cashflows: £Nil

Total fair value gains and losses on financial instruments for 2012 amounted to £0.8 million (2011: £Nil). Of this total amount, £10.3 million (2011: £Nil) related to hedge ineffectiveness on fair value hedges, (£2.0 million) (2011: £Nil) to hedge ineffectiveness on cash flow hedges and (£7.5 million) (2011: £Nil) to fair value gains and losses on items not in hedge accounting relationships.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

4. Operational Risk (unaudited)

The Group defines operational risk as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events”. This is in line with the Basel Committee’s definition of operational risk. In managing operational risk, the Group considers indirect financial costs and regulatory, reputational and customer impacts.

The Group currently has a waiver from the FSA, to allow us to adopt a combined approach to our Pillar I calculation in 2012, applying both Basic Indicator (BIA) and Standardised Approach (TSA) calculations. This recognises the fact that Virgin Money (a BIA bank) only completed the acquisition of Northern Rock (a TSA bank) at the start of 2012. While Virgin Money intends to deliver TSA across the company, the former Virgin Money operations (Church House Trust Limited, Virgin Money Unit Trust Managers Limited and Virgin Money Personal Financial Services Limited) will remain on BIA for a transitional period to allow for the roll out of an enhanced operational risk management methodology. This roll out is on target to be achieved in early 2013.

VM plc adopts the Standardised Approach to Operational Risk management and external benchmarking has confirmed that VM plc is in line with the FSA’s related qualifying criteria. The business has a well documented risk management framework with appropriate reporting of risk events and risk exposures to the Business Performance Committee.

Business units and functions formally assess their operational risks on an ongoing basis via a prescribed Risk Control Self Assessment (RCSA) process. The RCSA analysis is reviewed and updated to reflect changes to the risk and control environment arising from changes in products, processes and systems.

5. Legal Risk (unaudited)

The Group defines legal risk as “the risk of legal sanction, material financial loss or loss to reputation the Group may suffer as a result of its failure to comply with the law, inadequately document its contractual arrangements or inadequately assess and implement changes required by forthcoming legislation or emerging case law”.

The Risk Management Framework includes a Legal Risk Management Policy within which the Board has set a zero risk appetite (i.e. full compliance) in relation to legal risk, and standards that the business is expected to operate within. The framework also includes the governance and policy controls to enable identification of key legal risks, and of prevailing and emerging legal risk developments, issues and trends. The impacts of these developments on the Group are then assessed by the business and Legal function.

6. Regulatory Risk (unaudited)

Regulatory risk is defined as the risk of the Group failing to comply with the legal or regulatory requirements applying to its arrangements and activities, with the potential consequences of:

- Treating customers unfairly, potentially exposing them to financial or other detriment
- Being subject to legal or regulatory sanctions
- Suffering reputational damage
- Being used for the purposes of financial crime.

To manage the risk, the Group has a dedicated Regulatory Risk function reporting to the Chief Risk Officer. The Risk Management Framework includes a Regulatory Risk Policy within which the Board has set a zero risk appetite (i.e. full compliance) in relation to regulatory risk, and standards that the business is expected to operate within. The framework also includes the governance and policy controls to enable identification of key regulatory risks, and of prevailing and emerging regulatory risk developments, issues and trends. The impacts of these developments on the Group are then assessed by the business and the Compliance function.

Notes to the Financial Statements

For the year ended 31 December 2012

38. Risk Management and Monitoring (continued)

In addition to ensuring compliance with new developments, the framework requires ongoing review and challenge of the Group's compliance related processes and practices. It also requires the monitoring of consistent application of policies, on a risk based approach. The results of the reviews are reported to the Operational Risk and Compliance Committee, Business Performance Committee and Risk Management Committee on a regular basis.

39. Fair Value of Financial Assets and Liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value. Assets are presented at bid prices, whereas offer prices are used for liabilities. The accounting policy note at 1.8 sets out the key principles for estimating the fair values of financial instruments. This note provides some additional information in respect of financial instruments carried at amortised cost.

	Carrying value		Fair value	
	2012	2011	2012	2011
	£m	£m	£m	£m
Financial assets				
Cash and balances with central banks	1,604.5	62.8	1,604.5	62.8
Loans and advances to banks	1,310.2	801.8	1,310.2	801.8
Loans and advances to customers ¹	16,894.1	17.6	16,912.7	17.6
Investment securities held as loans and receivables	37.3	-	35.3	-
Financial liabilities				
Deposits by banks	3.4	253.8	3.4	253.8
Customer accounts	18,006.7	110.7	18,117.2	110.7
Debt securities in issue	2,266.6	-	2,266.6	-
Non core tier 1 notes	150.0	-	150.0	-

Valuation methods for calculations of fair values in this table are set out below:

Cash and balances with central banks

Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or reprice frequently.

Loans and advances to banks

Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

¹Amounts shown in respect of loans and advances to customers include fair value adjustments of portfolio hedging.

Notes to the Financial Statements

For the year ended 31 December 2012

39. Fair Value of Financial Assets and Liabilities (continued)

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value.

Investment securities held as loans and receivables

Fair values are based on quoted prices where available or by using discounted cash flows applying market rates.

Deposits by banks and customer accounts

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated using discounted cash flows, applying either market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Non-Core Tier One Notes

There is no active market for these instruments. The fair value of these instruments is considered to be approximate to their carrying value.

Determination of fair value

The table below summarises the fair value measurement basis used for assets and liabilities held on the balance sheet at fair value. There are three levels to the hierarchy as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

2012

	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	-	161.0	-	161.0
Available for sale securities	1,394.3	102.7	-	1,497.0
Financial liabilities				
Derivative financial instruments	-	285.6	-	285.6
Contingent consideration	-	-	5.0	5.0

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For the year ended 31 December 2012

39. Fair Value of Financial Assets and Liabilities (continued)

2011

	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	-	0.9	-	0.9
Available for sale securities	4.6	-	-	4.6
Financial liabilities				
Derivative financial instruments	-	-	-	-

40. Capital Resources

It is the Group's policy to manage a strong capital base to optimise shareholder returns whilst maintaining capital adequacy and satisfying key stakeholders. The Group manages its capital to meet the regulatory requirements established by the regulator, the Financial Services Authority.

The following table analyses the composition of the regulatory capital resources of the Group.

	2012	2011
	£m	£m
Core tier 1		
Ordinary share capital	-	-
Share premium	509.2	509.2
Retained earnings	251.5	32.9
Total core tier 1 capital	760.7	542.1
Other tier 1		
Non core tier 1 notes	150.0	-
Total tier 1 capital	910.7	-
Regulatory deductions	(75.4)	-
Total available capital resource	835.3	542.1
Capital ratio (unaudited)	19.9%	131.9%

Notes to the Financial Statements

For the year ended 31 December 2012

41. Off Balance Sheet Items

The table below summarises:

Loan commitments

Contractual amounts to which the Group is committed for extension of credit to customers.

Operating lease commitments

Minimum future lease payments under non-cancellable operating leases.

Capital commitments

Capital commitments for the acquisition of buildings and equipment.

2012

	Within one year	In one to five years	Over five years	Total
	£m	£m	£m	£m
Loan commitments	638.0	-	747.5	1,385.5
Operating lease commitments				
Land and buildings	5.8	22.3	14.9	43.0
Other operating leases	5.4	1.4	-	6.8
Capital commitments	2.4	-	-	2.4
	651.6	23.7	762.4	1,437.7

2011

	Within one year	In one to five years	Over five years	Total
	£m	£m	£m	£m
Loan commitments	-	-	-	-
Operating lease commitments				
Land and buildings	1.2	6.5	7.4	15.1
Other operating leases	-	-	-	-
Capital commitments	-	-	-	-
	1.2	6.5	7.4	15.1

Notes to the Financial Statements

For the year ended 31 December 2012

42. Related Party Transactions

Group:

The following transactions were carried out with related parties:

	Transaction value Year ended 31 December		Balance outstanding at 31 December	
	2012	2011	2012	2011
	£m	£m	£m	£m
London Marathon sponsorship fees and trademark licence fees to Virgin Enterprises Ltd	6.1	3.3	1.9	-
Virgin Money Overseas Limited	0.6	0.7	7.7	9.3
Other costs to Virgin Management Group Companies	1.0	0.6	-	0.2

The Group incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited in respect of a tripartite credit card agreement with MBNA.

The Group incurs credit card point of sale discount fees to Virgin Holidays Limited.

On 25 February 2010, Virgin Money Cards Limited entered into a Sterling denominated loan agreement with Virgin Money Overseas Limited. Interest is charged at rate equivalent to Australian Dollar 12 month LIBOR plus 2 per cent per annum.

A number of banking transactions are entered into with related parties as part of normal banking business. These include deposits. The volume of related party transactions outstanding at the year end and related income and expense for the year are set out below:

	Directors and key management personnel	
	2012	2011
	£m	£m
Deposits		
Deposits outstanding at 1 January	-	-
Net amounts deposited	0.3	-
Deposits outstanding at 31 December	0.3	-
Interest income earned	-	-

Notes to the Financial Statements

For the year ended 31 December 2012

42. Related Party Transactions (continued)

	2012 £m	2011 £m
Directors and key management personnel		
Salaries and other short term benefits	5.0	3.7
Share-based payments	1.5	1.4
Post-employment benefits	0.5	0.2
Total remuneration	7.0	5.3

Key management personnel refer to the Executive Committee of the Virgin Money Group and Non-Executive Directors. Refer to notes 7 and 34 for detail of share scheme transactions.

Company:

The following transactions with subsidiaries occurred in the year:

	Transaction value Year ended 31 December		Balance outstanding As at	
	2012	2011	2012	2011
	£m	£m	£m	£m
Recharges and trading balances from subsidiaries	3.9	21.1	22.5	(28.7)
Loans to subsidiaries	4.1	1.6	138.4	88.9
Gain on transfer of subsidiary to Virgin Money plc	320.0	-	-	-

43. Parent Undertaking

No single entity or individual has a controlling interest in the Company. The shareholder base of the Company includes four shareholders who together own more than 95% of the Ordinary shares with the remainder of the shares held by a combination of corporate and private shareholders, and the Employee Benefit Trust.

Notes to the Financial Statements

For the year ended 31 December 2012

44. Events After Balance Sheet Date

On 18 January 2013 the Group sold 100% of the ordinary share capital of Virgin Money Cards Limited to MBNA Europe Bank Limited ("MBNA") for an overall gain of £203.4m. The principal activities of Virgin Money Cards Limited were the marketing and direct distribution of Virgin Money branded personal credit cards issued by and under a partnership agreement with MBNA. Prior to the sale, all assets, liabilities and contracts not connected with the MBNA partnership agreement were transferred to Virgin Money Cards Limited's immediate parent, Virgin Money plc a wholly owned subsidiary undertaking.

On the same day Virgin Money plc entered into a transaction to acquire approximately one third of the Virgin Money branded personal credit card book issued by MBNA, for a purchase consideration of £1,019.6m which was paid in cash. The assets were previously managed jointly by MBNA and Virgin Money Cards Limited under a partnership agreement. The initial fair value of the assets acquired is estimated to be £1,019.6m with the credit card book being the only assets acquired. The gross contractual amounts due for the credit card book acquired are £1,042.7m and the initial estimate of contractual cash flows that are not expected to be collected equate to the difference in this value to the fair value. The associated acquisition costs of £6.3m have been charged to the income statement in 2012. The remaining two thirds of the portfolio managed under the partnership agreement are now wholly owned by MBNA. These assets will be rebranded no later than March 2014. £5m of the gain on sale of Virgin Money Cards Limited will be deferred and recognised in income over the rebranding period.

This transaction allows the Virgin Money Group to broaden the product set offered to consumers and provides further opportunities for growth.

Issued by Virgin Money Holdings (UK) Limited
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Registered in England and Wales no. 03087587

virginmoney.com

