# UK Asset Resolution Limited

## Annual Report & Accounts

### for the 12 months to 31 March 2015

Registered in England and Wales under company number 07301961

Cm 9081 June 2015

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Presented to Parliament
by the Economic Secretary to the Treasury
by Command of Her Majesty

June 2015

Cm 9081

Any enquiries related to this publication should be sent to us at pressoffice@ukar.co.uk.

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**UK Asset Resolution Limited contacts**
This document can be found on our website at www.ukar.co.uk.

**General enquiries should be addressed to:**

UK Asset Resolution Limited – Registered Office:
Croft Road
Crossflatts
Bingley
West Yorkshire
BD16 2UA

E-mail: pressoffice@ukar.co.uk

Company number 07301961

# Contents

# UKAR Group overview

## About UKAR

UK Asset Resolution Limited ('UKAR') is the holding company established on 1 October 2010 to bring together the government-owned businesses of Bradford & Bingley plc ('B&B') and NRAM plc ('NRAM'). These businesses are both closed to new business and are in run-off. UKAR is wholly owned by Her Majesty's Treasury ('HM Treasury'), whose shareholding is managed by UK Financial Investments Limited ('UKFI'). The full governance structure is set out in a framework document ('the Framework Document') agreed between UKAR and HM Treasury (see page 20 for details).

In addition, on 8 October 2013 UKAR Corporate Services Limited ('UKARcs'), a subsidiary business of UKAR, became responsible for the administration of the government's Help to Buy: mortgage guarantee scheme on behalf of HM Treasury. The scheme is managed on a nil-gain nil-loss basis with all costs being fully reimbursed by HM Treasury.

## Mission and purpose

Our mission and purpose were established in 2010 and continue to be:

**Mission**

**"To Maximise Value for the Taxpayer"**

**Vision**

**"Creating Success Together"**

**Strategic objectives**

1. Reduce, protect and optimise the balance sheet.
2. Maximise cost effectiveness and efficiency through continuous improvement.
3. Be excellent in customer and debt management.
4. Be a great place to work.

Whilst treating all stakeholders fairly.

**Values**

Straightforward

Positive

Caring

Responsible

Inspiring

## Key facts

| | |
|---|---|
| Number of customers: | 389,000 |
| Value of customer loans: | £52.7bn |
| Employees: | 2,078 |
| Locations: | Crossflatts, West Yorkshire<br>Doxford, Sunderland |

# Chairman's statement

UKAR was established in October 2010 to bring together the government owned businesses of B&B and NRAM and holds the mandate of carrying out the orderly management and wind-down of the closed mortgage books of both businesses.

Since then UKAR has achieved exceptional performance, repaying almost 30% of the government loans which have reduced from £48.7bn to £34.6bn and our total Balance Sheet has reduced by over 40%. We have demonstrated that our mortgage servicing capabilities are successful in delivering value with the number of mortgage accounts three months or more in arrears reducing by 70%.

The excellent progress we have made to date, combined with positive market conditions and investor interest in our mortgage assets, gives us confidence to move forward and establish a long term strategic solution for the servicing of the NRAM and B&B mortgage portfolios to secure the best possible long-term value for UKAR from the remaining assets.

As a result, earlier this year, we commenced two ambitious transactions. Alongside announcing a major sale process for the disposal of c.£13bn of assets we launched the process of the sale or outsourcing of our mortgage servicing activities. These transactions will run in parallel as there are important interactions between the two.

Due to European State Aid restrictions on us, currently any purchaser of our assets has effectively no alternative but to find a new servicer for those mortgages. If we are able to sell or outsource the mortgage servicing operations any future buyer of mortgage assets will have the option to continue to have those assets serviced by our highly skilled colleagues with deep knowledge of the complex mortgage books of the two heritage businesses and proven skills in debt management and serving customers. In addition, a new owner will not have the restrictions of State Aid and could if they wish actively seek new business which in turn would help retain and grow our current capabilities in serving our customers.

These transactions offer potential purchasers a unique opportunity to acquire a highly scalable mortgage servicing operation with the proven ability to service a wide range of loan products. However, this is highly complex and will be contingent on achieving value for money for the taxpayer and subject to the necessary approvals. If we determine that any bids do not represent good value for the taxpayer we will continue to build on the good work we have done to date, helping customers in financial difficulty, encouraging redemptions and managing the wind down of the legacy portfolios of mortgage assets by selling smaller portfolios over a longer timescale. If successful we will have substantially accelerated the wind down of the legacy mortgage books whilst ensuring that UKAR's remaining assets are managed properly with the interests of our customers protected.

### The Board

The UKAR Board comprises myself as Chairman, four independent Non-Executive Directors, two UKFI nominated Directors and two Executive Directors. In November we welcomed David Lunn to the Board when UKFI appointed him as one of their representative Non-Executive Directors to manage HM Treasury's shareholdings in UKAR. David replaced Christopher Fox who left UKFI in the same month and joined the British Business Bank. Ian Hares, our Finance & Investment Director was appointed to the Board in July.

# Chairman’s statement (continued)

### The Board (continued)

At the end of the year our internal review of the performance of the Board saw 91% of responses rated at the highest possible level and demonstrated that the Board worked well as a team and in a constructive manner. The Board considered whether an external evaluation would be valuable, as required at least every three years by the UK Corporate Governance Code but agreed that it was not appropriate at this point in time and the high costs of an external evaluation were not a good use of taxpayer funds. The results of the evaluations for the various Board Committees were also positive and provided assurance that they remained fit for purpose. I thank all Directors for their contribution to the effective running of UKAR. You will find full details of the Board structure and biographies of each Director on pages 21 to 25.

### Colleagues

The Board is acutely aware of the difficulties UKAR faces in retaining the expertise of our colleagues as we shrink the mortgage books and accelerate asset sales. Richard Banks and his management team have continued to lead the business extremely well, managing the orderly wind down of the two mortgage books and maximising value for the taxpayer whilst maintaining high levels of colleague engagement, embedding good regulatory conduct and treating our customers fairly.

Colleagues across UKAR have proven skills in serving customers and helping those who are in financial difficulty. Once again this year they have made tremendous efforts in enabling us to achieve our objectives and I want to thank all colleagues for their continued commitment, loyalty and contribution to the success of UKAR.

UKAR has made fantastic progress since our establishment in 2010, indeed the improvements in our operations are huge, and it is a credit to all our colleagues that we are now in this favourable position.

**Richard Pym**
Chairman
15 June 2015

# Chief Executive Officer's introduction

### Financial performance

I am pleased to report that UKAR achieved three of its financial targets agreed with UKFI for 2014/15. Over the past 12 months we paid HM Treasury £4.4bn (2013/14: £5.6bn) including £3.7bn (2013/14: £4.6bn) of principal on our loans from the government, reduced our year-on-year costs by 7% and achieved £1,398.1m in underlying profits (2013/14: £1,259.1m). Whilst B&B has made cumulative pre-tax profits since nationalisation this is primarily because of the zero cost funding of £18.4bn provided by HM Treasury and the Financial Services Compensation Scheme ('FSCS'). If the company had been funded externally this would have been at much higher market rates and it would not have made profits and its capital base would have been eroded.

We have continued to reduce arrears, which fell by 23% in the year. Unfortunately this was not as quickly as we had anticipated and our target was not achieved. However, our primary focus is on helping customers who are in arrears. Of our customers who are in arrears by 3 months or more, 40% are in a long term arrangement to repay and so ultimately will return to financial health.

A summary of UKAR's financial performance can be found on page 10, with more detail provided in the Financial Review on page 57.

### Balance Sheet

Since UKAR was formed the UKAR companies have repaid £14.1bn of government funding, including £3.7bn in 2014/15 (2013/14: £4.6bn). In addition, £0.7bn of third party debt was repurchased and £5.9bn of other funding was repaid on maturity in the year.

These repayments have been funded largely from an £8.5bn reduction in lending balances reflecting £5.3bn of secured residential redemptions, £0.1bn of commercial redemptions, £0.1bn of unsecured redemptions and £0.3bn of other regular repayments. In addition, £2.7bn of residential mortgages were sold during the year.

In October 2014 we concluded a competitive sales process for the sale of a portfolio of performing residential mortgages from the legacy books of B&B, NRAM and Mortgage Express ('MX') to Commercial First as part of a consortium led by JP Morgan for £2.7bn. The NRAM cash proceeds were retained to fund the buy back of a Covered Bond, which was completed in May 2015.

As at 31 March 2015, lending balances stand at £52.7bn (March 2014: £61.2bn). In total the Balance Sheet has reduced by £49.7bn from £115.8bn at formation to £66.1bn at 31 March 2015.

### Costs

We have continued to reduce costs and increase operational flexibility, migrating systems onto common platforms and creating common processes and controls. Whilst other cost reductions have been achieved as the size of the Balance Sheet reduces, diseconomies of scale are likely to make this increasingly challenging to achieve going forward.

### Customers

UKAR's approach to good conduct and delivering fair and appropriate outcomes to our customers is fully aligned with the Financial Conduct Authority's ('FCA's') principles. In April 2014 we implemented the Mortgage Market Review ('MMR') and we now have 125 colleagues qualified with the industry recognised CeMAP certification and thus qualified to provide regulated mortgage advice to customers who need it.

# Chief Executive Officer's introduction (continued)

### Customers (continued)

UKAR has almost 389,000 customers (2013/14: 467,000), with 455,000 mortgage accounts (2013/14: 529,000) and 106,000 unsecured personal loan accounts (2013/14: 119,000). In the main, these loans continue to perform well and over 94% are up to date.

We continue to proactively seek to support customers in financial difficulty and the total number of mortgage cases three or more months in arrears, including those in possession, reduced by 23% to 11,976 cases as at 31 March 2015 (March 2014: 15,483).

Currently 46% of UKAR residential mortgage accounts (excluding buy-to-let) held by 122,000 customers are 'interest only', with 75% of these having more than ten years until maturity. We have now contacted over 42,000 customers reminding them of their obligations and discussing with them how they can make plans for the future.

Although we aim for excellence in customer and debt management we are aware that sometimes things go wrong and we continue to deal with several legacy issues inherited from Northern Rock and B&B. Our intent is to do the right thing for our customers and make redress where appropriate. We have provided £295m for such remediation in the year.

Further information on our customer strategy is on pages 13 to 15.

### Colleagues

'Being a great place to work' remains one of our four strategic objectives and our internal survey results continued to show high levels of colleague engagement demonstrating that we are succeeding in this objective (see our people strategy on page 16).

Throughout UKAR we have a great deal of expertise in managing debt and customer service and we are focused on ensuring that customers who contact us have a good experience and that we reach the right outcome for them and for the taxpayer. Our customer offering relies also on the great work of colleagues in all our support areas who provide the training, technology, facilities and all the other back-up services that we need in order to serve our customers well.

As mentioned earlier in this report, it was particularly pleasing to conclude the sales process for a £2.7bn portfolio of mortgages in 2014 and the success of that transaction and the subsequent and ongoing work to transfer the servicing of those accounts is the result of the efforts of a large number of experienced and skilled colleagues.

### Conclusion

I thank all my colleagues for their continued efforts and commitment to UKAR and the Board and Executive management team for their ongoing support. It is only through their dedication and hard work that we are able to move into the next stage of our strategy and we intend to build on our success over the next twelve months to continue to deliver our financial objectives to the taxpayer whilst treating customers and our other stakeholders fairly.

**Richard Banks**
Chief Executive Officer
15 June 2015

# Strategic Report

# Key highlights

## Highlights of 2014/15

During the year we have made significant progress against all our key objectives and overall mission of maximising value for the taxpayer. Internally, UKAR measures its financial performance against the following four key performance indicators:

| Financial measure | 12 months to March 2015 | 12 months to March 2014 | 15 months to March 2014 |
|---|---|---|---|
| Underlying Profit Before Tax | £1,398.1m | £1,259.1m | £1,523.2m |
| Government Loan Repayments | £3.7bn | £4.6bn | £5.1bn |
| 3m+ Residential Arrears | 11,976 | 15,483 | 15,483 |
| Ongoing Administrative Expenses | £174.2m | £188.0m | £244.5m |

Underlying profit for the year to March 2015 has increased by £139.0m to £1,398.1m (12 months to March 2014: £1,259.1m). Although net interest income has reduced due to the shrinking Balance Sheet, profits have increased primarily due to a lower loan impairment charge, mainly as the result of rising house prices but also aided by the continued improvements in the level of arrears.

Government loan repayments of £3.7bn were £0.9bn lower than the prior year as cash is being accumulated to repay a £1.0bn covered bond maturity in 2015. A further £0.8bn was utilised for liability management projects to repurchase third party debt, thereby reducing and optimising the Balance Sheet. Other payments of £0.7bn, for interest costs, fees and taxes, were also made to the taxpayer during the year. Since the formation of UKAR in October 2010 payments to taxpayers now total £17.6bn, including £14.1bn of government loan repayments.

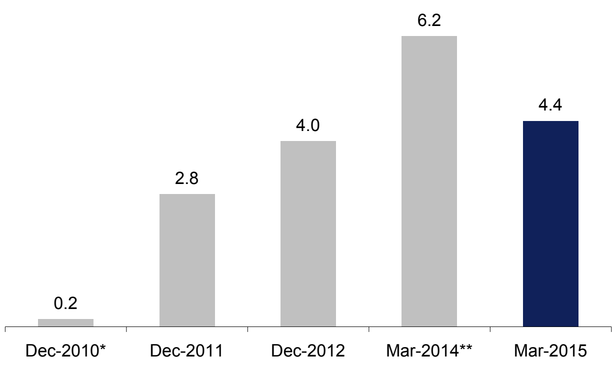
Arrears levels for both B&B and NRAM continue to fall as a direct consequence of proactive arrears management coupled with the continued low interest rate environment. The total number of mortgage accounts three or more months in arrears, including those in possession, reduced by 23% from 15,483 at 31 March 2014 to 11,976 cases as at 31 March 2015.

Ongoing administrative expenses (excluding UKARcs costs) for the year were £174.2m, which is 7% lower than the year to March 2014 (£188.0m).

On 13 October 2014, UKAR sold a portfolio of mortgages for £2.7bn. The portfolio was sold via a competitive sales process which saw a high level of interest resulting in a sale price in excess of par and a premium in the region of £55m, which when adjusted for costs, hedging impacts and margins between May and the completion date gave an accounting profit on disposal of £18.3m. The sale has helped us to accelerate the delivery of value for the taxpayer and the repayment of the government loan. Of the cash proceeds received from the sale, £1.6bn was retained and has since been used to repurchase a long-dated Covered Bond in May 2015.

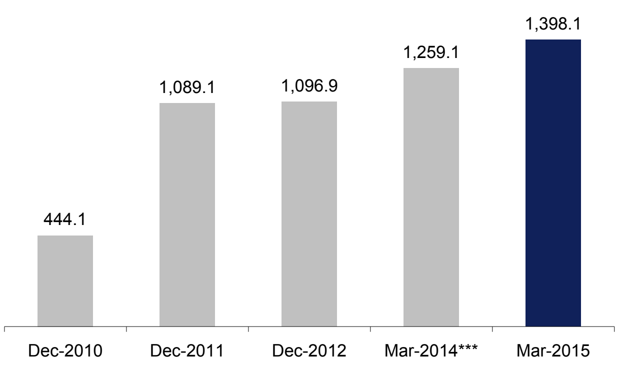
Please see pages 57 to 66 for a full review of the 2014/15 financial performance.

**Total cash payments to HM Treasury (£bn)**




*  3 months to December 2010
** 15 months to March 2014

**Underlying profit (£m)**



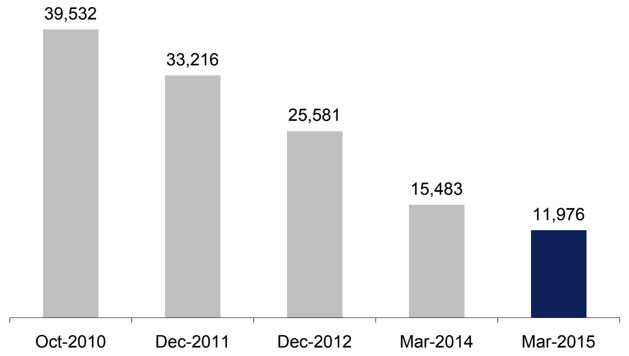

*** 12 months to March 2014

# Key highlights (continued)

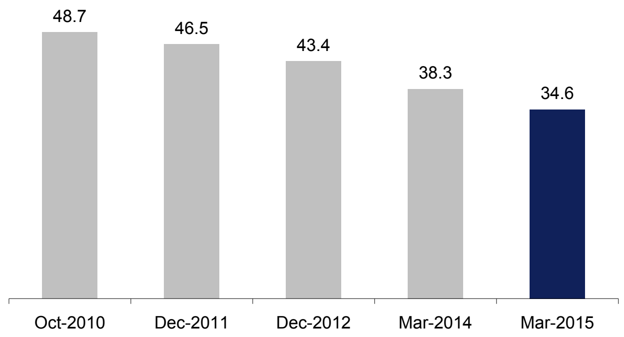
## Highlights of 2014/15 (continued)

Since the formation of UKAR in October 2010 we have made significant progress towards our long term objectives by reducing arrears, repaying government loans, reducing the Balance Sheet and driving cost effectiveness.

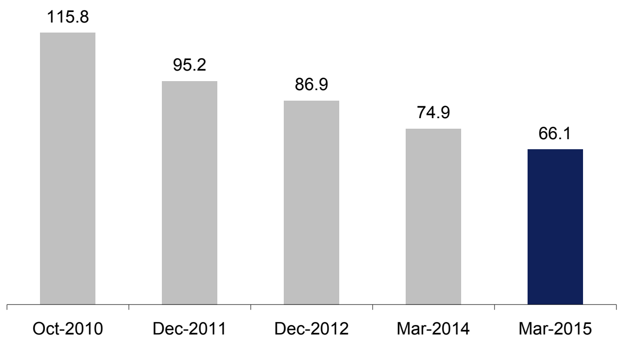
**3m+ arrears down 70%**



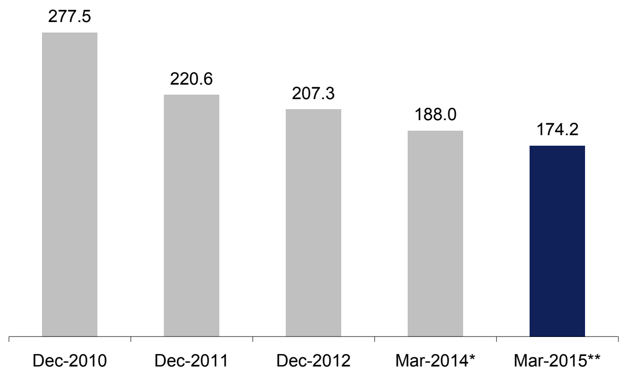

**Repaid £14.1bn of government loans**




**Balance sheet assets (£bn) down 43%**




**Ongoing operating expenses (£m) down 37%**




** 12 months to March 2014 excluding UKARcs costs of £1.8m*
*** 12 months to March 2015 excluding UKARcs costs of £3.0m*

# Strategy and operating environment

## Company strategy

On the formation of UKAR in October 2010 it was anticipated that our strategy would involve three elements which have been implemented in parallel:

### (1) Repair and prepare

'Repair and prepare' focused on the formation of UKAR, the definition of UKAR's mission and strategy and implementation of an efficient, integrated operating model. This has included the transfer of all our mortgages onto a single system, the migration to a new IT provider and the exit from the Gosforth site.

Under this phase we agreed the UKAR strategic objectives which underpin all that UKAR is doing. These objectives are as follows:

- to reduce, protect and optimise the Balance Sheet;
- to maximise cost effectiveness and efficiency though continuous improvement;
- to be excellent in customer and debt management; and
- to be a great place to work.

This stage of the process is now largely complete.

### (2) Implement and improve

'Implement and improve' is the increasing focus on maximising the value of the mortgage book through optimising redemptions and minimising losses. Here our proactive customer strategy is to engage with our customers, understand their circumstances and design appropriate strategies. During 2014/15 we have continued to contact our interest only customers with less than ten years remaining on their mortgage through contact programmes targeting cohorts who did not respond previously. We also contacted customers who may be susceptible to interest rate rises and those who may have more immediate affordability problems. Moving forward, we will implement a contact strategy for all our interest only customers aligned to the term remaining on their mortgage and target cohorts with more than ten years remaining.

### (3) Realise and release

'Realise and release' focuses on extraction of value by selling parts of the book to accelerate the repayment of the government loans.

This is a unique business, born out of the credit crisis. The legacy banks of Northern Rock and B&B were nationalised in 2008. In 2009 the FSA were required to provide a capital waiver for Northern Rock. Similarly, if B&B had not received the interest free funding provided on nationalisation it would have seen an erosion of its capital base from 2009 onwards. With the government support we have consistently achieved excellent results in building a fit for purpose mortgage servicing business and the time has now arrived for us to build on our success.

Our focus on customers together with the improving UK economy has delivered excellent results since UKAR was formed in 2010. Three month arrears have fallen 70% and the Balance Sheet has reduced 43% as customers remortgage elsewhere and assets are sold at prices that deliver taxpayer value. Most recently UKAR sold a portfolio of performing mortgages for £2.7bn with settlement proceeds received in October 2014. The book was sold through a competitive sales process which saw a high level of interest and resulted in a sale price in excess of par. The proceeds included a premium of around £55m over the book value, representing good value for the taxpayer.

We have now begun a process to sell a further significant portion of the mortgage book, five times greater than the sale achieved in 2014. In addition, we are seeking to sell or outsource our operational capability to maximise the benefit of the investment we have made to date and the expertise we have built in servicing mortgages. Having brought together two organisations, migrated the NRAM mortgage book of 450,000 accounts onto UKAR systems and started a programme of asset sales, these two programmes are our most ambitious initiatives to date and the work on these over the next twelve months will determine the next stage in our future.

# Strategy and operating environment (continued)

## Customer strategy

Our colleague survey demonstrates clearly that our people are very committed to providing excellent customer service and are focused on ensuring we the do the right things for our customers. UKAR has almost 389,000 customers (2014: 467,000), with 455,000 mortgage accounts (2014: 529,000) and 106,000 unsecured personal loan accounts (2014: 119,000). The majority of these loans continue to perform well with more than 94% of mortgage customers up to date with their monthly payments.

### Support for customers experiencing payment difficulties

Although levels of arrears are reducing we continue to see a number of customers facing financial difficulty including some entering arrears for the first time. We endeavour to contact all customers following a missed payment to understand their specific situation and find solutions to help them manage their mortgage. For customers experiencing temporary or short-term financial difficulty this includes a range of forbearance options. During the year, over 30,000 arrangements were successfully completed and approximately 1,000 account modifications were made to assist customers with the repayment of their mortgage. Where appropriate we actively encourage customers to seek help from non-fee charging debt advice agencies.

Repossession is always viewed as a last resort but unfortunately in some situations this is inevitable and the best course of action to prevent further indebtedness for the customer. Repossessions continue to decrease and totalled 2,856 in the year (12 months to March 2014: 5,046).

### Proactive customer engagement

In addition to our contact strategies for customers in arrears, we also engage proactively with other groups of vulnerable customers who may need to consider their financial situation now to ensure they are ready for the future, such as those coming to the end of an interest only mortgage term. Our aim is to remind customers of their obligations, provide a range of useful information and help them plan ahead. It is encouraging that about a half of all the interest only customers we contact engage with us.

### Doing the right thing for our customers

In December the High Court ruled that customers with loans over £25,000, who had historically been sent incorrect documentation stating that their loans were regulated under the Consumer Credit Act ('CCA'), should receive remediation in line with that provided in 2012 on CCA loans of less than £25,000. Therefore, a charge of £268m has been recognised in the year. However, NRAM has sought clarification of this decision through the Court of Appeal and we are waiting for the outcome to be announced. Should this appeal be successful, this charge will be reversed.

## Strategy and operating environment (continued)

# Case Study

## Supporting customers in financial difficulty

### Mr and Mrs S

**Mrs S contacted NRAM in August 2013 to advise that her husband had damaged his back in a car accident and required an operation, leaving him out of work for some time. As a result, they were unable to maintain their full monthly mortgage payments and fell into arrears.**

Their circumstances were reviewed and following a full income and expenditure assessment the advisor suggested that Mrs S may wish to consider temporarily switching to Interest Only repayments. Mrs S agreed that this would allow her to maintain payments and give her husband time to recover and return to work.

When the temporary Interest Only period ended in October 2014 and the mortgage reverted to Repayment, another full review and income and expenditure assessment was carried out. Although Mr S had returned to work it was clear they would still struggle to clear the arrears within a reasonable timeframe.

We discussed their options and agreed that the most suitable option was to switch part of the mortgage to Interest Only for five years with the rest of the loan remaining on a repayment basis (known as Part & Part). This would allow them to remain in the home, while making regular overpayments to clear the arrears.

By February 2015, the couple had brought the account up to date and have switched back to Repayment earlier than anticipated.

- Our Customer Assistance Team attempt to contact all customers within **two** days of a missed payment.

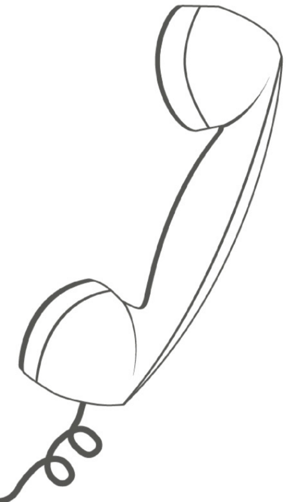
- Mortgage accounts three or more months in arrears, including possessions, have reduced by **70%** since UKAR formed in 2010.

- **94%** of our customers are fully up to date with their mortgage payments.

## Strategy and operating environment (continued)

# Case Study

## Free impartial debt advice



### Mr and Mrs T

**Mr and Mrs T first started to struggle financially when Mr T was made redundant. They fell behind on various credit commitments that previously they had managed easily. By the time Mr T found a new job, their mortgage arrears were £883 and their unsecured debt was more than £27,000.**

In discussing the position with Mr T, our advisors recognised that the unsecured debts were affecting their ability to repay the mortgage arrears and that they might benefit from free, independent debt advice.

Mr T said his new salary was now much lower and with interest mounting on their debts they didn't know where to turn. The advisor explained UKAR's partnership with StepChange, and with Mr T's consent, transferred the call to one of the charity's advisors.

Mr T worked with a StepChange advisor to build a clear picture of their financial position, listing their debts, income, expenditure and assets. This showed that Mr and Mrs T had a surplus income of £648 each month, to pay towards their mortgage arrears of £883 and unsecured debts of £27,000.

Stepchange recommended a Debt Management Plan (DMP), which included a payment of £148 towards their mortgage arrears. This would clear their mortgage arrears in six months and once these arrears were repaid, any future surplus funds would be shared between the remaining creditors to ensure our customers became debt-free as soon as possible.

Mr and Mrs T made the first payment to their DMP in September 2014 and their mortgage arrears are now fully repaid.

- For the 12-month period to March 2015, we referred approximately **2,200** customers to free and impartial debt advice providers to help customers reorganise their finances.

- Since 2011 we have signposted around **16,500** customers to free and impartial debt advice of which we believe over **50%** entered into some form of Debt Solution.

- Research from Money Advice Service suggests those people who seek debt advice are **twice** as likely to move back into a manageable debt position within 12 months.

# Strategy and operating environment (continued)

## People strategy

UKAR's Vision is 'Creating Success Together' and we believe colleagues are the differentiating factor in delivering strong and sustained performance.

'Being a great place to work' is one of our four strategic objectives. We believe it is important that colleagues feel valued, are proud of the contribution they make and are given the opportunity to grow and learn new skills. Colleagues who enjoy their work strive to do the best they can which increases productivity, gives better service to our customers and maximises value for the taxpayer.

### Culture

The UK Regulatory requirement to enhance culture across Financial Services is supported by UKAR's aspiration to build a culture focused on doing the right thing for all stakeholders. This includes recognising the importance of robust risk management, integrity and ethical behaviour and good conduct; placing customers at the heart of all we do.

The Board and senior management set the cultural tone at the top, ensuring that UKAR's values and culture support the delivery of UKAR objectives. To this end, at the beginning of the financial year we reviewed and updated our Balanced Scorecard to place greater emphasis on conduct and how we achieve our targets. In addition, we increased the potential impact the Balanced Scorecard has on the annual incentive schemes that UKAR operates.

### Values

The values, behaviours and standards that underpin the way we do business were shaped by colleagues in 2011 through a series of manager events, focus groups, surveys and interviews. We wanted to ensure that everyone had an opportunity to have their say in the creation of our values which are embedded from the approach we take to recruiting colleagues through to our performance framework, our training programmes and how we incentivise and thank colleagues for the work they do. It is not just 'what' is delivered, it is 'how' it is delivered and the behaviours that our colleagues demonstrate as part of their day-to-day work. For the 2014/15 performance year we also launched a new performance framework which further embeds this approach and has an equal weighting between the 'what' and the 'how'.

### Engagement

We have developed an 'engagement framework' which encompasses all aspects of colleague life at UKAR and we track how we are doing against key areas by way of a twice yearly colleague engagement survey. Our most recent survey in March 2015 had an excellent response rate, with 88% of colleagues sharing their views. Our survey tracker score, based upon five key questions measuring UKAR as an employer, rose 3 points to a record high of 86%, which is 10% above the benchmark figure provided by our survey business partner, People Insight.

### Diversity

UKAR treats colleagues as individuals and we recognise the benefits of having a diverse workforce. Appointments and promotions are made according to the ability to meet the requirements of the job.

In particular, UKAR's workforce comprises 61% female to 39% male colleagues. On the Board we have one female (11%) and eight male (89%) Directors. Two of the six members (33%) of the Executive Committee and 35% of the Senior Leadership Team are female compared to none and 21% respectively upon the formation of UKAR.

### Learning and development

UKAR invests significantly in improving performance and increasing employability and we aim to provide an average of six days development per colleague each year. We also support a wide range of learning from process and operational training through to professional study. During the year we delivered 12,392 days of training and 75% of colleagues have undertaken development programmes to support their career.

In 2010 we introduced our Apprenticeship Scheme and we currently have 22 apprentices within the business and intend to recruit a further 20 this year. To date 52 apprentices have secured permanent roles at UKAR. Our Undergraduate and Graduate schemes continued with three and five placements respectively in 2014. We plan to recruit four Graduates, four Undergraduates and four Summer Interns in 2015. We also support the government's Centre of Excellence initiative.

### Well-being

UKAR supports colleagues through various 'well-being' programmes, offering membership of a private medical insurance scheme or the opportunity to contribute towards a healthcare cash plan and access to the Employee Assistance Programme.

# Strategy and operating environment (continued)

## People strategy (continued)

### Recognition

We have a popular recognition scheme enabling colleagues to show their appreciation to others by sending an e-card or by means of other on-the-spot awards. Colleagues who are an inspiration to others by living the UKAR values, going the extra mile, delivering superior performance or demonstrating exemplary behaviour can be nominated for quarterly and annual awards. We also celebrate the work of teams across UKAR by having a team of the quarter and team of the year scheme.

## Community and environmental strategy

### Community

We are committed to:

- using the skills of the business to support education in our communities;
- building the skills of our colleagues through community engagement; and
- supporting colleagues with their own community and charity initiatives.

During 2014/15, UKAR supported MIND as our corporate charity and at each major site we also supported a local charity chosen by our colleagues. These were Martin House Children's Hospice in Crossflatts and Daft as a Brush Cancer Patient Care in Doxford. The total amount raised for these and other charities in 2014/15 was £65,607. In addition, UKAR matched employee fundraising to the total of £33,823 and payroll giving totalled £16,246.

UKAR's site charities for 2015/16 are Yorkshire Air Ambulance in Crossflatts and Children North East in Doxford.

Colleagues in UKAR are given the opportunity to volunteer to help our communities by working with a number of charities including Young Enterprise, a charity set up to work with schools to inspire young people with the confidence, ability and ambition to succeed in a challenging and changing economy.

### Environment

We are committed to:

- reducing environmental impact wherever possible;
- increasing recycling programmes; and
- creating awareness of environmental programmes and engaging colleagues in these activities.

We seek to improve our environmental performance through a range of initiatives and in 2014/15 we achieved the following:

- Recycling 96.0% of waste recycled.
- Landfill 4.0% of waste sent to landfill.
- Carbon emissions * Reduced by 8.5%.

** Carbon produced from utilities (Gas / Electric consumption).*

Further details on our community and environmental strategy can be found on page 77.

# Risk overview

UKAR adopts an Enterprise-wide Risk Management Framework ('the Framework') which is designed to support the identification, assessment, management and control of the principal risks that threaten the achievement of UKAR's strategic and business objectives. The Framework sits alongside the Ten Year Business Plan, the Capital Statement and the Liquidity Statement in defining the high-level architecture of UKAR's business planning and risk management systems. The Framework itself is underpinned by UKAR's Risk Appetite Framework and a suite of high level risk policies which define the breadth of UKAR's exposure to inherent risks and the management of these risks within appetite. The scope of the Framework extends to all principal risk types faced by UKAR. The table below illustrates the principal risk categories which could impact the delivery of the strategic objectives, key mitigating actions, key indicators and the 2015/16 focus.

| Principal risk | Key mitigating actions | Key indicators | Focus 2015/16 |
|---|---|---|---|
| **Conduct risk**<br>The risk of UKAR treating its customers unfairly and delivering inappropriate outcomes leading to customer detriment or impacting market integrity. | ▪ Conduct Risk Framework to ensure customers are central to the delivery of our objectives.<br>▪ Conduct risk assessments are integral to all business change and customer initiatives.<br>▪ Conduct Risk Dashboard tracked and actioned by relevant committees.<br>▪ Colleague rewards driven by Conduct risk metrics. | ▪ Volume of upheld complaints.<br>▪ Market Regulatory Indicators.<br>▪ Internal quality assurance results.<br>▪ Incentive scheme tracking. | ▪ Fair and appropriate customer outcomes.<br>▪ Complaint handling and Root Cause analysis.<br>▪ Empowering front line operations.<br>▪ Risk culture. |
| **Operational risk**<br>The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. | ▪ Quarterly Risk & Control Self Assessment ('RCSA') process to identify and assess key operational risks.<br>▪ Scenario analysis to determine the potential impact of high impact, low likelihood events.<br>▪ Forward looking Key Risk Indicator monitoring to proactively identify shifts in risk exposure.<br>▪ Loss event monitoring to identify control failures and appropriate corrective action.<br>▪ Risk appetite monitoring to ensure we are operating within Board approved limits. | ▪ Comparison of scenario analysis and RCSA financial impacts against defined risk appetite.<br>▪ Number and value of operational risk loss events.<br>▪ People risk metrics (attrition and absence).<br>▪ Systems risk metrics (availability and security incidents). | ▪ Continued investment in core IT systems to limit systems outages and security breaches.<br>▪ Tracking of operational loss events and subsequent control improvements.<br>▪ Assessment of cyber risk exposure and control effectiveness through security penetration testing and colleague awareness campaigns.<br>▪ Ongoing monitoring of people and process risks associated with a reducing business. |
| **Credit risk**<br>The current or prospective risk to earnings or capital arising when a customer (residential or commercial) or counterparty defaults on its contractual obligations to the company. | ▪ Credit Risk Policy, incorporating Board approved risk appetite to support the ongoing management of credit risk.<br>▪ Forbearance Programme structured to support customers through periods of distress.<br>▪ Dedicated Credit Risk Committee and robust processes and controls to identify credit risk exposures and action appropriate mitigation.<br>▪ Euro and US dollar cash balances are held at a range of highly rated banks. | ▪ Impairment charge.<br>▪ Loan to Value.<br>▪ Arrears.<br>▪ Counterparty ratings. | ▪ Manage the credit risk on the underlying mortgage book.<br>▪ Interest Only repayment strategy.<br>▪ End of Term Account Management including consideration of the impact of the new pension rules.<br>▪ Ongoing monitoring of asset sale influence on the overall credit quality of the book.<br>▪ Ongoing monitoring of credit rating movements of wholesale counterparties. |
| **Strategic risk**<br>The current or prospective risk to earnings and/or fair value, given the B&B and the NRAM Balance Sheet structures, arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. | ▪ Governance structure.<br>▪ Enterprise Wide Risk Management Framework.<br>▪ Risk Appetite Framework.<br>▪ Risk policies.<br>▪ Capital Assessment Framework. | ▪ Material risks managed within defined risk appetite. | ▪ On-going monitoring of strategic risks with the potential to significantly impact the delivery of strategic objectives.<br>▪ Oversight of the execution of asset sales and the sale or outsourcing of mortgage servicing. |
| **Liquidity risk**<br>The risk that either B&B and/or NRAM are unable to meet their obligations as they fall due. | ▪ The defined appetite for liquidity risk is low. Sterling liquidity is held as cash balances at the Bank of England.<br>▪ Stress & Scenario testing is undertaken to ensure that B&B and NRAM will be able to meet their obligations in extreme conditions. | ▪ Changes in the maturity profiles of assets and liabilities.<br>▪ Level of liquidity.<br>▪ Contingency funding plan early warning indicators. | ▪ Manage liquidity to ensure UKAR has adequate levels of liquidity to meet its commitments at all times and maintain liquidity within levels agreed with HM Treasury facilities and the Liquidity Risk Policy. |
| **Market risk**<br>The risk that changes in the level of interest rates, the rate of exchange between currencies or the price of securities or other financial contracts, including derivatives, will have an impact on the results of operations or the financial condition of B&B and/or NRAM. | ▪ Market risk is managed and monitored within defined risk appetite and policy.<br>▪ B&B and NRAM use derivative instruments to mitigate the market risk exposures.<br>▪ Stress & Scenario testing is undertaken to ensure losses are acceptable even under extreme conditions. | ▪ The sensitivity of interest income to changes in market rates.<br>▪ Variations on the rate of repayment of fixed rate mortgages. | ▪ Manage market risk within defined risk appetite. |
| **Regulatory risk**<br>The risk of UKAR failing to comply with the legal and regulatory requirements applying to its arrangements and activities. | ▪ Zero tolerance appetite in respect of Regulatory Risk.<br>▪ Establish minimum standards and responsibilities to ensure the effective management of Regulatory Risk.<br>▪ Regulatory Risk dashboard tracked and actioned by Executive Risk Committee. | ▪ Volume of regulatory breaches.<br>▪ Industry relevant regulatory developments.<br>▪ Industry fines and cost of redress.<br>▪ Regulatory relationships. | ▪ On-going monitoring of changes in regulation.<br>▪ Open dialogue with Regulators.<br>▪ Analysis of FCA fines. |

**Richard Banks**
Chief Executive Officer, on behalf of the Board
15 June 2015

# Directors' Report and Governance Statement

# Corporate governance

## Introduction

UKAR is the holding company established on 1 October 2010 to bring together the government-owned businesses of B&B and NRAM.

UKAR is 100% owned by the UK government which exercises control through UKFI. UKFI was set up on 3 November 2008 to manage the government's investments in Royal Bank of Scotland, Lloyds Banking Group, Northern Rock and Bradford & Bingley.

UKAR governs and controls NRAM and B&B, as their sole shareholder. Although managed under a common board and management structure, NRAM and B&B (the 'Principal Subsidiaries') remain separate legal entities and continue to operate as individual companies with their own individual brands and Balance Sheets.

This corporate governance section summarises the governance regime applicable to UKAR including its Principal Subsidiaries referred to above (the 'Group') at the date of this report.

### UKAR Corporate Services Limited

In 2013, UKAR was appointed by HM Treasury to administrate the Help to Buy: mortgage guarantee scheme on its behalf. The administration of the Scheme is kept separate from UKAR's core operations through a separate company, UKARcs.

## Governance structure

The governance structure for the Group is determined by the UK Asset Resolution and UK Financial Investments Limited Relationship Framework Document agreed between UKAR and UKFI, acting on behalf of HM Treasury. The Framework Document sets out how the relationship between the Group and UKFI will work in practice. The terms of the Framework Document are reflected below and throughout this report.

The Framework Document is intended to ensure that the relationship between the companies in the Group, UKFI, HM Treasury (as Shareholder and the provider of financial support) and the FCA (as regulator), operates in the context of the over-arching objective of maximising value for the taxpayer, whilst paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. The Framework Document requires the Group to set strategic aims and develop a business plan to achieve the overarching objectives.

### Principles of the Framework Document

The relationship between the Group and UKFI operates according to the following principles under which UKFI:

- appoints the Chairman of the Board and is entitled to appoint one or more Non-Executive Directors;
- is required to consent to the appointment of other members of the Board proposed for appointment by the Nomination Committee and agrees the terms on which the Directors are appointed, remunerated and incentivised;
- agrees with the Board the high level objectives which the business plan ('the Plan') is designed to achieve and any revisions to it;
- reviews with the Board from time to time the Group's strategic options;
- requires that the Board is accountable to it for delivering the agreed Plan;
- gives the Board the freedom to take the action necessary to deliver the Plan;
- monitors the Group's performance to satisfy itself that the Plan is on track; and
- is to be informed if the Group proposes to take certain significant actions and provide prior written consent before such action is taken.

# Corporate governance (continued)

## Governance structure (continued)

### Monitoring performance

UKFI monitors the Group's performance against the Plan by means of the following main mechanisms:

- monthly (or, at UKFI's request more frequent) meetings between the Group and UKFI to review performance to date against the Plan; and
- monthly (or, at UKFI's request, more frequent) financial and business performance monitoring to track the progress of the Plan and the Group's performance against agreed objectives on a timely, regular and appropriate basis.

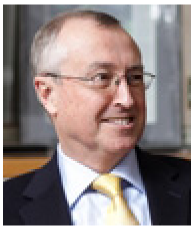
In addition, UKFI has certain monitoring and information access rights and its approval must be obtained for certain material actions and transactions, as defined in the Framework Document.

## Board of Directors

UKAR, B&B and NRAM share a common Board of Directors. The individual profiles included in this section, therefore, set out the Directorships of all three companies.

The biographical details of each Director demonstrate the broad range of experience and expertise they bring to the Board.

### Richard Pym – Non-Executive Chairman



Richard became Chairman of UKAR in July 2010 having been appointed Chairman of B&B in November 2008 and NRAM in January 2010. He also chairs the Nomination Committees of all three companies and the Transaction Approvals Committee of B&B and NRAM.

Richard is a Non-Executive Chairman of Nordax Bank AB (publ) and Chairman of Allied Irish Banks plc.

He was Group Chief Executive of Alliance & Leicester plc until July 2007. Formerly, he was Chairman of the Co-operative Bank plc, BrightHouse Group plc and Halfords Group plc, and a Non-Executive Director of The British Land Company plc, Old Mutual plc and Selfridges plc. Richard is a Fellow of the Institute of Chartered Accountants in England and Wales.

### Richard Banks - Chief Executive Officer

Richard became Chief Executive Officer of UKAR in July 2010 and was appointed Chief Executive Officer of B&B and NRAM in October 2010. He is also a member of the Transaction Approvals Committee of B&B and NRAM.

Richard is Chairman of Shop Direct Financial Services Ltd and Non-Executive Director of Liverpool Compact, which provides work experience for 14-19 year olds. From 30 March 2015 he joined the Student Loan Company Ltd as an interim Non-Executive Director.

Before joining the Board of B&B in May 2009, Richard's career has been in retail and commercial banking. He was previously a Director of Alliance & Leicester plc where he was Group Risk Director and before that Managing Director of Commercial Banking. Richard is an Associate of the Chartered Institute of Banking and was formerly a Non-Executive Director of ICICI Bank UK plc.

# Corporate governance (continued)

## Board of Directors (continued)

### Kent Atkinson - Senior Independent Director

Kent joined the Boards of UKAR and B&B in October 2010, and has been a Non-Executive Director of NRAM since January 2010. He is our Senior Independent Director, Chairman of the Audit Committees and a member of the Risk Committees of all three companies.

Kent was previously Group Finance Director of Lloyds TSB Group plc and subsequently a Non-Executive Director. He is a Non-Executive Director, Chairman of the Audit Committee and a member of the Risk Committee of the Bank of Ireland Group. Previously he was a Non-Executive Director and a member of the Audit Committee and Mergers & Acquisition Committee of Gemalto NV; the Senior Independent Director and Chairman of the Audit Committee of Coca-Cola HBC AG; a Non-Executive Director, Chairman of the Group Audit and Compliance Committee and a member of the Risk and Investment Committees of Standard Life plc; a Non-Executive Director, Chairman of the Audit Committee and a member of the Risk Committee of Northern Rock plc; the Senior Independent Director and Chairman of the Audit Committees of Cookson Group plc and Telent plc (previously Marconi Corporation plc); and a Non-Executive Director and a member of the Audit Committee of Millicom International Cellular S.A.

### Michael Buckley – Non-Executive Director

Michael joined the Boards of UKAR and NRAM in October 2010, and has been a Non-Executive Director of B&B since July 2007. He is a member of the Audit, Risk and Nomination Committees of all three companies and the Transaction Approvals Committee of B&B and NRAM.

Michael is Chairman of KKR Alternative Investment Management Ltd and KKR Credit Advisors (Ireland) Ltd. He is also a senior advisor to a number of privately held Irish and US based companies, and is an Adjunct Professor at the Department of Economics at NUI University College, Cork.

He was the Non-Executive Chairman of DCC plc from May 2008 to October 2014 and Senior Independent Director of DCC plc from September 2005 to May 2008. From April 2003 until April 2012 he was a Non-Executive Director of M&T Corporation in the USA. He was Group Chief Executive of Allied Irish Banks plc from 2001 to 2005 having earlier served as Managing Director of AIB Capital Markets and AIB Poland. Previously he was Managing Director of the NCB Group, and a senior public servant in Ireland and the EU.

### Sue Langley OBE – Non-Executive Director

Sue joined the Boards of UKAR and B&B in October 2010, having joined the Board of NRAM in January 2010. She is Chairman of the Remuneration Committee and a member of the Nomination Committee of all three companies.

Sue is CEO of UK Financial Services – UK Trade & Investment. Previous roles include Director of Market Operations and a member of the Executive Team for Lloyd's of London, Chairman of Lloyd's Japan and Director of Lloyd's Asia, Chief Operating Officer and a member of the Executive Team of the Hiscox Group and Board member for Hiscox Syndicates and Hiscox Insurance. She joined Hiscox from PricewaterhouseCoopers where she was a Principal Consultant working with a range of FTSE companies.

### David Lunn – Non-Executive Director

David joined the Boards of UKAR, B&B and NRAM in November 2014 after being appointed by UKFI to manage HM Government's shareholdings in the UKAR companies. He is also a member of the Transaction Approvals Committee of B&B and NRAM.

David came to UKFI from HM Treasury, where he worked on many of the interventions made by the UK government in response to the financial crisis. Most recently, he headed the HM Treasury team leading on the development of bank and other financial sector resolution policy. A career civil servant, he joined HM Treasury in 2009 from the Department for Transport, where he worked on a variety of policy areas, with a focus on the funding and financing of the Department's major projects. He joined the then Department of Transport as a Government Economist in 1995.

# Corporate governance (continued)

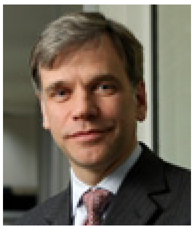
## Board of Directors (continued)

### John Tattersall – Non-Executive Director

John joined the Boards of UKAR and NRAM in October 2010, having joined the Board of B&B in April 2010. He is Chairman of the Risk Committees and a member of the Audit and Remuneration Committees of all three companies.

John retired as a partner in PricewaterhouseCoopers LLP in 2009, where he had worked since 1975, latterly as leader of the firm's Financial Services Regulatory Practice and a senior client relationship partner. He started his career in the financial services sector with Kleinwort Benson Ltd in 1973. Until 2009 he was Chairman of the Risk and Regulation Committee of the Financial Services Faculty of the Institute of Chartered Accountants in England and Wales, and a member of the faculty board. He is currently a Non-Executive Director of UBS Ltd, R Raphael & Sons plc (Raphael's Bank), CCLA Investment Management Ltd, South East Institute for Theological Education, Diocesan Trustees (Oxford) Ltd, The Oxford Diocesan Board of Finance, RC Bond Holdings Ltd and Retail Charity Bonds plc. He is also Chairman of the Gibraltar Financial Services Commission, Chairman of the court of the Royal Foundation of St Katharine, and a non-stipendiary priest in the Church of England. He acted as Consultant Editor and joint author of two books 'A Practitioner's Guide to the Basel Accord' and 'A Practitioner's Guide to FSA Regulation of Banking', and served as a member of the Independent Commission on Equitable Life payments.

### Keith Morgan – Non-Executive Director



Keith joined the Boards of UKAR and B&B in October 2010, having joined the Board of NRAM in January 2010. He is a member of the Risk and Remuneration Committees of all three companies and the Transaction Approvals Committee of B&B and NRAM.

Keith is CEO of the British Business Bank and a Director of British Business Bank Plc. Until August 2012, he was a Director of UKFI, responsible for managing the government's shareholdings in UKAR, B&B and NRAM. He was also a Non-Executive Director of Northern Rock plc until its sale to Virgin Money in January 2012. Keith joined UKFI from Banco Santander where he was a Director of Sovereign Bancorp in the U.S.A. focusing on the integration of Sovereign into Santander. He was previously Director of Strategy & Planning at Abbey National, where he was a member of the Executive Committee and was also Chairman of Santander's Asset Management and Credit Card businesses in the UK. Before joining Abbey in 2004, Keith spent 18 years at L.E.K. Consulting, where he was a partner specialising in financial services.

### Ian Hares - Finance & Investment Director

Ian Hares became Finance & Investment Director in December 2013 having been Investment Director since 2011. He was appointed to the Boards of UKAR, B&B and NRAM in July 2014. He is also a member of the Transaction Approvals Committee of B&B and NRAM.

Ian has over 35 years experience within the financial services industry having previously worked for Santander UK Group, Alliance & Leicester plc, Girobank plc and National Westminster Bank Group.

### Resignations

Christopher Fox – Non-Executive Director resigned from the Board with effect from 20 November 2014.

### Balance of Executive and Non-Executive Directors

The Board comprises a Non-Executive Chairman, four independent Non-Executive Directors, two Executive Directors and two UKFI nominated Non-Executive Directors. The Non-Executive Directors have experience in a range of commercial or banking activities. The Board has determined that the Non-Executive Directors, who are not appointed by the Shareholder, are independent, because of the commonality of purpose between UKAR and the Principal Subsidiaries and a rigorous focus on the identification of any specific conflicts of interest.

# Corporate governance (continued)

## Board of Directors (continued)

### Relationship between the Chairman and the Chief Executive Officer

A clear division of responsibility exists between the Chairman and the CEO, which is set out in writing in the UKAR Governance Documentation and has been approved by the Board. The Chairman is responsible for leadership of the Board and the CEO is responsible for leadership of the business.

### Senior Independent Director

The role of the Senior Independent Director is to act as a sounding board for the Chairman, as a trusted intermediary for the other Directors and, where necessary, a point of contact for the Shareholder. The responsibilities of the role include the evaluation of the Chairman’s performance.

### Company Secretary

The Company Secretary supports the Chairman in designing the induction programme for new Directors, the delivery of the corporate governance agenda and by ensuring that information is made available to the Board members on a timely basis. The Company Secretary advises the Directors on Board procedures and corporate governance matters.

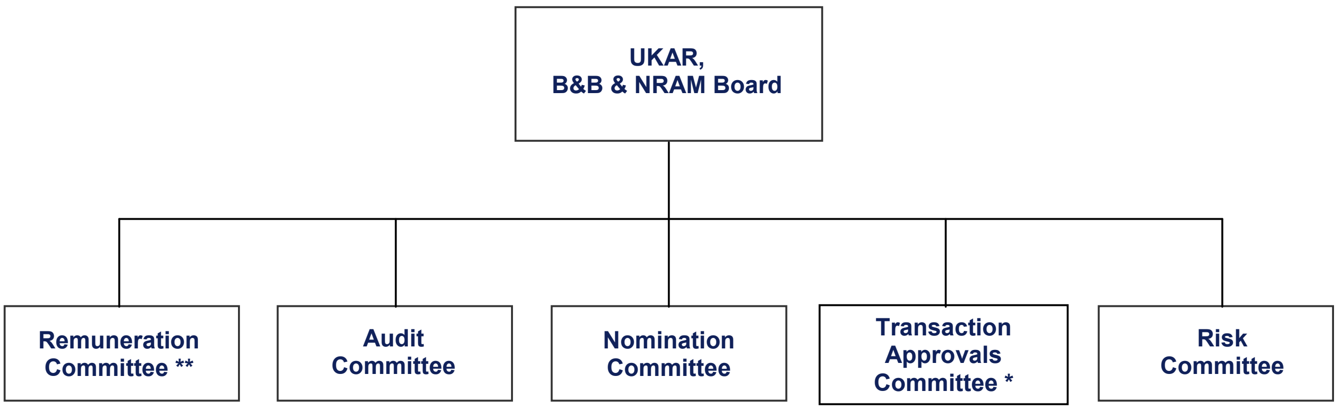
John Gornall was appointed Company Secretary of UKAR, NRAM and B&B with effect from 30 June 2014 following the resignation of Paul Hopkinson.

## How the Board operates

### Board structure and governance

In accordance with best practice outlined in the UK Corporate Governance Code and the requirements of the Framework Document, the Board has delegated various powers and authorities to its Committees. They play a key role in ensuring the effectiveness of the corporate governance framework by supporting the Board and carrying out its functions.

**Board and Committee structure**




* The Principal Subsidiaries operate a Transaction Approvals Committee which is included in these accounts for a full understanding of the Group Committee Structure.

** A separate sub-committee has been established by the Board to set the fees of the Chairman and Non-Executive Directors see further detail on page 31.

# Corporate governance (continued)

## How the Board operates (continued)

During 2014/15, the Chairman of each Committee was:

| Committee | Chairman |
|---|---|
| Remuneration Committee | Sue Langley |
| Audit Committee | Kent Atkinson |
| Nomination Committee | Richard Pym |
| Transaction Approvals Committee | Richard Pym |
| Risk Committee | John Tattersall |

Each of the Board Committees have detailed Terms of Reference setting out their remit and authority. Details of the membership of each Committee, the role and key activities are set out in the individual Committee Chairman's reports on pages 30 to 55.

The Remuneration Committee Chairman's Report and details of the role of the Remuneration Committee are provided in the Directors' Remuneration Report on page 30.

### Board and Committee meetings

The Board and its Committees meet regularly throughout the year. All agendas are structured to allow adequate and sufficient time for discussions of the items on the agenda, particularly strategic issues.

The attendance of individual Board members at Board and Committee meetings during 2014/15, together with the overall number of meetings held is set out below. Where a Director was appointed or resigned during the year the total number of meetings they were eligible to attend is show in brackets.

| | Board | Audit | Nomination | Remuneration | Risk | Transaction Approvals * |
|---|---|---|---|---|---|---|
| **Number of meetings held** | **9** | **3** | **4** | **5** | **4** | **10** |
| **Chairman** | | | | | | |
| Richard Pym | 9 | - | 4 | - | - | 10 |
| **Chief Executive** | | | | | | |
| Richard Banks | 9 | - | - | - | - | 10 |
| **Senior Independent Director** | | | | | | |
| Kent Atkinson | 9 | 3 | - | - | 4 | - |
| **Independent Non-Executive Directors** | | | | | | |
| Michael Buckley | 9 | 3 | 4 | - | 4 | 10 |
| Sue Langley | 9 | - | 4 | 5 | - | - |
| John Tattersall | 9 | 3 | - | 5 | 4 | - |
| **Non-Executive Directors** | | | | | | |
| David Lunn (appointed 20.11.14) | 3 (3) | - | - | - | - | 4 (4) |
| Keith Morgan | 9 | - | - | 5 | 4 | 8 |
| Christopher Fox (resigned 20.11.14) | 6 (6) | - | - | - | - | 6 (6) |
| **Executive Directors** | | | | | | |
| Ian Hares (appointed 08.07.14) | 6 (6) | - | - | - | - | 5 (5)** |

* *The Transaction Approvals Committee only relates to the Principal Subsidiaries.*
** *Ian Hares was appointed to the Transaction Approvals Committee with effect from 28 October 2014.*

In addition to the scheduled Board meetings, the Board also met at short notice on a quorate basis on four occasions to meet additional business requirements and three Board Committee meetings were held.

# Corporate governance (continued)

## How the Board operates (continued)

### Board and Committee meetings (continued)

The Company Secretary or his nominee attends each meeting as Secretary to the Board and other representatives from specific business functions and/or external advisors are invited to attend as appropriate.

During the year each of the Non-Executive Directors met the time commitment specified in their letters of appointment.

### Board responsibilities

The Board's role is to provide leadership and oversight of the management of the Company, whilst setting the strategic direction, in order to achieve its objectives. The Board is responsible for:

- setting the Group's strategic aims and developing and recommending revisions to the Plan to deliver the over-arching objective of protecting and creating value for the taxpayer, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. Any proposed revisions to the Plan are subject to review and approval by UKFI;
- delivering the Plan in accordance with the requirements of the Framework Document. In this respect, decisions on the day-to-day running of the Group, rest with the Board in accordance with the Directors' statutory, common law and fiduciary responsibilities. UKFI is committed to giving the Board the freedom necessary to deliver the agreed Plan and will not interfere in day-to-day operational and commercial matters; and
- ensuring that the necessary financial and human resources are in place for the Group to deliver the agreed Plan, set the Group's values and standards and ensure that its obligations to HM Treasury as Shareholder are understood and met.

The Board has a written schedule of those matters reserved for its determination and those matters reserved for UKFI, in accordance with the Framework Document.

### Board activities 2014/15

The Board's primary role throughout the year has continued to be to provide leadership and oversight to ensure the overarching objectives in the Framework Document are met. As part of this, the key activities during 2014/15 have included:

- reviewing the Group's strategic options and plans, as more fully explained on page 12;
- approving the Annual and Interim Financial Statements;
- approving key performance indicators and endorsing Balanced Scorecard results;
- approving the Risk Appetite Statement;
- oversight and approval of high level remediation activity;
- reviewing the composition of remediation activities, including in relation to Consumer Credit redress;
- considering and approving a refreshed Ten Year Plan;
- approving strategic transactions including the sale of mortgage assets and the tender and buy back of certain listed securities;
- receiving regular updates on finance, investment, risk and other key areas of the business to inform monitoring of progress against the Plan and future strategy; and
- ensuring decision making at all levels reflects good conduct and the fair treatment of customers.

# Corporate governance (continued)

## How the Board operates (continued)

### Board appointments and composition

UKFI considers that the composition of the Board is a critical factor and seeks to secure an environment in which it shares a common view about Board composition and succession with the Chairman, including size, balance of experience and diversity. To achieve this and ensure that a common governance approach is applied, the Group operates under the following principles:

- the Chairman and either the Chairman of UKFI or a senior employee nominated by the Chairman of UKFI (the 'Nominated Officer'), will discuss and confirm Board composition and succession regularly in the light of performance and the requirements of the Plan;
- UKFI will be entitled to appoint to the Board one or more Non-Executive Directors nominated by UKFI (the 'Shareholder Directors'); Mr Lunn and Mr Morgan are currently appointed as such Directors. The Group acknowledges that the Shareholder Directors intend to liaise with and report to representatives of UKFI from time to time in relation to the business of the Group and decisions made, or to be made, by the Board in order to assist with the exercise of their powers and duties as Directors;
- one or more senior representatives of UKFI will, if so requested by UKFI, attend meetings of the Board in an observer capacity;
- the Chairman will discuss with the Nominated Officer any impending changes to Board membership;
- the Chairman of the Nomination Committee will meet with the Nominated Officer as necessary to obtain UKFI's approval to any proposed Board changes before they become subject to the formal appointment/consent procedure. The Articles of Association require that at every Annual General Meeting each Director, other than the Shareholder Directors who are expressly exempt from this provision, shall retire from office and may offer themselves for re-appointment;
- Non-Executive Directors are appointed for a specified term, subject to re-appointment in accordance with the above procedures;
- the Chairman and the Non-Executive Directors each have a letter of appointment which sets out the terms and conditions of their Directorships, including fees payable, where applicable, and the expected time commitment;
- the Nomination Committee reviews the leadership needs of the Group, including succession planning for both Executive and Non-Executive Directors and, in particular, the key roles of Chairman and Chief Executive; and
- the Board will ensure that suitably rigorous appraisals are made of the effectiveness of the Chairman and the Board.

The Nomination Committee considers the composition of the Board and its Committees annually to ensure this remains fit for purpose and makes any recommendations to the Board for consideration in accordance with its Terms of Reference. This takes into account the challenges and opportunities facing the Company and the skills and expertise needed on the Board in the future. The Chairman regularly meets with UKFI, the shareholder representative to discuss UKAR matters, including the constitution of the Board.

### Board evaluation

The Board is committed to undertaking a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors. The review provides the opportunity for the Board to reflect on the effectiveness of its activities and the quality of its decisions.

During 2014/15, the Board and Committee evaluation exercise was conducted by the Chairman with assistance from the Company Secretary.

All Executive Directors, Non-Executive Directors and the Chairman participated in the annual appraisal to ensure that the operation of the Board and its Committees continued to be of the highest standard. The appraisal process consisted of questionnaires that canvassed Directors' views on a wide range of matters including:

- effectiveness of the Board and how it works together as a unit;
- role of the Committees and their interaction with the Board;
- effectiveness of the Chairman;
- Board meeting process; and
- composition of the Board.

# Corporate governance (continued)

## How the Board operates (continued)

### Board evaluation (continued)

The Company Secretary reported to the Chairman on the outcome of the evaluation exercise, which showed that the Board and its Committees are discharging their responsibilities effectively. The outcomes of the evaluation were positive and all comments have been reviewed by the Board and its Committees. Where appropriate, any changes to further enhance effectiveness will be implemented during the course of 2015/16. The Chairman comments further on the conclusions in his Chairman's Statement on page 5 of these accounts.

Evaluation of individual Non-Executive Directors has also been addressed directly by the Chairman.

The Chairman's own performance was evaluated by the Directors and his annual review carried out on behalf of the Board by the Senior Independent Director.

### Induction and training

The Group requires all newly appointed Directors to undergo a formal induction training programme appropriate to their skills and experience, to ensure that they:

- are fully aware of and understand their role, duties and responsibilities as a Director; and
- have a good understanding of the operation of the business, so as to contribute effectively.

Directors receive a tailored induction programme designed to meet their individual needs and level of knowledge and experience. Where appropriate this includes time with each of the Executive Directors, the Company Secretary, other members of the Executive Committee ('ExCo'), a wide range of senior management from across the business and a meeting with the Group's solicitors.

The Group also requires Non-Executive Directors to undertake relevant ongoing training and development to improve their capabilities and thereby contribute more effectively to Board decision making.

A comprehensive thematic training programme is in place, which covers key areas of the business and topical issues, such as regulatory developments, and takes account of the outcomes of the annual Board evaluation.

The Board is kept up to date on legal, regulatory and governance matters through regular papers from the Company Secretary, Risk Director and external advisors as appropriate.

### Timely and quality information

The Board believes that it receives and has access to, on a timely basis, all relevant information which is of a sufficient quality to make appropriate decisions and discharge its duties and obligations. The Board reviewed this matter as part of the annual evaluation process and there were no issues arising.

All Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that Board procedures and applicable rules are followed. Where necessary, Directors are able to take independent professional advice at the Group's expense.

### Internal control and risk management

The Board is responsible for the Group's system of internal control and seeks regular assurance to satisfy itself that the system is functioning effectively in managing risks in the manner which it has approved. Such a system can only provide reasonable and not absolute, assurance against material misstatement or loss, as it is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. Throughout the year ended 31 March 2015, the Group has operated a system of internal control, which includes an ongoing risk management process for identifying, evaluating and managing the principal risks faced by the Group. During the year, the Board has continued to review the effectiveness of the Group's system of financial and non-financial controls including operational and compliance controls, risk management systems and the Group's material risk exposures and associated mitigating actions.

The Group is committed to developing and maintaining an appropriate Risk Management Framework and culture with the aim of continuing to ensure that Management understand the key risks that the business faces and its appetite for them. This is achieved through an organisational structure with clear reporting lines governed by appropriate business monitoring mechanisms, codes of conduct and policy statements. Internal control and risk management systems are integrated into strategic considerations and business planning processes.

# Corporate governance (continued)

## How the Board operates (continued)

### Internal control and risk management (continued)

Under the Risk Management Framework, the Group operates a risk management process, producing an enterprise-wide risk profile. This identifies the Group’s principal risks, the probability of those risks occurring and their impact should they occur. Management regularly takes action to improve the design and operation of suitable controls, either as a result of its own initiative, or in response to reports from Internal Audit and other oversight review functions.

The risk management process is complemented by a formalised reporting and escalation process for emerging control issues. Internal Audit has a key role in maintaining the control environment by providing independent assurance on the effectiveness of the Group’s internal control systems. The Risk Committee and the Audit Committee oversee the risk management process, regularly consider the enterprise-wide risk profile and receive monitoring reports to update them on progress.

The system of risk management and internal control has operated effectively throughout 2014/15 and up to the date of approval of the Annual Report and Accounts.

In monitoring the effectiveness of this system, the Board takes into account the work of the Risk Committee which reviews the Group's principal risks and how these are being managed. The Risk Committee also considers reports from Compliance and from Management on the system of internal control, adherence to regulatory requirements and material control weaknesses, where these exist, together with actions taken to address them. The Audit Committee considers reports from Internal Audit and External Audit on the system of internal control and material control weaknesses, where these exist, together with actions taken to address them. The Chairmen of the Risk Committee and the Audit Committee report on the outcome of each meeting to the Board, where appropriate, and the Board also receives minutes of these Committee meetings.

In addition, as part of the process of preparing this statement, the Board has also performed its annual assessment of the effectiveness of risk management and internal control systems. This annual assessment adopted the recommendations of current best practice guidance issued by the Financial Reporting Council. The Board of Directors is not aware of any material risk events or internal control failures that arose across the Group during 2014/15 that are not being addressed in accordance with the internal control procedures of the Group.

### Going concern

The Directors have assessed, taking into consideration the principal risks set out on pages 18 and 71 to 74, potential future strategic options and the current and anticipated economic conditions, the Company's and the Group's ability to continue as a going concern. As set out in note 1 to the Financial Statements and in the Annual Reports and Accounts of B&B and NRAM, HM Treasury has provided confirmation to the Directors of those two companies that it is HM Treasury's intention to fund those companies so as to maintain them as a going concern and has provided various on-demand facilities to each of those companies, to enable those companies to meet their debts as and when they fall due, for a period up to at least 1 January 2017. Accordingly, the Directors of B&B and NRAM are satisfied at the time of approval of these Financial Statements that the B&B and NRAM companies and groups have adequate resources to continue in business for the foreseeable future. The Directors of the Company confirm that, therefore, they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future and for this reason they continue to adopt the going concern basis in preparing the Financial Statements.

### Longer term viability

UKAR was established to oversee the orderly run-off of B&B and NRAM for the UK government and continues to receive funding and guarantees from HM Treasury to enable it to undertake this activity. The Board have no reason to believe that support from HM Treasury will be withdrawn or curtailed after 1 January 2017. With this in mind, the Directors have assessed the longer term viability of the Group, taking into account the strategy set out on pages 12 to 17 and the principal risks set out on pages 18 and 71 to 74, and have concluded that, provided the financial support from HM Treasury continues, the Group will remain viable throughout the entire period of its run-off. The length of this period will depend on the success of strategic initiatives, including the current proposals to sell further mortgage assets and to sell or outsource the Group’s mortgage servicing operations.

### Corporate governance codes

In accordance with the requirements of the Framework Document, the Group is committed to complying with the UK Corporate Governance Code wherever practicable. The Board and UKFI consider the Group’s compliance on at least an annual basis.

# Directors' remuneration report

Sue Langley OBE, Chairman of the Remuneration Committee, introduces the Directors' Remuneration Report and summarises the Committee's main areas of focus during 2014/15.

"As Chairman of the Remuneration Committee, I am pleased to present UKAR's report on Directors' Remuneration for 2014/15.

The work of the Committee during 2014/15 has covered a range of topics within our Terms of Reference, including review of the reward strategy to ensure it continues to remain aligned to UKAR's business strategy, alignment between remuneration and top talent within the business, oversight of performance review and associated bonus payments and ensuring the continued alignment of remuneration with prudent risk management. The Committee ensures that all of UKAR's incentive arrangements support appropriate customer outcomes in line with the FCA's conduct risk agenda. Retention of key colleagues is an increasingly important focus as UKAR plans to execute more asset sales and to look to divest the operational business which could then continue to service these assets.

The committee works closely with UKFI on remuneration matters in line with the Shareholder Framework Agreement."

### Membership

The Remuneration Committee was in place throughout 2014/15 and had the following membership at 31 March 2015:

Sue Langley (Chairman)
Keith Morgan
John Tattersall

There were no changes to the membership of the Remuneration Committee during 2014/15.

Details of the skills and experience of Committee members can be found in the Directors' biographies on pages 21 to 23.

### Summary of responsibilities

The Remuneration Committee is responsible for:

- making recommendations to the Board concerning Executive and other Code Staff remuneration arrangements;
- recommending proposals in respect of related pay schemes; and
- overseeing any major changes in benefit structures.

### Meetings

The Committee held five meetings during the year, complying with the requirements of its Terms of Reference. The attendance of individual members at meetings is set out on page 25.

The Committee also invites the following to attend its regular meetings:

- David Lunn, as a UKFI appointed Director;
- members of ExCo, including the CEO, HR Director and Risk Director;
- Company Secretary or his nominee; and
- other representatives from business functions and/or external advisors from time to time.

### Reporting to the Board

The Committee Chairman reported to the Board after each Committee meeting, summarising the key matters discussed, and the Board has also received the minutes of each meeting.

### Governance

The Committee completed an annual review of its Terms of Reference and undertook an evaluation process in accordance with the requirements of those Terms of Reference. The results of the evaluation were positive and provided assurance that the Committee remained fit for purpose.

# Directors' remuneration report (continued)

## Chairman's overview of 2014/15

UKAR manages all colleagues, regardless of their position within the company, against the same set of reward principles which focus on fair and transparent remuneration.

Executive remuneration is aligned to UKAR's business strategy, aimed at delivering value for taxpayers. Base salaries are targeted at a mid-market level for companies of UKAR's size, to enable the business to retain talented individuals in key leadership roles. UKAR operates an annual Short Term Incentive Plan (‘STIP’) and a Medium Term Incentive Plan (‘MTIP’), which operates over three years, for Executive Directors and this variable remuneration is modest by comparison with market levels. The annual bonuses are capped at 60% of base salary for excellent performance and the medium-term incentive plan has a maximum value of 20% of base salary per annum. Although UKAR is not subject to the variable pay cap introduced under the European Union Capital Requirements Directive it does comply with the cap. In addition, a large percentage of annual bonus is compulsorily deferred over a three year period and clawback provisions enable variable pay to be recouped in exceptional circumstances.

Performance conditions for annual bonus are directly linked to business goals including financial, operational and non-financial objectives. Financial objectives comprise: profitability, management of costs and repayment of government debt. Operational and non-financial criteria include customer service, management of arrears, people management and maintaining effective internal controls. The medium-term incentive scheme targets UKAR's performance over a three year period in driving additional cash from asset sales and other management activities which do not diminish taxpayer value.

UKAR has shown strong performance for 2014/15 achieving its underlying profit before tax, government loan repayment and cost targets. Although a significant reduction in arrears has been delivered the stretching arrears target for 3 months or more arrears levels has not been achieved.

Good progress has also been made against the performance targets for the three years from April 2014 to March 2017 in respect of the Medium-Term Incentive Plan. Strong performance against all the criteria is reflected in the performance-related remuneration levels detailed in this Remuneration Report.

Looking forward UKAR continues to face challenges as the business reduces in size. Our colleagues are fundamental to the success of our organisation and UKAR will continue to focus on ensuring it has the best people available to meets its needs. Consequently, the Remuneration Committee will continue to consider the approach to reward as the business evolves. As the mortgage book continues to reduce, the operational risk UKAR carries is forecast to increase. This is particularly true of people risk in terms of unplanned attrition and colleague engagement. Specific reward initiatives have been developed to mitigate this risk and these will be implemented over the short to medium term.

Although it is not required to do so UKAR continues to seek, as far as possible, to comply with the regulatory and governance requirements which apply to UK listed companies and the FCA's IFPRU Remuneration Code.

## Non-Executive Directors

The Chairman and Non-Executive Directors each have a letter of appointment which sets out the terms and conditions of their directorship, including fees payable.

Further detail in relation to Board appointments is provided on page 27.

The Board has delegated authority to set the fees of the Chairman and Non-Executive Directors to a Remuneration Committee (Non-Executive Directors) consisting of Richard Banks, David Lunn and Ian Hares, subject to UKFI approval.

As shown in table 2 below, there has been no change to the fee levels for Non-Executive Directors in the reporting period. The Non-Executive Directors volunteered to reduce their fees by 5% in October 2012 in anticipation of a reduced workload. However, in respect of the additional work and time that the Non-Executive Directors are being asked to assign to UKAR there will be a 5.3% uplift to the fees with effect from 1 April 2015. The Chairman has waived any increase to his fees.

# Directors' remuneration report (continued)

## Non-Executive Directors (continued)

**Table 1 – Details surrounding fees for Non-Executive Directors**

| Element | Purpose and link to strategy | Operation | Maximum opportunity |
|---|---|---|---|
| **Fees** | To provide a competitive level of fees that reflect the skills, experience and time commitment required for the roles. | The ongoing effectiveness and appropriateness of the remuneration of the Chairman and the Non-Executive Directors is reviewed annually by the Executive Remuneration Committee (Non-Executive Directors) and agreed by UKFI.<br><br>All Non-Executive Directors take part in an annual evaluation process. | The fees for each Non-Executive Director are provided below.<br><br>Non-Executive Directors are not eligible to participate in any Group company's executive remuneration programme and receive no pension benefits. |

**Table 2 - Fees for the Chairman and Non-Executive Directors ('NEDs')**

| Per annum | 2014/15 | 2013/14 | % Increase / Decrease |
|---|---|---|---|
| Chairman | £125,000 | £125,000 | 0% |
| NED Base fee / Senior Independent Director | £47,500 | £47,500 | 0% |
| Committee Chairman | £14,250 | £14,250 | 0% |
| Committee Member | £4,750 | £4,750 | 0% |

## Directors' remuneration policy

### Policy overview

UKAR's Reward Policy applies to all colleagues across the organisation and is reviewed annually by the Remuneration Committee taking account of UKAR's business goals and public ownership. The policy is published and available to all colleagues internally.

The main purpose of the policy is to support the achievement of UKAR's overall business strategy by establishing an objective, consistent and fair reward system. This in turn provides a competitive yet cost-effective salary, incentive and benefits package to all colleagues that reflects their role, competencies and the contribution they make, both now and in the future. The policy also seeks to support UKAR's unique circumstances and needs to be agile to respond to the changing economic and regulatory environment.

UKAR's reward policy aims to support the retention and attraction of high quality colleagues by differentiating reward for high performers. Reward is only one lever available to mitigate the risk of talented colleagues leaving the company and the reward policy is, therefore, aligned closely to the overarching HR strategy. This is becoming more important to UKAR's success given the contraction of the business and consequently the overall reward policy continues to be regularly reviewed.

UKAR recognises and consults with the Unite trade union. As part of the pay negotiations for all colleagues, UKAR discusses its approach to pay for executives to ensure that the Union is fully aware of the approach UKAR intends to take and has an opportunity to raise questions. In 2014/15, UKAR continued to apply a consistent salary review process across all of the Group including executives and senior managers.

# Directors' remuneration report (continued)

## Directors' remuneration policy (continued)

### The remuneration policy for directors

**Table 3 – Key aspects of the remuneration policy for Executive Directors**

| Element | Purpose and link to strategy | Operation | Maximum opportunity |
|---|---|---|---|
| **Base salary** | To attract and retain key talent by ensuring an appropriate, competitive benefits package. | Roles are benchmarked externally. Salaries are reviewed by the Remuneration Committee and recommendations are submitted to the Board and UKFI, the shareholder representative, based upon the skills and experience they bring to the role. | The base salary for each Executive Director is confirmed later in the report.<br><br>There is no prescribed maximum. However, the Remuneration Committee reviews the salary against the salary range each year before considering whether any increase is appropriate. They also consider the pay approach used for all UKAR colleagues.<br><br>The approach to pay increases, including that for promotions/ increased responsibility is in line with the approach taken for all colleagues. |
| **Benefits** | To provide a competitive package, aligned to market practice. | The benefit package for Executive Directors was agreed when UKAR was formed following external benchmarking. The package includes annual holiday entitlement, life assurance, car allowance, private medical insurance, income protection insurance, personal accident insurance and assistance with relocation, travel and accommodation where necessary.<br><br>Individuals promoted to Executive Director from a below-Board role may retain entitlements under UKAR's Redundancy Policy. | Each benefit has its own maximum in line with the nature of the benefit and the policy that surrounds it. |
| **Pension** | To provide a competitive package, aligned to market practice. | Directors are either offered a pension allowance or employer contribution into UKAR's pension plan. The approach taken depends on the Director's individual circumstances. | The pension allowance for the CEO is set at 30% of base salary. Other Executive Directors receive either a pension contribution of 15% of base salary or an equivalent cash allowance. |

# Directors' remuneration report (continued)

## Directors' remuneration policy (continued)

### The remuneration policy for directors (continued)

**Table 3 – Key aspects of the remuneration policy for Executive Directors (continued)**

| Element | Purpose and link to strategy | Operation | Maximum opportunity |
|---|---|---|---|
| **Short-Term Incentive Plans**<br><br>**(Annual Bonus)** | To reward performance for delivery of key financial and operational targets. | UKAR's STIP is linked to achievement of the financial and operational targets in place for the relevant year alongside personal performance. Conduct risk is also a key element of the STIP aligned to UKAR's zero appetite for conduct risk.<br><br>Targets for customer outcomes and conduct risk, plus other key organisational metrics, are included in the UKAR Balanced Scorecard. Failure to achieve these targets would result in a reduction to the bonus pool.<br><br>Given UKAR's status, all awards are made in cash as there is no option to award shares.<br><br>From the 2014/15 year onwards, 60% was paid initially with the remainder paid in equal instalments over the following three years.<br><br>The Remuneration Committee approves personal objectives for the year for Executive Directors.<br><br>Any potential awards, including deferrals, are subject to Remuneration Committee discretion. Malus and clawback operate where appropriate and, in line with best practice, the Remuneration Committee considers whether there has been any significant issues, such as misstatement of results or misconduct as part of their consideration around approval of bonus awards. UKAR considered extending the period for deferral but decided not to do so, given the size of the awards that are made and the fact that it is a business with a limited lifespan.<br><br>Should an event occur which the Remuneration Committee consider would materially alter achievement against targets, it has the discretion to change the personal objectives or targets. However, such change, in the opinion of the Committee, must not have the effect of making the performance objective or corporate assessments materially more onerous or easier to satisfy than it was immediately before the event in question. | Up to 60% of base annual salary. |
| **Medium-Term Incentive Plan** | To reward performance for delivery of key metrics directly linked to UKAR's overarching strategy. | The MTIP measures performance over 3-year performance periods. MTIP performance periods run in sequence, rather than being a rolling annual grant programme with overlapping performance periods.<br><br>Performance metrics are aligned to targets around driving additional cash from asset sales and other management activities which do not diminish taxpayer value.<br><br>Given UKAR's status, all awards are made in cash as there is no option to award shares.<br><br>For the 2014/15 to 2016/17 MTIP cycle, vesting will take place following the end of the 3-year period, subject to the performance conditions being met.<br><br>Any potential awards, including deferrals, are subject to Remuneration Committee discretion and malus and clawback operates where appropriate.<br><br>Should an event occur which the Remuneration Committee consider would materially alter achievement against targets, it has the discretion to change the targets. However, such change, in the opinion of the Committee, must not have the effect of making the performance objective or corporate assessments materially more onerous or easier to satisfy than it was immediately before the event in question. | Up to 60% of base annual salary.<br><br>The MTIP is not cumulative. The Directors can only participate in one scheme at any time. Therefore, over the three year period of each scheme the average annualised payment is a maximum of 20% of base salary. |

# Directors' remuneration report (continued)

## Directors' remuneration policy (continued)

### Choice of performance measures and approach to target setting

UKAR has clear performance metrics understandable to every colleague in the business. In addition to financial and operational targets, a Balanced Scorecard brings together colleague measures and customer conduct measures. Given the nature of its ownership and the focus on repaying government debt, the MTIP scheme is aligned to driving additional cash from asset sales and other management activities which do not diminish taxpayer value. Details of schemes are found in table 3.

### Differences in remuneration policy for Executive Directors compared to other employees

The reward policy applies to all colleagues in the organisation and aims for objectivity, consistency and fairness. However, market practice means that to ensure UKAR remains competitive there are different benefits at various levels. Executive Directors packages, when compared to other colleagues across the organisation, have higher holiday entitlement and employer pension contribution/allowance, increased car allowance, earlier eligibility for income protection insurance, eligibility for personal accident insurance and longer contractual notice periods.

A salary increase matrix applies to all colleagues including the Executive Directors with increases based upon an individual's position in their salary range and their personal performance.

### Approach to recruitment and promotions

In the case of a new appointment to the Board the reward package is set in line with the structure agreed by the Remuneration Committee, as outlined above and also requires Board and UKFI approval. This approach was taken when Ian Hares was appointed to the Board as Finance & Investment Director with effect from 8 July 2014.

The Remuneration Committee has the discretion to make additional awards to replace remuneration forfeited when a new Executive Director is appointed. Any awards would take account of the size of the award the individual was leaving behind, together with the vesting and performance conditions. The Committee has not made any such awards to date.

### Service contracts and payments for loss of office

UKAR's policy is to employ Executive Directors on service agreements with 12 months employer notice periods. Wherever possible UKAR will seek to minimise any potential payments for loss of office. UKAR has not made any loss of office payments in this reporting period.

**Table 4 – Details of service contracts and loss of office payments policy**

| Provision | Detailed terms |
|---|---|
| **Employer notice period** | 12 months |
| **Termination payment** | In the event of termination by the company, other than for misconduct, Executive Directors' contracts provide for 12 months' notice, or payment of base salary, pension and fringe benefits in respect of the unexpired portion of the notice period.<br><br>'Good leavers', who are colleagues who leave through redundancy or retirement, may also be eligible for:<br>▪ STIP subject to assessment of the normal performance conditions and payable on the normal payment date, pro-rata by leave date; and<br>▪ MTIP subject to the normal performance conditions and payment date, reduced pro-rata to the portion of the performance period that has expired.<br><br>Individuals may also be eligible for statutory redundancy pay.<br><br>Where an individual is appointed as an Executive Director through internal promotion, they may also retain eligibility for the company's redundancy policy which provides for a payment based on a number of weeks base salary per year of service. This does not apply to Richard Banks, as he was recruited from outside the organisation but Ian Hares has retained his rights under the company's redundancy policy.<br><br>UKAR calculates redundancy pay as follows:<br>▪ Under 22 years of age – 2 weeks pay for each year of service in that age bracket.<br>▪ 22 – 41 years of age – 4 weeks pay for each year of service in that age bracket.<br>▪ >41 years of age – 6 weeks pay for each year of service in that age bracket.<br><br>Colleagues receive a minimum of 12 weeks pay and maximum of 90 weeks pay. |

# Directors' remuneration report (continued)

## Directors' remuneration policy (continued)

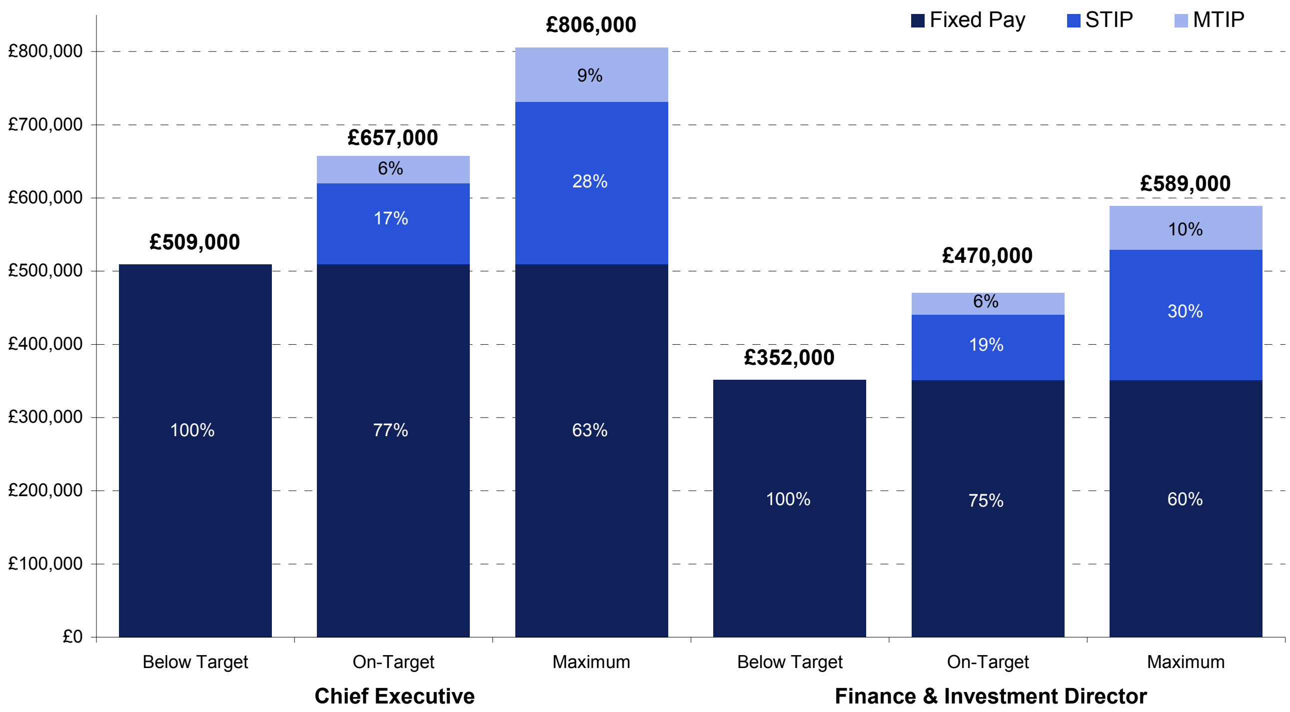
### External Non-Executive Director positions

Executive Directors are permitted to take up external Non-Executive Director positions at the Board's discretion, providing they do not conflict with their duties at UKAR. Where the appointment is not related to UKAR's business activity the Executive Director is permitted to retain any fees they receive.

### Reward scenarios

The following chart shows how the make up of the executives' remuneration varies depending on performance.

**Figure A: Executive Director total annual remuneration at different levels of performance**




**Assumptions:**
Minimum = fixed pay only (salary + benefits + pension)
On-target = 50% vesting of the STIP, and MTIP awards (annualised)
Maximum = 100% vesting of the STIP, and MTIP awards (annualised)

# Directors' remuneration report (continued)

## Annual report on remuneration

This section of the report provides the detail behind the remuneration policy statements outlined earlier.

### Remuneration for 2014/15

The tables below set out the earnings for both the Executive and Non-Executive Directors during the 2014/15 reporting year and compares them against the same period from the 2013/14 reporting period.

**Table 5 – Remuneration payments for Executive Directors (Audited)**

| | Richard Banks | |
|---|---|---|
| | April 2014 - March 2015 | April 2013 - March 2014 |
| **Base Salary** | £370,650 | £364,500 |
| **Benefits** [1] | £27,297 | £27,149 |
| **Pension** [2] | £111,195 | £109,350 |
| **STIP Awarded** [3] | | |
| **- STIP Non Deferred** | £86,451 | £69,984 |
| **- STIP Deferred** | £57,634 | £104,976 |
| **MTIP Awarded** [4] | - | £138,720 |
| **Total** | **£653,227** | **£814,679** |

| | Ian Hares [5] | |
|---|---|---|
| | April 2014 - March 2015 | April 2013 - March 2014 |
| **Base Salary** | £217,039 | - |
| **Benefits** [1] | £7,832 | - |
| **Pension** [2] | £32,496 | - |
| **STIP Awarded** [3] | | |
| **- STIP Non Deferred** | £54,694 | - |
| **- STIP Deferred** | £36,463 | - |
| **MTIP Awarded** [4] | - | - |
| **Total** | **£348,524** | **-** |

| | Phillip McLelland [6] | |
|---|---|---|
| | April 2014 - March 2015 | April 2013 - March 2014 |
| **Base Salary** | - | £186,541 |
| **Benefits** [1] | - | £7,228 |
| **Pension** [2] | - | £26,600 |
| **STIP Awarded** | | |
| **- STIP Non Deferred** | - | - |
| **- STIP Deferred** | - | - |
| **MTIP Awarded** | - | - |
| **Total** | **-** | **£220,369** |

1 *This includes Private Medical Insurance and any allowances for housing or a car.*
2 *Both Richard Banks and Ian Hares received a pension allowance. Phillip McLelland received employer pension contributions to the company scheme.*
3 *The STIP is deferred as described on page 34.*
4 *This was paid in line with scheme rules, as outlined in this report. As the scheme runs from April 2014 to March 2017 there was no MTIP payment awarded during the year.*
5 *Ian Hares' total emoluments for 2014/15 only covers the period from his appointment as Executive Director on 8 July 2014.*
6 *Phillip McLelland resigned in November 2013 and as such his payments are prorated and he forfeited any right to receive incentive payments.*

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

### Remuneration for 2014/15 (continued)

**Table 6 – Remuneration payments for Non-Executive Directors (Audited)**

| | Fees [1] | |
|---|---|---|
| | April 2014 - March 2015 | April 2013 - March 2014 |
| Richard Pym | £125,000 | £150,156 |
| Kent Atkinson | £66,500 | £66,500 |
| Michael Buckley | £66,500 | £66,500 |
| Sue Langley [2] | £66,500 | £66,500 |
| Louise Patten [3] | - | £42,750 |
| John Tattersall | £71,250 | £67,688 |
| Christopher Fox [4] | - | - |
| David Lunn [4] | - | - |
| Keith Morgan [5] | £61,750 | £61,750 |
| **Total** | **£457,500** | **£521,844** |

*1 In addition, the company meets certain travel costs for Board Directors which are considered taxable. The company considers that such travel is an essential requirement of Directors duties and does not confer any personal benefit. Total tax paid to HMRC on behalf of Directors was £8,770.94.*
*2 Until October 2013 Sue Langley's fees for her services were paid to Lloyd's of London. Therefore, April 2013 to March 2014 includes £33,250 paid to Lloyd's of London.*
*3 Louise Patten stepped down as a Non-Executive Director with effect from 31 December 2013 and no payments were made for loss of office.*
*4 Christopher Fox was replaced by David Lunn on 20 November 2014 as UKFI representative; neither of them received any fees.*
*5 Keith Morgan is a UKFI appointed Director but is not an employee of UKFI and as such he received fees.*

### Percentage increase in the remuneration of the Chief Executive Officer

During the year UKAR's total remuneration costs have fallen marginally (see table 14) but the table below shows a summary of year-on-year changes between 31 March 2014 and 31 March 2015 for the Chief Executive Officer versus colleagues who were in the business at both year-ends. The 5.6% increase in average colleague base salary reflects UKAR's commitment to promote internally where possible and aligning the salaries of colleagues to minimum benchmarks. The percentage change to benefits for both the Chief Executive Officer and colleagues is primarily driven by a 20% increase to private medical insurance premiums, which constitute a larger part of the average colleague benefit package than it does for the Chief Executive Officer. The decrease to both colleague annual bonus payments and Richard Banks' STIP is reflective of the stretching arrears target for 3 months or more arrears levels not being achieved.

**Table 7 – Comparison of CEO remuneration change versus average employee's**

| | % change year-on-year [1] |
|---|---|
| **Chief Executive** | |
| - base salary [2] | 1.69% |
| - benefits | 0.54% |
| - STIPs | -17.65% |
| **Average per employee** | |
| - base salary [2] | 5.61% |
| - benefits | 7.46% |
| - annual bonus | -18.18% |

*1 This information is based upon year-on-year comparison for colleagues who were in the business during both periods.*
*2 Following the annual pay review, employee base salaries were increased by an average of 2.56% in July 2014.*

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

### Highest-paid Director's remuneration change versus median

The table below shows the relationship between the remuneration of the highest-paid Director and the median remuneration of the organisation's workforce. For this purpose, total remuneration includes salary and taxable benefits. It does not include pension contributions, however payments made in lieu of pension have been included. The reduction in the ratio primarily reflects that there was no vesting of MTIP awards in 2014/15, whereas 2013/14 included two payments relating to the period 1 January 2011 to 31 December 2013.

**Table 8 – Comparison of highest-paid Director's remuneration versus all colleagues**

| | All colleague ratio | |
|---|---|---|
| | **2014/15** | **2013/14** |
| Highest-paid Director's total remuneration | £653,227 | £814,679 |
| Median remuneration for UKAR colleagues | £21,936 | £20,694 |
| **Remuneration ratio** | **29.8** | **39.4** |

### STIP for the year ending 31 March 2015

The individual targets used for the STIP scheme are based on key metrics and assessment of performance year-on-year. All four financial and operational elements are weighted equally. The business has achieved three of these objectives but did not achieve the stretching target for numbers of accounts 3 months or more in arrears. However, the Remuneration Committee noted the continued excellent progress in this area with arrears steadily reducing month on month with a reduction of 23% in the year and over 70% since UKAR was formed. As a result, the Remuneration Committee and Board agreed that discretion would be used on that measure and one quarter of the target would be applied for bonus purposes. This means that STIP payments for 2014/15 would be paid at 3.25 targets met and an assessment of personal performance, as shown in tables 10, 11 and 12. The Committee also considered whether there were any circumstances that could have justified clawback or malus in the year, taking input from the Risk Director. It agreed that there were no circumstances that would have justified this.

**Table 9 – STIP targets 2014/15**

| | Measure | Target | Weighting | Outcome |
|---|---|---|---|---|
| **Financial** | Underlying profit before tax | >£1,163.1m | 25% | Exceeded |
| | Costs [1] | <£171.4m | 25% | Exceeded |
| | Government loan repayments | >£3,565m | 25% | Exceeded |
| **Operational** | Reduction in number of customers 3 months or more in arrears | >5,233 | 25% | Not Achieved |
| **Non-Financial [2]** | Balanced Scorecard | Green | 0% to -40% | Achieved |

1 *The cost target excluded UKARcs and certain costs for ongoing strategic activity.*
2 *The Balanced Scorecard was reviewed this year and the targets realigned to the FCA's conduct risk agenda. As a result the Balanced Scorecard acts as a 'reducer' to the maximum bonus to ensure colleagues demonstrate the right behaviours. The 10 measures including internal control, customer metrics and people management are rated red, amber or green at the end of the year. Green results in no reduction, amber in a 2% reduction and red in a 4% reduction. In the most extreme case, with all 10 measures judged as red, the bonus pool would be reduced by 40%.*

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

### STIP for the year ending 31 March 2015 (continued)

The individual objectives that influence the performance rating for Richard Banks and Ian Hares, which in turn determine the amount of incentive earned, are detailed below.

**Table 10 – Richard Banks' 2014/15 Personal Objective Assessment**

| Objective detail | Achievement |
|---|---|
| Lead the development of strategic options to enable UKAR to maximise value for the taxpayer. | Strategic options have been developed throughout the year and as announced in the Chancellor's Budget on 18 March 2015 two transactions have now been launched. |
| Oversight of the Balance Sheet Optimisation programme. | Asset sales and liability management exercises have been developed and implemented as approved by UKFI / HM Treasury including the £2.7bn sale of a portfolio of assets in October 2014. |
| Oversee delivery of the customer contact programme and develop solutions to reduce the risk of customers entering into arrears. | Several programmes have been initiated to help reduce the number of customers moving into arrears including an extension of proactive contact to customers with interest only mortgages. The number of mortgage customers three months or more in arrears has reduced by 23% this year. |
| Oversight of UKAR Corporate Services. | All UKAR obligations to HM Treasury have been met, with governance operating to a high standard and Service Level Agreements exceeded. |
| Lead colleagues to maintain the UKAR values and standards in line with principles of good governance, Conduct and TCF, maintaining morale in a declining Balance Sheet. | Excellent financial performance whilst TCF standards have been maintained ensuring UKAR keeps the interests of customers and market integrity at the heart of the business. High levels of colleague engagement have been maintained. |

**Table 11 – Ian Hares' 2014/15 Personal Objective Assessment**

| Objective detail | Achievement |
|---|---|
| Provide clear leadership and technical input to the delivery of the UKAR Strategy development and implementation. | Strategic options have been developed throughout the year and as announced in the Chancellor's Budget on 18 March 2015 two transactions have now been launched. |
| Deliver cash generative Balance Sheet transactions creating additional government loan repayments. | Asset sales and liability management exercises have been developed and implemented as approved by UKFI / HM Treasury including the £2.7bn sale of a portfolio of assets in October 2014. |
| Financial Reporting and Business support, Oversight of Banking Operations services and delivery of key projects. | Full year and interims delivered to high standard and Treasury Management System delivered as planned. |
| Lead delivery of proactive customer campaigns. | Significantly improved direction and coordination of activity with rollout of specific programmes in respect of interest only and interest rate susceptibility. |

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

### STIP for the year ending 31 March 2015 (continued)

The UKAR STIP is comprised of financial and operational objectives. The Balanced Scorecard targets have all been achieved and there is no reduction. Personal objectives are measured in a range from 'under performing' at 0% to 'surpasses expectations' with a range of 40-60%. Discretion is applied in respect of the actual bonus awards within the ranges in the table 12.

**Table 12 - STIP award matrix**

| Targets achieved | Surpasses expectations | On track / Achieved | Too early to assess / Work in Progress / Developing | Under-performing |
|---|---|---|---|---|
| 4 | 60% - 40% | 39.9% - 20.0% | 19.9% - 5.0% | 0% |
| 3.25 | 51% - 34% | 33.9% - 17.0% | 16.9% - 4.2% | 0% |
| 3 | 48% - 32% | 31.9% - 16.0% | 15.9% - 4.0% | 0% |
| 2 | 30% - 18% | 17.9% - 10.0% | 9.9% - 2.0% | 0% |
| 1 | 15% - 9% | 8.9% - 5.0% | 4.9% - 1.0% | 0% |

Richard Banks' performance was discussed at a private session of the Remuneration Committee in April 2015 and subsequently with the whole Board. It was agreed that Richard had achieved all his personal objectives and that his continued leadership had driven the high performance of UKAR and, as highlighted earlier in this report, the three financial targets have been achieved. Although the stretching target around the number of mortgage accounts three or more months in arrears was not achieved, it is pleasing that the total value of arrears owed by customers has fallen by 25%. In addition, Richard has also led the development of the strategic options which has enabled the business to seek expressions of interest for a major sale of assets and the divestment of the mortgage operations part of the business. It was agreed that his performance had 'surpassed expectations' which under the bonus scheme rules gives the Committee discretion in the range of 34%-51%. The Board agreed with the Chairman's recommendation to award Richard Banks a bonus of 38.66% which equates to £144,085 for the year.

Ian Hares' annual performance was also discussed in the private session of the Remuneration Committee in April 2015. It was agreed that Ian had delivered all his personal objectives, particularly the £2.7bn sale of a mortgage portfolio and has developed as a respected member of the Board adding value to meetings, particularly on the strategic objectives and Balance Sheet Optimisation activity. It was determined that his performance had 'surpassed expectations' which under the bonus scheme rules gives the Committee discretion in the range of 34%-51%, and the Board agreed with the recommendation by the Chief Executive Officer to award him a bonus of 42% which equates to £124,740 for the year.

### Grant and vesting of MTIP awards

There was an MTIP grant made in the reporting period, linked to the launch of the new scheme which runs from 1 April 2014 to 31 March 2017.

There was no vesting of MTIP awards during the year. UKAR operated an MTIP scheme which covered the period January 2011 to December 2013, which paid out in March 2014 linked to targets for the period 1 January 2011 to 31 December 2013. The targets for this scheme relate to driving additional shareholder value and/or early repayment of government loans.

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

### Total pension entitlements

Richard Banks receives a cash supplement of 30% of basic salary in lieu of UKAR pension benefit and Ian Hares receives a cash supplement of 15%. Neither of the Executive Directors have ever been a member of the UKAR Pension Plan.

None of the Executive Directors have accrued any defined benefit pension during their tenure as a Director.

During the reporting period, NRAM pension payments due to former Directors of the former Northern Rock plc, paid directly by NRAM and not connected to the Northern Rock Staff Pension Scheme were as follows (no similar payments were made by B&B during any of these periods):

| April 2014 - March 2015 | April 2013 - March 2014 |
|---|---|
| £326,679 | £316,584 |

For details of UKAR's accounting for retirement benefits see note 17 to the Financial Statements.

### Payments within the period to past directors for loss of office

There have been no payments made to any Directors within the reporting period relating to loss of office.

### Performance

The table below shows a summary of Richard Banks' incentives that have been paid or vested since UKAR was formed, as compared to his total remuneration package.

**Table 13 – Summary of CEO remuneration and incentives**

| | 2011 | 2012 | 2013/14 (Apr 13 - Mar 14) | 2013/14 (15 month) | 2014/15 |
|---|---|---|---|---|---|
| Total Remuneration | £596,697 | £642,820 | £814,679 | £980,771 | £653,227 |
| STIP (as % of maximum) | 60% | 43% | 80% | 80% | 64% |
| MTIP Vesting (as % of maximum) | N/A | 100% | 100% | 100% | N/A |

### Relative importance of the spend on pay

This section shows the percentage change in the cost of pay across the company, compared with statutory profit after tax.

**Table 14 – Summary of colleague remuneration costs compared to statutory profit**

| | 2012 | 2013/14* | 2014/15 | % Change |
|---|---|---|---|---|
| Total remuneration costs for UKAR (salary, pension, bonus benefits) | £76.1m | £64.9m | £64.7m | (0%) |
| Profit after tax | £563.8m | £869.7m | £771.6m | (11%) |

** Represents the 12 months to 31 March 2014.*

### External advisors

UKAR is advised by New Bridge Street ('NBS') who were appointed by the Remuneration Committee in 2011. The total fees paid to NBS in respect of its services to the Committee during the year were charged on a time spent basis and amounted to £76,008. NBS is a signatory to the Remuneration Consultants' Code of Conduct which requires it to provide objective and impartial advice.

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

### External Directorships

The tables below outline the external non-executive directorships that Richard Banks and Ian Hares held during the 2014/15 reporting period.

**Table 15 – Richard Banks' External Directorships**

| Position | 2012 | 2013/14 (15 month) | 2014/15 |
|---|---|---|---|
| ICICI Bank UK [1] | £60,000 | £75,000 | £15,000 |
| Shop Direct Financial Services Ltd | N/A | £11,600 | £70,000 |
| Liverpool Compact Education Business Partnership | £0 | £0 | £0 |

*1 Richard Banks stepped down from his directorship with ICICI Bank UK with effect from 30 June 2014.*

Richard Banks has also been appointed to an interim role on the Board of the Student Loans Company for a period of 6 months with effect from 30 March 2015. For this appointment he will receive fees of £4,500 (£9,000 per annum).

**Table 16 – Ian Hares' External Directorships**

| Position | 2012 | 2013/14 (15 month) | 2014/15 |
|---|---|---|---|
| Asset & Liability Management Association Ltd | N/A | N/A | £0 |

### How the policy will be applied in 2015 onwards

Reward will continue to play an important part in the delivery of UKAR's strategy, both at executive level and across the organisation. As highlighted earlier, retention of key colleagues in the coming year will become even more important as UKAR aims to deliver its strategy of asset sales with retained servicing.

### 2015/16 salary review

UKAR applies the same approach to salary uplifts for its Executive Directors as for the rest of the colleague population, with increases based upon a matrix of position against salary range and performance rating.

Richard Banks' current and previous salaries are as follows:

**Table 17 – 2014 salaries for the Executive Directors**

| | Salary as at 1 January 2011 | Salary as at 1 January 2012 | Salary as at 1 January 2013 | Salary as at 1 April 2014 | Salary as at 1 April 2015 |
|---|---|---|---|---|---|
| Richard Banks | £340,000 | £346,800 (+2.0%) | £355,500 (+2.5%) | £364,500 (+2.5%) | £372,700 (+2.25%)[1] |
| Ian Hares | - | - | - | £297,000[2] | £297,000 (+0%) |

*1 Richard Banks' annual pay rise was effective from 1st July 2014.*
*2 Effective from Ian Hares' appointment as Executive Director as at 8 July 2014.*

### Structure of STIP and MTIP

The maximum potential earnings under the STIP scheme for 2015/16 will be unchanged, with the financial and operational targets updated in line with UKAR's business plan. The MTIP scheme in place covers the 2014/15 to 2016/17 performance period and will be reviewed and updated in line with the organisational strategy if it is deemed appropriate.

### Performance targets for the STIP and MTIP awards to be granted in 2015 and beyond

The targets for both of these schemes have received Remuneration Committee, Board and UKFI approval.

# Directors' remuneration report (continued)

## Annual report on remuneration (continued)

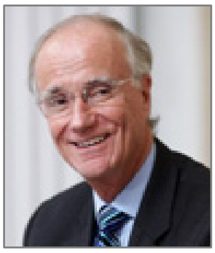
### Approval

This Directors’ Remuneration Report, including both the Policy and Annual Remuneration Report has been approved by the Board of Directors.

Signed on behalf of the Board of Directors.

**Sue Langley OBE**
Chairman of the Remuneration Committee

# Audit Committee Chairman's report



Kent Atkinson, Chairman of the Audit Committee, reports on how the Audit Committee discharged its responsibilities during 2014/15.

"During 2014/15 the Audit Committee continued to fulfil its key role in monitoring the integrity of financial reporting for the business and supporting the Board in ensuring the Financial Statements are fair, balanced and understandable. In addition, we have continued to provide assurance that the Group has in place effective audit processes and internal control systems."

### Membership

The Audit Committee was in place throughout 2014/15 and had the following membership at 31 March 2015:

Kent Atkinson (Chairman)
Michael Buckley
John Tattersall

There were no changes to the membership of the Audit Committee during 2014/15.

Details of the skills and experience of Committee members can be found in the Directors' biographies on pages 21 to 23.

### Summary of responsibilities

The Audit Committee is responsible for monitoring, reviewing and advising the Board on:

- all regulatory, prudential and accounting requirements that may affect the Group;
- integrity of the Financial Statements and external reporting responsibilities;
- effectiveness of the Group's systems of internal control and auditing plans;
- the Whistleblowing Policy;
- the role, objectivity and effectiveness of internal and external auditors; and
- results of the external audit and any significant matters identified.

### Meetings

The Committee held three meetings during the year, complying with the requirements of its Terms of Reference. The attendance of individual members at meetings is set out on page 25.

The Committee also invites the following to attend its regular meetings:

- David Lunn, as a UKFI appointed Director;
- members of ExCo, including the CEO, Finance & Investment Director and Risk Director;
- Head of Internal Audit and the external auditors;
- Company Secretary or his nominee; and
- other representatives from business functions and/or external advisors from time to time.

The internal and external auditors each held a separate private session with the Committee which was not attended by the Executive. The private sessions provided the opportunity for the Committee to discuss matters directly with the relevant audit teams.

### Reporting to the Board

The Committee Chairman reported to the Board after each Committee meeting, summarising the key matters discussed, and the Board has also received the minutes of each meeting.

### Governance

The Committee completed an annual review of its Terms of Reference and undertook an evaluation process in accordance with the requirements of those Terms of Reference. The results of the evaluation were positive and provided assurance that the Committee remained fit for purpose.

# Audit Committee Chairman's report (continued)

### Chairman's overview of 2014/15

The work of the Committee during 2014/15 has covered a variety of topics within its Terms of Reference, some of the more significant are set out below:

| Financial reporting | Internal audit | External audit | Governance and other matters |
|---|---|---|---|
| Oversight of the Annual and Interim Financial Statements, taking into account the requirements of HM Treasury consolidation. | Approval of the Annual Plan and monitoring its effectiveness.<br>Approval of the objectives for the Head of Internal Audit.<br>Oversight of internal audit activity. | Oversight of the effectiveness of external audit.<br>Approval of the year-end strategy and performance evaluation. | Oversight of effectiveness of systems of internal control.<br>Oversight of the effectiveness of the Whistleblowing Policy.<br>Approval of the Non-Audit Services Policy.<br>Approval of the Recruitment of Audit Staff Policies.<br>Senior Accounting Officer governance framework and certification. |

### Financial reporting and significant financial judgements

The Committee reviewed the content of the Interim and Annual Financial Statements and advised the Board on whether, in the opinion of the Committee, taken as a whole, these are fair, balanced and understandable and provide the information necessary for the shareholder to assess the position and performance, business model and strategy.

During the period the Committee assessed the financial reporting processes, with assistance from management and the internal and external auditors. Management produced a comprehensive report providing details of judgements taken and other key reporting matters considered in preparing each set of results. The external auditors produced a similar report based on their audit findings. The Committee considered the following significant issues and judgements in relation to the Group's Financial Statements and disclosures:

| Significant issue | Financial outcome |
|---|---|
| **Loan loss provisioning** | Despite further improvements in the level of arrears and the economy, the provision remains highly material and from necessity, is based on many judgemental assumptions. The Committee considered loss coverage ratios for the various elements of the book in light of these improvements and sought justification for changes from last year's levels. Particular focus was placed on the higher risk areas of the loan book, such as equity release loans and those subject to fraud and professional negligence. |
| **Provision for customer redress** | Throughout the year the Committee have been kept informed of the approach to customer remediation, considered any developments and agreed provisions where appropriate. In the light of legal advice, the Committee carefully considered the accounting treatment of the NRAM loans for amounts greater than £25,000, which by definition fall outside of CCA regulation but for whom CCA documentation had been provided. At the date of the Interim Financial Report, before the original court decision was known, the exposure was noted as a contingent liability and disclosed accordingly. Having lost the initial court case, the Committee agreed the proposed provision. |
| **Fair value of derivatives** | The number of derivatives held by UKAR has reduced significantly since formation as the inherited Balance Sheets are simplified. Methods continued to be reviewed against market best practice and the Audit Committee was satisfied that the bases adopted were appropriate. |
| **Hedge accounting** | Over 76% of UKAR's total derivative books are in IAS39 hedge relationships at notional value. The Audit Committee reviewed the approach and were satisfied that it remains compliant with IFRS. |
| **Pension accounting** | The Audit Committee reviewed the key assumptions for the two defined benefit pension schemes. Additional assurance in this area was provided by the Company's actuarial advisors. |

# Audit Committee Chairman's report (continued)

### Financial reporting and significant financial judgements (continued)

| Significant Issue | Financial Outcome |
|---|---|
| **Taxation** | Existing provisions were reviewed for appropriateness and the Committee were satisfied that all tax matters were compliant. |
| **Going concern** | Following confirmation of HM Treasury's continued financial support for the Principal Subsidiaries and sight of the EU State Aid Report, the Audit Committee determined that it continued to be appropriate to prepare the accounts on a going concern basis. |
| **Disclosures in the Annual Report and Accounts** | The Committee were comfortable that, taken as a whole, the Annual Report provided a fair, balanced and understandable reflection of UKAR's performance for the year and the financial position as at 31 March 2015. |

### Internal audit

Deloitte LLP provide the internal audit services through an outsourced contract. Further details of the provision of the Internal Audit service can be found on page 71.

The Audit Committee fulfilled its responsibility to monitor the objectiveness and effectiveness of internal audit through:

- considering reports at each meeting from the Head of Internal Audit. These reports highlight existing and emerging matters of significance, areas of concern, planned actions, monitoring procedures and any other matters which are likely to impact on internal controls;
- review and approval of the annual Internal Audit Plan, together with any changes required on a quarterly basis;
- approval of the Terms of Reference for Internal Audit on an annual basis;
- reviewing the adequacy and effectiveness of the activities carried out by the function; and
- the Head of Internal Audit attended all Audit Committee meetings during 2014/15 and has direct access to the Audit Committee and its Chairman.

The Audit Committee has satisfied itself that the Internal Audit function was effective and adequately resourced through the regular meetings held with, and reports provided by, the Head of Internal Audit.

### Internal control

The Audit Committee reviewed the effectiveness of the system of internal control in accordance with the UK Corporate Governance Code.

The Committee reviewed reports on Whistleblowing and received assurance that the Policy is reinforced annually to all colleagues through mandatory training.

Further information on the approach to the Board's review of the Group's system of internal control is given within the Corporate Governance section on pages 28 and 29.

### External audit

The Committee places great importance on ensuring there are high standards of quality and effectiveness in the external audit process and is responsible for recommending the appointment, re-appointment and removal of the external auditors. It reviewed the scope and results of the annual external audit and its cost effectiveness.

The external auditors may attend all meetings of the Committee and they have direct access to the Committee and its Chairman at all times.

The Audit Committee considered and approved the external audit plans and approach prior to the external auditors undertaking their audit work.

The external audit contract was last put out to tender in 2010 with PricewaterhouseCoopers LLP ('PwC') being appointed as external auditors from 28 April 2011 for an initial three year term, subsequently agreed to be extended up to 31 March 2014 due to the change in financial period. A full evaluation of PwC's performance was undertaken following the completion of all year-end work in 2013, which reported satisfaction with their performance since appointment, and was considered by the Audit Committee in October 2013. In January 2014, the Audit Committee agreed to extend PwC's contract for a further two years, until the year ending 31 March 2016.

# Audit Committee Chairman's report (continued)

### Non-audit services

The Audit Committee also develops and recommends to the Board a policy on the supply of non-audit services by the internal or external auditors and reviews this annually, taking into account any relevant ethical guidance on the matter:

- the Policy clearly sets out the circumstances in which it is appropriate to employ any audit partner for additional work, the safeguards required and the mandate structure for approval;
- the Finance & Investment Director must be aware of the hiring of auditors for all non-audit work;
- the Chairman of the Audit Committee must sign off work which will cost more than £25,000;
- the auditors are required to demonstrate that accepting such a contract will not damage their independence or objectivity; and
- the Audit Committee reviews the audit and non-audit fees paid to the internal and external auditors every six months and monitors the total spend on non-audit work relative to the spend on audit work.

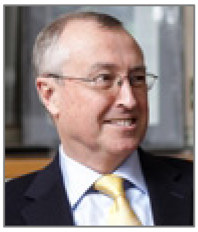
### Priorities for 2015/16

For 2015/16, the key areas of focus for the Committee will include:

- ensuring continued oversight of the financial position and control environment of the Group taking into account the impact of the strategic developments detailed in the Chairman's statement on pages 5 to 6; and
- oversight of proposals in relation to the future tendering of internal and external audit, taking account of the latest best practice, changes in legislation, regulation and the requirements of the Framework Agreement.

**Kent Atkinson**
Chairman, Audit Committee

# Nomination Committee Chairman's report



Richard Pym, Chairman of the Nomination Committee, reports on how the Nomination Committee discharged its responsibilities during 2014/15.

"The Nomination Committee has an important role in ensuring the composition of the Board and its Committees reflect the best governance practice, taking into account the strategic direction and unique nature of the business. During 2014/15 the Committee has overseen the appointments made to the Board, ensuring appropriate processes were followed."

## Membership

The Nomination Committee was in place throughout 2014/15 and had the following membership as at 31 March 2015:

Richard Pym (Chairman)
Michael Buckley
Sue Langley

There were no changes to the membership of the Nomination Committee during 2014/15.

Details of the skills and experience of Committee members can be found in the Directors' biographies on pages 21 to 23.

## Summary of responsibilities

The Nomination Committee is responsible for monitoring, reviewing and advising the Board on:

- the composition of the Board and appropriate succession plans;
- identification of potential Executive and Non-Executive Directors;
- appointment or re-appointment of Directors, having regard to the requirement for the Board to have the appropriate range of skills and experience; and
- the leadership needs of the business, the succession plans for key executive roles and the diversity policies.

## Meetings

The Committee held four meetings during the year, complying with the requirements of its Terms of Reference. The attendance of individual members at meetings is set out on page 25.

The Committee also invites the following to attend its regular meetings:

- David Lunn, as a UKFI appointed Director;
- members of ExCo, including the CEO and HR Director;
- Company Secretary or his nominee; and
- other representatives from business functions and/or external advisors from time to time.

## Reporting to the Board

The Committee Chairman reported to the Board after each Committee meeting, summarising the key matters discussed, and the Board has also received the minutes of each meeting.

## Governance

The Committee completed an annual review of its Terms of Reference and undertook an evaluation process in accordance with the requirements of those Terms of Reference. The results of the evaluation were positive and provided assurance that the Committee remained fit for purpose.

# Nomination Committee Chairman's report (continued)

### Chairman's overview of 2014/15

The work of the Committee during 2014/15 has covered a variety of topics within its Terms of Reference and the key activities undertaken during the year have included:

- oversight of the appointment process for a new Executive Director and for a new Non-Executive Director proposed by the shareholder;
- ongoing review of Executive Development and Succession Planning to ensure it remains fit for purpose taking account of any strategic developments;
- review of the Constitution of the Board and its Committees, taking account of changing membership, and recommendation of required changes to the Board;
- review and recommendation of the renewal of Non-Executive Director contracts; and
- recommendation for the reappointment of Directors at the Annual General Meeting.

### Diversity Policy

The Board Diversity Policy endorses the principles of best practice and recognises the benefits of having a diverse Board. The policy requires that in reviewing board composition, the Committee will consider the benefits of all aspects of diversity including skills, background, race, experience, gender and other qualities of Directors. Due to the unique nature of the appointment process and the anticipated reduction in the size of the Board, a gender target is considered to be inappropriate.

### Appointment of Directors

Following the resignation of Phillip McLelland as Finance Director in November 2013, Ian Hares was appointed as Finance & Investment Director, with the intention that after a period of satisfactory performance he would be appointed to the Board. The Committee fully supported this proposal to strengthen the composition of the Board and Mr Hares was appointed as a Director on 8 July 2014. It was not considered appropriate to use open advertising or an external search consultancy in these circumstances.

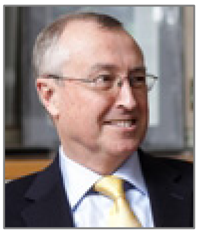
In accordance with the Framework Document UKFI is entitled to appoint one or more Non-Executive Directors and appointed David Lunn, UKFI's Head of UKAR, as a Non-Executive Director on 20 November 2014, following the resignation of Christopher Fox with effect from the same date. In such circumstances the use of open advertising or an external search consultancy is inappropriate.

### Priorities for 2015/16

In 2015/16 the Committee will continue to oversee Executive Development, monitor succession planning and Board composition to ensure that appropriate plans are in place to meet the changing requirements of the business, taking into account the strategic developments.

**Richard Pym**
Chairman, Nomination Committee

# Transaction Approvals Committee Chairman's report



Richard Pym, Chairman of the Transaction Approvals Committee, reports on how the Transaction Approvals Committee discharged its responsibilities during 2014/15.

"During the year the Transaction Approvals Committee has overseen the key strategic transactions for the business and ensured that they remained in line with the objective of maximising value for the taxpayer."

### Membership

The Transaction Approvals Committee was in place throughout 2014/15 and had the following membership at 31 March 2015:

Richard Pym (Chairman)
Richard Banks
Michael Buckley
Ian Hares
David Lunn
Keith Morgan

The following changes were made to the Committee membership during the year:

- Christopher Fox resigned from the Board and consequently his role on the Transaction Approvals Committee with effect from 20 November 2014.
- David Lunn was appointed to the Committee with effect from his appointment to the Board on 20 November 2014.
- Ian Hares was appointed to the Committee with effect from 28 October 2014.

Details of the skills and experience of Committee members can be found in the Directors' biographies on pages 21 to 23.

### Summary of responsibilities

The Committee is authorised to approve the implementation of strategic transactions, including inter alia, the terms, timing, pricing, documentation and appointment of advisors, in accordance with any directions and limits set by the Board and with reference to the requirements of the Framework Document.

### Meetings

The Committee meets as and when necessary depending on proposals for strategic transactions. The attendance of individual members is set out on page 25.

The Committee also invites the follow to attend its regular meetings:

- Company Secretary or his nominee; and
- other representatives from business functions and/or external advisors from time to time, as appropriate.

### Reporting to the Board

The Committee Chairman reported to the Board after each Committee meeting, summarising the key matters discussed, and the Board has also received the minutes of each meeting.

### Governance

The Committee completed an annual review of its Terms of Reference and undertook an evaluation process in accordance with the requirements of those Terms of Reference. The results of the evaluation were positive and provided assurance that the Committee remained fit for purpose.

# Transaction Approvals Committee Chairman's report (continued)

### Chairman's overview of 2014/15

The Transaction Approvals Committee fulfilled its remit during 2014/15 through the receipt of updates on the strategic transactions of B&B and NRAM and approval of the key stages of individual projects. This included approval and oversight of the processes for the sale of a portfolio of residential mortgages and for the tender and buy back of certain listed securities.

### Priorities for 2015/16

During 2015/16 the Transaction Approvals Committee will continue to oversee any strategic transactions, provide support to the Board in relation to strategy developments and will continue to work to ensure that the overarching objective of "maximising value for the taxpayer" is achieved.

**Richard Pym**
Chairman, Transaction Approvals Committee

# Risk Committee Chairman's report

John Tattersall, Chairman of the Risk Committee, reports on how the Risk Committee discharged its responsibilities during 2014/15.

"During 2014/15 the Risk Committee continued to support the Board in ensuring that key risks are managed and monitored within the approved risk appetite. In conjunction with the Audit Committee, we ensure that an appropriate risk culture and systems of internal control to mitigate those key risks are maintained. Areas of focus this year have been to monitor the wind down impact on the risk profile of the business, to review market and regulatory change, and to ensure that conduct risk is embedded in everything we do."

### Membership

The Risk Committee was in place throughout 2014/15 and had the following membership on 31 March 2015:

John Tattersall (Chairman)
Kent Atkinson
Michael Buckley
Keith Morgan

There were no changes to the membership of the Risk Committee during 2014/15.

Details of the skills and experience of Committee members can be found in the Directors' biographies on pages 21 to 23.

### Summary of responsibilities

The main role of the Risk Committee is to advise the Board on the principal risks inherent in the business, risk governance and the effectiveness of the systems of control necessary to manage such risks and to present its findings to the Board. This responsibility requires the Risk Committee to:

- keep under review the adequacy of the Group's risk management frameworks and systems of internal control, which include financial, operational and compliance risk management controls; and
- foster a culture that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of the Group.

### Meetings

The Committee held four meetings during the year, complying with the requirements of its Terms of Reference. The attendance of individual members at meetings is set out on page 25.

The Committee also invites the following to attend its regular meetings:

- David Lunn, as a UKFI appointed Director;
- members of the ExCo, including the CEO, Finance & Investment Director and Risk Director;
- Head of Compliance;
- Head of Internal Audit and the external auditors;
- Company Secretary or his nominee; and
- representatives from other business functions from time to time.

The Risk Director and Head of Compliance each held a separate private session with the Committee which provided an opportunity for any issues to be raised without any members of the Executive present.

### Reporting to the Board

The Committee Chairman reported to the Board after each Committee meeting, summarising the key matters discussed, and the Board has also received the minutes of each meeting.

### Governance

The Committee completed an annual review of its Terms of Reference and undertook an evaluation process in accordance with the requirements of those Terms of Reference. The results of the evaluation were positive and provided assurance that the Committee remained fit for purpose.

# Risk Committee Chairman's report (continued)

### Chairman's overview of 2014/15

The work of the Committee during 2014/15 has included the review of the principal risks each quarter, based on comprehensive reports from the Risk Director and Head of Compliance. The principal risks are:

- Conduct Risk;
- Regulatory Risk;
- Operational Risk;
- Credit Risk;
- Strategic Risk;
- Liquidity Risk; and
- Market Risk.

In addition the Committee considered a variety of topics throughout the year, including:

- overseeing the conduct risk approach;
- monitoring the reducing business and the potential for increased operational risks;
- considering the risks involved in the sale of various parts of the loan book and of the mortgage servicing operations;
- considering the impact of emerging risks such as interest rate predictions and cyber risk;
- maintaining an overview of the key industry, legal and regulatory change issues;
- monitoring progress on control improvements to address historical legacy issues; and
- overseeing and monitoring the progress of the IT Refresh Programme and organisation restructure.

### Risk Committee activities in 2014/15

The Risk Committee fulfilled its remit through:

- oversight of the embedding of a supportive culture in relation to the management of risk;
- making appropriate recommendations to the Board on all significant matters relating to the Group's risk appetite, strategy and policies;
- monitoring the overall risk appetite within the Group and risk management performance, taking into account the current and prospective macroeconomic and financial environment, drawing on financial stability assessments such as those published by the Bank of England, FCA and other relevant authoritative sources;
- assisting the Board in discharging its responsibilities for the setting of risk policies;
- periodically reviewing the Group's material risk exposures in relation to risk appetite and capital adequacy;
- ensuring 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;
- considering reports from Compliance and Management on the system of internal control; and
- overseeing UKAR's insurance programme and claims recoveries.

Further information on the role of the Risk Committee and its oversight of the risk management process is provided on page 70.

# Risk Committee Chairman's report (continued)

### Priorities for 2015/16

Against a backdrop of external economic challenges for UKAR customers and internal challenges associated with a business in run-off, a number of principal risks remain inherent, including strategic, conduct, regulatory, operational and credit risk. These risks will continue to be monitored to ensure they remain within the Board approved risk appetite. Our approach to risk means that regular monitoring and reporting of all risks will be visible at the relevant committees, ensuring that risk management supports the business in the next phase of the business strategy.

- **Conduct risk** - ensuring fair and appropriate customer outcomes and meeting regulatory expectations are at the heart of the business. We will continue to work hard to deal with customer complaints and review root cause analysis to improve our delivery of fair and appropriate customer outcomes. This will involve empowering front line operations to place the customer at the heart of what we do.

- **Regulatory risk** - management is key to ensuring compliance with the FCA's principles, rules and guidance. Our approach is focused on eliminating regulatory risk through a zero risk appetite.

- **Operational risk** - is particularly relevant since we are a reducing business and managing the people and process risks which this creates is a key priority.

  Regulators and our business peers continue to express significant concern about the prevalence and impact of cyber security threats. The increasing importance of systems, the internet and telecommunications to complete business operations makes any threat to the security or availability of systems and information a risk to our success. This was a key focus in 2014/15 and will remain a high priority during 2015/16. We will continue to monitor significant cyber security risks and reported breaches to assess the effectiveness of implemented controls to mitigate such risks.

- **Credit risk** - given UKAR's customer profile, work continues to understand our customers' current financial position and in particular quantify the impact of interest rate rises. Our focus is on the various cohorts of customers who might be most impacted, for example, those in retirement, and ensuring that customers with interest only mortgage balances are able to repay their loans at the end of their term.

- **Strategic risk** - the key strategic risks include those relating to management of a mortgage book in wind down. The proposal to sell a significant proportion of the mortgage book potentially increases this risk. One initiative being undertaken to mitigate this risk is to sell or outsource operational capability. However, these major initiatives introduce strategic risk of their own and particular focus will be on the execution of these initiatives, which are likely to carry a level of increased operational risk during the sale and delivery phases. Mitigation will be through robust risk and project management oversight. In addition, the committee will continue to monitor historical remediation, the wider economic and political environment, the resolution of financial issues within the Eurozone and multiple regulation changes.

UKAR principal risks are described in detail on pages 18 and 71 to 74.

**John Tattersall**
Chairman, Risk Committee

# Key performance indicators ('KPIs') - UKAR

In addition to the primary Financial Statements, we have adopted the following KPIs in managing business performance in the context of the Group's strategic priorities:

| Strategic priorities | Financial measures | 12 months to 31 March 2015 | 12 months to 31 March 2014 | 15 months to 31 March 2014 | Commentary |
|---|---|---|---|---|---|
| Optimise the Balance Sheet | Total lending balances £bn<br>Secured £bn<br>Unsecured £bn | 52.7<br>51.6<br>1.1 | 61.2<br>59.9<br>1.3 | 61.2<br>59.9<br>1.3 | Lending balances reduced by 14.0% during the year due to £5.3bn of secured residential redemptions, £0.1bn of commercial redemptions, £0.1bn of unsecured loan redemptions and £0.3bn of other capital repayments. In addition, £2.7bn of residential mortgages were sold during the year. |
| | Residential mortgage redemption rate %<br>Residential redemptions £bn | 9.0<br>5.3 | 7.6<br>4.9 | 7.1<br>5.8 | Redemption rates have increased compared to 2014 reflecting increases in house prices and improved levels of remortgage activity across the market. |
| | Government loan repayments £bn<br>Government loan balance £bn | 3.7<br>34.6 | 4.6<br>38.3 | 5.1<br>38.3 | £2.4bn repaid against the B&B Working Capital Facility and £1.3bn on the NRAM government loan. The main drivers of the decrease are the build up of cash ahead of the maturity of other wholesale funding in 2015 and cash used to repurchase third party debt. |
| | Total cash payments to HM Treasury £bn | 4.4 | 5.6 | 6.2 | Total cash paid to HM Treasury during the year. This includes principal and interest repayments, guarantee fees and corporation tax paid. The main driver of the decrease is the lower repayments of loan principal as explained above. |
| Minimise impairment and losses | Residential arrears balance: total residential mortgage balance %<br>Residential payments overdue £m | 0.18<br>90.6 | 0.20<br>121.2 | 0.20<br>121.2 | This represents the value of customers' missed payments as a proportion of the total balance of all residential mortgages and reflects that the level of debt owed on mortgages is falling at a quicker rate than the reduction in the book. |
| | Residential arrears 3 months and over and possessions as % of the book:<br>- by value<br>- by number of accounts<br>Number of residential arrears 3 months and over and possessions cases | <br><br>3.35<br>2.64<br><br>11,976 | <br><br>3.82<br>2.93<br><br>15,483 | <br><br>3.82<br>2.93<br><br>15,483 | The reduction in arrears reflects both our continued focus on customers in financial difficulty and the continuing support provided to mortgage customers by low interest rates. |
| | Impairment provisions:<br>Residential secured £m<br>Cover %<br>Unsecured £m<br>Cover %<br>Commercial / other £m<br>Cover % | <br>888.0<br>1.71<br>205.1<br>16.20<br>76.7<br>12.51 | <br>1,151.8<br>1.90<br>214.7<br>14.35<br>90.9<br>12.73 | <br>1,151.8<br>1.90<br>214.7<br>14.35<br>90.9<br>12.73 | The level of residential impairment Balance Sheet provision reduced by £263.8m. The reduced provision reflects improved arrears performance, the benefit of improving house prices and realised losses within the year. Coverage has increased on the unsecured book due to an increase in provisions on late arrears cases. Commercial coverage has remained broadly in line with the prior year. |
| Reduce costs | Ongoing costs (excluding UKARcs) £m<br>Ratio of costs to average interest-earning assets:<br>- ongoing % | 174.2<br><br>0.26 | 188.0<br><br>0.25 | 244.5<br><br>0.26 | Ongoing costs have reduced reflecting a full year benefit of lower IT costs following the transfer of our IT infrastructure to HCL Technologies that was completed last year and other cost reductions as the size of the Balance Sheet reduces. The ratio of costs to average interest-earning assets has remained broadly in line with the prior year. |

# Financial review

These financial results are for the year to 31 March 2015. The previous financial results were for the 15 month period to 31 March 2014 ('15 months to March 2014') and therefore these are included as the primary comparative below. However, to aid comparison to the prior year additional unaudited disclosures of the results for the 12 months to 31 March 2014 ('12 months to March 2014') have been made in an appendix to this document and will be referred to in the following commentary.

## Performance

Underlying profit for the year to March 2015 has increased by £139.0m to £1,398.1m (12 months to March 2014: £1,259.1m; 15 months to March 2014: £1,523.2m). Although net interest income has reduced due to the shrinking Balance Sheet, profits have increased primarily due to a lower loan impairment charge, mainly supported by the continued improvements in the level of arrears and lower losses as the result of rising house prices.

For the year to March 2015 underlying net operating income has decreased by £78.0m to £1,408.3m (12 months to March 2014: £1,486.3m; 15 months to March 2014: £1,846.9m) due to lower income from the reducing Balance Sheet, partly offset by lower funding costs. Ongoing administrative expenses continue to fall. For the year to March 2015 expenses, excluding £3.0m UKARcs costs, were 7% lower than the previous year at £174.2m (12 months to March 2014: £188.0m; 15 months to March 2014: £244.5m, both excluding £1.8m UKARcs costs). Impairment on loans to customers for the year to March 2015 was a credit of £150.6m, a reduction of £197.2m from the prior year charge (12 months to March 2014: £46.6m charge; 15 months to March 2014: £95.1m charge). Net impairment on investment securities was a £16.4m credit for the year (12 months to March 2014: £9.2m; 15 months to March 2014: £17.7m). The number of mortgage accounts 3 or more months in arrears including possessions reduced by 23% compared to March 2014.

The Board continue to believe it is appropriate to assess performance based on the underlying profits of the business, which excludes the remediation of inherited regulatory defects and certain gains or losses such as the repurchase of our own liabilities at a discount or premium. Whilst these gains or losses permanently impact capital reserves, the Board does not believe that they reflect the performance of the underlying business. Also excluded are movements in fair value and hedge ineffectiveness relating to financial instruments which are expected to be held to maturity. These movements will have no material impact over the life of the associated financial instruments. The commentary on the results in this statement uses underlying profits and its components as the primary measure of performance. An analysis of the difference between the statutory profit and the underlying profit of UKAR is provided below.

For the year to March 2015 statutory profit of £972.3m (12 months to March 2014: £1,113.0m; 15 months to March 2014: £1,374.4m) includes a £295.0m charge for customer redress, which principally relates to a £268.2m provision for an ongoing court case regarding CCA loans over £25k. Please see page 126 for further details.

### Income Statement

| | UKAR | | B&B | | NRAM | |
|---|---|---|---|---|---|---|
| **For the year ended 31 March / 15 months ended 31 March** | **2015** | **2014** | **2015** | **2014** | **2015** | **2014** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| Net interest income | 1,369.0 | 1,830.6 | 477.6 | 511.9 | 891.4 | 1,318.7 |
| Underlying net non-interest income [1,2] | 39.3 | 16.3 | 28.1 | 30.2 | 8.2 | (15.7) |
| **Underlying net operating income** | **1,408.3** | **1,846.9** | **505.7** | **542.1** | **899.6** | **1,303.0** |
| Ongoing administrative expenses [1] | (177.2) | (246.3) | (84.7) | (113.5) | (89.5) | (131.0) |
| Impairment on loans to customers | 150.6 | (95.1) | 80.0 | (78.8) | 70.6 | (16.3) |
| Net impairment on investment securities [3] | 16.4 | 17.7 | 2.0 | 13.9 | 14.4 | 3.8 |
| **Underlying profit before taxation** | **1,398.1** | **1,523.2** | **503.0** | **363.7** | **895.1** | **1,159.5** |
| Unrealised fair value movements on financial instruments | (8.1) | (29.6) | 23.5 | (26.7) | (31.6) | (2.9) |
| Hedge ineffectiveness | (74.9) | (27.6) | (67.8) | (6.3) | (7.1) | (21.3) |
| Provision for customer redress | (295.0) | (115.8) | (10.3) | (14.5) | (284.7) | (101.3) |
| Profit on sale of loans to customers | 22.3 | 21.2 | 15.3 | - | 7.0 | 21.2 |
| (Loss)/gain on repurchase of own liabilities | (70.1) | 2.9 | (50.3) | 2.9 | (19.8) | - |
| **Statutory profit before taxation** | **972.3** | **1,374.3** | **413.4** | **319.1** | **558.9** | **1,055.2** |

*1 UKAR underlying net non-interest income and ongoing administrative expenses include £3.0m in relation to UKARcs (2014: £1.8m).*
*2 Underlying net non-interest income includes net fee and commission income, net realised gains less losses on investment securities and other operating income.*
*3 UKAR numbers include consolidation adjustments.*

# Financial review (continued)

### Net interest income

| For the year ended 31 March / 15 months ended 31 March | UKAR 2015 £m | UKAR 2014 £m | B&B 2015 £m | B&B 2014 £m | NRAM 2015 £m | NRAM 2014 £m |
|---|---|---|---|---|---|---|
| **Interest receivable and similar income** | | | | | | |
| On secured loans | **1,909.1** | 2,714.9 | **738.0** | 1,005.4 | **1,171.1** | 1,709.5 |
| On other lending | **54.3** | 89.6 | **-** | - | **54.3** | 89.6 |
| On investment securities and deposits | **47.4** | 80.0 | **18.9** | 33.3 | **29.8** | 48.2 |
| **Interest receivable and similar income** | **2,010.8** | 2,884.5 | **756.9** | 1,038.7 | **1,255.2** | 1,847.3 |
| **Interest expense and similar charges** | | | | | | |
| On amounts due to banks and HM Treasury | **(402.5)** | (741.9) | **(183.9)** | (418.8) | **(218.6)** | (323.1) |
| State guarantee fee [2] | **(31.2)** | (46.9) | **(31.2)** | (46.9) | **-** | - |
| On debt securities and other | **(208.1)** | (265.1) | **(64.2)** | (61.1) | **(145.2)** | (205.5) |
| **Interest expense and similar charges** | **(641.8)** | (1,053.9) | **(279.3)** | (526.8) | **(363.8)** | (528.6) |
| **Net interest income** | **1,369.0** | 1,830.6 | **477.6** | 511.9 | **891.4** | 1,318.7 |
| **Average balances** | | | | | | |
| Interest-earning assets ('IEA') | **66,376** | 75,489 | **31,746** | 35,021 | **34,630** | 40,469 |
| Financed by: | | | | | | |
| - Interest-bearing funding | **41,313** | 50,805 | **10,162** | 13,619 | **31,151** | 37,186 |
| - Interest-free funding [1] | **25,063** | 24,684 | **21,584** | 21,402 | **3,479** | 3,283 |
| **Average rates %** | **%** | % | **%** | % | **%** | % |
| Gross yield on IEA | **3.03** | 3.07 | **2.38** | 2.38 | **3.62** | 3.66 |
| Cost of interest-bearing funding [2] | **(1.48)** | (1.59) | **(2.44)** | (2.83) | **(1.17)** | (1.14) |
| Interest spread | **1.55** | 1.48 | **(0.06)** | (0.45) | **2.45** | 2.52 |
| State guarantee fee [2] | **(0.05)** | (0.05) | **(0.10)** | (0.11) | **-** | - |
| Contribution of interest-free funding [1] | **0.56** | 0.52 | **1.66** | 1.73 | **0.12** | 0.09 |
| **Net interest margin on average IEA** | **2.06** | 1.95 | **1.50** | 1.17 | **2.57** | 2.61 |
| **Annual average Bank Base Rate** | **0.50** | 0.50 | **0.50** | 0.50 | **0.50** | 0.50 |
| **Annual average 1-month LIBOR** | **0.50** | 0.49 | **0.50** | 0.49 | **0.50** | 0.49 |
| **Annual average 3-month LIBOR** | **0.55** | 0.51 | **0.55** | 0.51 | **0.55** | 0.51 |

*1 Interest-free funding is calculated as an average over the financial period, and includes the Statutory Debt and share capital and reserves.*
*2 At the time of the nationalisation of B&B, HM Treasury provided a guarantee with regard to certain wholesale borrowings and derivative transactions existing at that time. The amount of this fee is dependent on balances outstanding and hence it is included within 'interest expense and similar charges. The cost of interest-bearing funding is shown excluding this state guarantee fee.*

Net interest income for the year to March 2015 was £1,369.0m (12 months to March 2014: £1,469.2m; 15 months to March 2014: £1,830.6m). Across both books there was a reduction in income due to the decrease in average interest-earning assets over the year. However, this impact was partly offset by the improving funding mix on the B&B Balance Sheet as the Working Capital Facility ('WCF') was repaid.

Underlying net interest margin for the year to March 2015 has increased to 2.06% at UKAR level from 1.95% in the 15 months to March 2014 (12 months to March 2014: 1.98%).

On the B&B book the underlying net interest margin increased 0.33% to 1.50%, primarily due to reducing funding costs as the relatively expensive WCF is repaid. The WCF interest rate of Bank Base Rate + 500bps is in excess of the average yield on interest earning assets of 2.38%. Over the past two years, the cost of interest-bearing funding has fallen significantly as the WCF balance has reduced and is now 2.44% (15 months to March 2014: 2.83%; 2012: 3.49%). Without the benefit of the Statutory Debt being interest-free, B&B would be loss making.

# Financial review (continued)

### Net interest income (continued)

In NRAM, the net interest margin decreased to 2.57% from 2.61%, mainly due to the proceeds from the sale of mortgage assets being held in a low interest account with the Government Banking Service. These proceeds were utilised for the repurchase of a Covered Bond in May 2015.

### Underlying net non-interest income

Underlying net non-interest income increased by £22.2m to £39.3m in the year to March 2015 (12 months to March 2014: £17.1m; 15 months to March 2014: £16.3m), primarily due to net realised gains on investment securities and other operating income, partly offset by lower redemption and arrears fee income. The 12 months to March 2014 and 15 months to March 2014 other operating income includes the profits from the sale and leaseback of Doxford (Sunderland) properties (£7.3m) and the current year includes the profits from the sale and leaseback of the Crossflatts (West Yorkshire) property (£9.6m).

Other operating income includes £3.0m for UKARcs, which reflects the reimbursement by HM Treasury of the costs associated with administering the Help to Buy: mortgage guarantee scheme.

### Net non-interest income

| | UKAR | | B&B | | NRAM | | UKARcs | |
|---|---|---|---|---|---|---|---|---|
| **For the year ended 31 March / 15 months ended 31 March** | **2015 £m** | **2014 £m** | **2015 £m** | **2014 £m** | **2015 £m** | **2014 £m** | **2015 £m** | **2014 £m** |
| Total net fee and commission income | **10.5** | 17.9 | **11.8** | 17.8 | **(1.3)** | 0.1 | **-** | - |
| Net realised gains less losses on investment securities | **12.8** | (12.5) | **4.5** | 11.6 | **8.3** | (24.1) | **-** | - |
| Other operating income | **16.0** | 10.9 | **11.8** | 0.8 | **1.2** | 8.3 | **3.0** | 1.8 |
| **Underlying net non-interest income** | **39.3** | 16.3 | **28.1** | 30.2 | **8.2** | (15.7) | **3.0** | 1.8 |
| Unrealised fair value movements on financial instruments | **(8.1)** | (29.6) | **23.5** | (26.7) | **(31.6)** | (2.9) | **-** | - |
| Hedge ineffectiveness | **(74.9)** | (27.6) | **(67.8)** | (6.3) | **(7.1)** | (21.3) | **-** | - |
| Provision for customer redress | **(295.0)** | (115.8) | **(10.3)** | (14.5) | **(284.7)** | (101.3) | **-** | - |
| **Statutory net non-interest income** | **(338.7)** | (156.7) | **(26.5)** | (17.3) | **(315.2)** | (141.2) | **3.0** | 1.8 |

### Accounting volatility on derivative financial instruments

NRAM and B&B use derivative financial instruments for economic hedging purposes. Most of these are designated and accounted for as IAS 39 'Financial Instruments: Recognition and Measurement' compliant fair value or cash flow hedge relationships. Where effective hedge relationships can be established, the movement in the fair value of the derivative is offset in full or in part either by opposite movements in the fair value of the instrument being hedged or by being taken to reserves. Any ineffectiveness arising from different movements in fair value will offset over the life of the hedge relationship.

The Income Statement charge for hedge ineffectiveness was £74.9m in the year (12 months to March 2014: £18.2m; 15 months to March 2014: £27.6m). The increased charge in the year was due to the early termination of a number of derivatives that were no longer required, as the latest projections indicated that the B&B Lifetime mortgage portfolio was overhedged.

Unrealised fair value movements were a net loss of £8.1m in the year (12 months to March 2014: loss of £33.3m; 15 months to March 2014: loss of £29.6m). These losses generally relate to derivatives that act as an economic hedge but were not treated as an accounting hedge under IAS 39.

### Provision for customer redress

UKAR defines conduct risk as the risk of UKAR treating its customers unfairly and delivering inappropriate outcomes leading to customer detriment or impacting market integrity. Since the creation of UKAR we have been remediating a series of conduct issues inherited from the legacy businesses, including the mis-selling of Payment Protection Insurance ('PPI') by Northern Rock and the issue of non-compliant CCA loan documentation to certain customers.

# Financial review (continued)

### Provision for customer redress (continued)

In December the High Court ruled that customers with loans over £25,000, who had incorrectly been sent documentation stating that their loans were regulated under the Consumer Credit Act ('CCA'), should receive remediation in line with that provided in 2012 on CCA loans of less than £25,000. Therefore, a charge of £268m has been recognised in the year. However, NRAM has sought clarification of this decision through the Court of Appeal and we are waiting for the outcome to be announced. Should this appeal be successful, this charge will be reversed.

UKAR remain committed to doing the right thing for our customers and where we identify issues that have caused customer detriment, we will ensure that they are fully remediated. Apart from the charge relating to CCA regulated loans noted above, a further charge of £26.8m for customer redress has been made during the year to address inherited issues. We continue to receive PPI complaints although the flow has reduced considerably and a further £33m has been allocated to this provision to meet anticipated claims over the next three years, however, this has been partly offset by the release of provisions for other previously identified issues that had been over-estimated.

### Ongoing administrative expenses

Costs for the year include £3.0m for UKARcs relating to the provision of administrative support to the government's mortgage guarantee scheme (12 months to March 2014: £1.8m; 15 months to March 2014: £1.8m). These costs were fully reimbursed by HM Treasury.

The Group has continued to focus on maximising cost effectiveness and efficiency through continuous improvement. Ongoing administrative expenses for the year were £177.2m (12 months to March 2014: £189.8m; 15 months to March 2015: £246.3m) which, when excluding UKARcs costs, is 7% lower. The transfer of our IT infrastructure to HCL Technologies ('HCL') was completed last year with the current year benefiting from a full year of IT costs at the lower run rate. Other cost reductions have been achieved as the size of the Balance Sheet reduces.

### Administrative expenses

| | UKAR | | B&B | | NRAM | | UKARcs | |
|---|---|---|---|---|---|---|---|---|
| For the year ended 31 March / 15 months ended 31 March | 2015 £m | 2014 £m | 2015 £m | 2014 £m | 2015 £m | 2014 £m | 2015 £m | 2014 £m |
| Wages and salaries | **58.6** | 71.3 | **58.6** | 71.3 | **-** | - | **-** | - |
| Social security costs | **5.9** | 7.4 | **5.9** | 7.4 | **-** | - | **-** | - |
| Defined benefit pension costs | **(4.3)** | (0.8) | **(0.6)** | 2.4 | **(3.7)** | (3.2) | **-** | - |
| Defined contribution pension costs | **4.1** | 4.2 | **4.1** | 4.2 | **-** | - | **-** | - |
| Other retirement benefit costs | **0.4** | 0.6 | **0.4** | 0.6 | **-** | - | **-** | - |
| **Total staff costs** | **64.7** | 82.7 | **68.4** | 85.9 | **(3.7)** | (3.2) | **-** | - |
| IT costs | **35.0** | 63.0 | **33.2** | 60.8 | **1.7** | 2.2 | **0.1** | - |
| Outsourced and professional services | **19.6** | 30.4 | **14.9** | 22.6 | **3.8** | 7.5 | **0.9** | 0.3 |
| Depreciation and amortisation | **16.8** | 19.4 | **15.7** | 18.4 | **0.5** | 0.8 | **0.6** | 0.2 |
| Management recharge to NRAM / UKARcs | **-** | - | **(80.8)** | (110.0) | **79.6** | 109.4 | **1.2** | 0.6 |
| Other administrative expenses | **41.1** | 50.8 | **33.3** | 35.8 | **7.6** | 14.3 | **0.2** | 0.7 |
| **Total administrative expenses** | **177.2** | 246.3 | **84.7** | 113.5 | **89.5** | 131.0 | **3.0** | 1.8 |

# Financial review (continued)

### Arrears and loan impairment: residential and unsecured loans

Total UKAR loan impairment provisions as at 31 March 2015 were £1,169.8m (2014: £1,457.4m) comprising residential mortgages £888.0m (2014: £1,151.8m), unsecured loans £205.1m (2014: £214.7m) and commercial property of £76.7m (2014: £90.9m).

### Arrears and possessions

| At 31 March | | UKAR | | | |
|---|---|---|---|---|---|
| | | 2015 | | 2014 | |
| | | Residential | Unsecured | Residential | Unsecured |
| **Arrears 3 months and over** | | | | | |
| Number of cases | No. | **11,005** | **8,877** | 14,139 | 10,445 |
| Proportion of total accounts | % | **2.43** | **8.38** | 2.68 | 8.76 |
| Asset value | £m | **1,575.5** | **147.8** | 2,067.5 | 172.7 |
| Proportion of book | % | **3.09** | **13.92** | 3.48 | 13.47 |
| Total value of payments overdue | £m | **62.8** | **26.3** | 84.3 | 23.0 |
| Proportion of total book | % | **0.12** | **2.48** | 0.14 | 1.80 |
| **Possessions** | | | | | |
| Number of cases | No. | **971** | **-** | 1,344 | - |
| Proportion of total accounts | % | **0.21** | **-** | 0.25 | - |
| Asset value | £m | **133.9** | **-** | 199.0 | - |
| Proportion of book | % | **0.26** | **-** | 0.34 | - |
| Total value of payments overdue | £m | **8.8** | **-** | 14.0 | - |
| Proportion of total book | % | **0.02** | **-** | 0.02 | - |
| New possessions | No. | **2,856** | **-** | 6,996 | - |
| **Total arrears 3 months and over and possessions** | | | | | |
| Number of cases | No. | **11,976** | **8,877** | 15,483 | 10,445 |
| Proportion of total accounts | % | **2.64** | **8.38** | 2.93 | 8.76 |
| Asset value | £m | **1,709.4** | **147.8** | 2,266.5 | 172.7 |
| Proportion of book | % | **3.35** | **13.92** | 3.82 | 13.47 |
| Total value of payments overdue | £m | **71.6** | **26.3** | 98.3 | 23.0 |
| Proportion of total book | % | **0.14** | **2.48** | 0.16 | 1.80 |
| **Payments overdue** | | | | | |
| Total value of payments overdue | £m | **90.6** | **26.8** | 121.2 | 23.8 |
| Proportion of total book | % | **0.18** | **2.53** | 0.20 | 1.86 |
| **Loan impairment provision** | | | | | |
| As % of total balances | % | **1.71** | **16.20** | 1.90 | 14.35 |

# Financial review (continued)

### Arrears and possessions (continued)

| | | B&B | | NRAM | | | |
|---|---|---|---|---|---|---|---|
| At 31 March | | 2015 | 2014 | 2015 | | 2014 | |
| | | Residential | Residential | Residential | Unsecured | Residential | Unsecured |
| **Arrears 3 months and over** | | | | | | | |
| Number of cases | No. | **3,144** | 3,739 | **7,861** | **8,877** | 10,400 | 10,445 |
| Proportion of total accounts | % | **1.37** | 1.43 | **3.49** | **8.38** | 3.87 | 8.76 |
| Asset value | £m | **440.0** | 528.7 | **1,135.5** | **147.8** | 1,538.8 | 172.7 |
| Proportion of book | % | **1.64** | 1.78 | **4.70** | **13.92** | 5.20 | 13.47 |
| Total value of payments overdue | £m | **12.5** | 15.3 | **50.3** | **26.3** | 69.0 | 23.0 |
| Proportion of total book | % | **0.05** | 0.05 | **0.21** | **2.48** | 0.23 | 1.80 |
| **Possessions** | | | | | | | |
| Number of cases | No. | **381** | 435 | **590** | **-** | 909 | - |
| Proportion of total accounts | % | **0.17** | 0.17 | **0.26** | **-** | 0.34 | - |
| Asset value | £m | **54.6** | 63.8 | **79.3** | **-** | 135.2 | - |
| Proportion of book | % | **0.20** | 0.21 | **0.33** | **-** | 0.46 | - |
| Total value of payments overdue | £m | **2.4** | 3.2 | **6.4** | **-** | 10.8 | - |
| Proportion of total book | % | **0.01** | 0.01 | **0.03** | **-** | 0.04 | - |
| New possessions | No. | **958** | 1,987 | **1,898** | **-** | 5,009 | - |
| **Total arrears 3 months and over and possessions** | | | | | | | |
| Number of cases | No. | **3,525** | 4,174 | **8,451** | **8,877** | 11,309 | 10,445 |
| Proportion of total accounts | % | **1.54** | 1.60 | **3.75** | **8.38** | 4.21 | 8.76 |
| Asset value | £m | **494.6** | 592.5 | **1,214.8** | **147.8** | 1,674.0 | 172.7 |
| Proportion of book | % | **1.84** | 1.99 | **5.03** | **13.92** | 5.66 | 13.47 |
| Total value of payments overdue | £m | **14.9** | 18.5 | **56.7** | **26.3** | 79.8 | 23.0 |
| Proportion of total book | % | **0.06** | 0.06 | **0.24** | **2.48** | 0.27 | 1.80 |
| **Payments overdue** | | | | | | | |
| Total value of payments overdue | £m | **19.3** | 23.7 | **71.3** | **26.8** | 97.5 | 23.8 |
| Proportion of total book | % | **0.07** | 0.08 | **0.30** | **2.53** | 0.33 | 1.86 |
| **Loan impairment provision** | | | | | | | |
| As % of total balances | % | **1.82** | 1.99 | **1.58** | **16.20** | 1.82 | 14.35 |

### Arrears and loan impairment: residential loans

UKAR adheres to the FCA's regulatory guidance regarding Treating Customers Fairly and continues to work closely with customers experiencing, or likely to experience, financial difficulty in maintaining their mortgage payments. UKAR offers a range of measures to support these customers depending upon their individual circumstances and ability to pay with the long term aim of sustaining their mortgage commitments and remaining in their homes. Possession continues to be a last resort.

# Financial review (continued)

### Arrears and loan impairment: residential loans (continued)

Strong arrears performance continues. UKAR has seen arrears in both companies fall as a direct consequence of proactive arrears management coupled with the continued low interest rate environment. The total number of cases 3 or more months in arrears, including those in possession, reduced by 23% from 15,483 at 31 March 2014 to 11,976 at 31 March 2015. The total value of payments overdue by residential customers has reduced from £121.2m at 31 March 2014 to £90.6m at 31 March 2015 equivalent to 0.18% of mortgage balances (2014: 0.20%).

Provisions for residential loan impairment held on the Balance Sheet have reduced by £263.8m since 31 March 2014 to £888.0m (2014: £1,151.8m) reflecting realised losses, the reduction in arrears cases and the benefit of improving house prices.

Included within the above, fraud and professional negligence provisions have decreased by £68.6m since 31 March 2014 to £252.7m (2014: £321.3m) as a result of write-offs following the sale of properties and the impact of reducing the level of provisions across a number of portfolios as valuations benefit from improving house prices. Total UKAR fraud provisions represent coverage of 39% of suspected fraud and professional negligence cases (2014: 45%). Within the B&B book, fraud and professional negligence provisions have reduced since 31 March 2014 by £55.2m to £209.8m (2014: £265.0m). In the NRAM book, fraud and professional negligence provisions have reduced by £13.4m to £42.9m (2014: £56.3m).

As a proportion of balances, the residential impairment provision was 1.71% (2014: 1.90%). The residential loan impairment credit was £170.4m for the year (2014: £52.8m charge). The reduction in the charge results from lower arrears volumes and the benefit of improving house prices.

The number of properties in possession for UKAR decreased from 1,344 at 31 March 2014 to 971 at 31 March 2015. Within B&B, possession stock decreased from 435 cases at 31 March 2014 to 381 at 31 March 2015. In NRAM possession stock reduced to 590 cases from 909 at 31 March 2014. A total of 2,856 properties were taken into possession in the year (12 months to March 2014: 5,046; 15 months to March 2014: 6,996).

In addition to residential property possessions, there are also a number of buy-to-let properties within B&B managed by Law of Property Act ('LPA') receivers. The LPA 'for sale' stock decreased from 369 cases at 31 March 2014 to 240 at 31 March 2015.

During the year, 3,229 cases (12 months to March 2014: 6,066; 15 months to March 2014: 7,857) were sold following possession and a further 363 cases (12 months to March 2014: 291; 15 months to March 2014: 367) were sold which were under LPA management. Total realised losses on properties sold following possession or sold by an LPA were £154.2m (12 months to March 2014: £282.4m; 15 months to March 2014: £374.1m), all of which had previously been fully provided for. Within these losses £28.0m were fraudulent and professional negligence cases (12 months to March 2014: £39.3m; 15 months to March 2014: £53.2m).

### Arrears and loan impairment: unsecured loans

The number of unsecured loans 3 months or more in arrears was 8,877 cases (2014: 10,445). The charge for unsecured loan impairment for the year was £22.7m, £1.5m higher than the prior year (12 months to March 2014: £21.2m; 15 months to March 2014: £36.4m). Asset coverage was 16.20% at 31 March 2015 (2014: 14.35%).

The provision for unsecured loans was £205.1m at 31 March 2015 (2014: £214.7m). Realised losses in the year were £32.3m (12 months to March 2014: £60.9m; 15 months to March 2014: £82.2m) all of which had previously been fully provided for.

### Arrears and loan impairment: commercial loan book

The provision for the commercial book has decreased to £76.7m from £90.9m at 31 March 2014, with coverage at 12.51% (2014: 12.73%). We continually review the level of provisions against each individual loan based on current and future property valuations, future rental income projections, tenant quality and general market conditions.

### Net impairment release on investment securities

UKAR continues to review securities held on the Balance Sheet and believes the risk of further impairment is not significant. During the financial year we have identified a number of assets in both B&B and NRAM where events have occurred that caused us to reverse impairments previously charged. These have resulted in a net credit to impairment in the year of £16.4m (12 months to March 2014: £9.2m; 15 months to March 2014: £17.7m).

# Financial review (continued)

### Profit on sale of loans to customers

In the year to March 2015, UKAR sold a portfolio of mortgages for £2.7bn. The portfolio was sold via a competitive sales process which saw a high level of interest resulting in a sale price in excess of par and a premium in the region of £55m, which when adjusted for costs, hedging impacts and margins between May and the October completion date gave an accounting profit on disposal of £18.3m. In addition, a further £4.0m relating to warranty provisions on historic transactions was released.

### Loss on repurchase of own liabilities

In the year to March 2015, B&B and NRAM repurchased £708.6m (12 months to March 2014: £nil; 15 months to March 2014: £5.3m) of their liabilities yielding £77.2m of net pre-tax losses (12 months to March 2014: £nil; 15 months to March 2014: £2.9m gain), £70.1m of which is recognised in statutory profit with the balance being recognised in reserves. The liabilities repurchased included subordinated debt which was bought back at a price greater than par. Whilst this resulted in a net loss within the year, the transaction creates value for the taxpayer by removing significant future liabilities as a large portion of this debt attracted compounding interest, simplifies our Balance Sheet and increases our ability to deliver future transactions to the benefit of the taxpayer.

### Taxation

The total Income Statement tax charge for the year ended 31 March 2015 was £200.7m (12 months to March 2014: £243.3m; 15 months to March 2014: £308.3m). Given the statutory profit before taxation of £972.3m (12 months to March 2014: £1,113.0m; 15 months to March 2014: £1,374.3m) this equates to an effective tax rate of 20.6% (12 months to March 2014: 21.9%; 15 months to March 2014: 22.4%).

## Balance Sheet

### Balance Sheet summary

| | UKAR | | B&B | | NRAM | |
|---|---|---|---|---|---|---|
| **At 31 March** | **2015** | **2014** | **2015** | **2014** | **2015** | **2014** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| Loans to customers: | | | | | | |
| - residential mortgages | **51,085.1** | 59,344.6 | **26,916.1** | 29,758.0 | **24,169.0** | 29,586.6 |
| - commercial loans | **536.3** | 623.0 | **399.6** | 454.8 | **136.7** | 168.2 |
| - unsecured lending | **1,061.1** | 1,281.9 | **-** | - | **1,061.1** | 1,281.9 |
| Wholesale assets | **9,705.8** | 8,598.2 | **2,863.7** | 3,051.5 | **6,945.3** | 5,663.3 |
| Fair value adjustments on portfolio hedging | **467.7** | 308.8 | **414.5** | 223.0 | **53.2** | 85.8 |
| Derivative financial instruments | **2,962.7** | 4,616.2 | **877.2** | 1,569.6 | **2,085.5** | 3,046.6 |
| Other assets | **323.6** | 167.3 | **161.1** | 97.7 | **173.4** | 89.2 |
| **Total assets** | **66,142.3** | 74,940.0 | **31,632.2** | 35,154.6 | **34,624.2** | 39,921.6 |
| Statutory Debt and HM Treasury loans | **34,619.4** | 38,350.5 | **20,963.3** | 23,415.3 | **13,656.1** | 14,935.2 |
| Wholesale funding | **23,132.5** | 29,005.2 | **6,757.4** | 8,212.9 | **16,480.4** | 20,912.5 |
| Derivative financial instruments | **570.0** | 446.0 | **499.1** | 331.9 | **70.9** | 114.1 |
| Other liabilities | **750.2** | 582.0 | **215.9** | 220.4 | **543.0** | 378.3 |
| Other capital instruments | **17.1** | 215.3 | **7.8** | 159.1 | **9.3** | 56.2 |
| Equity | **7,053.1** | 6,341.0 | **3,188.7** | 2,815.0 | **3,864.5** | 3,525.3 |
| **Total equity and liabilities** | **66,142.3** | 74,940.0 | **31,632.2** | 35,154.6 | **34,624.2** | 39,921.6 |

The Balance Sheet has decreased by £8.8bn to £66.1bn from £74.9bn since March 2014.

Lending balances have reduced by £8.5bn (14.0%) to £52.7bn during the year to March 2015 due to £5.3bn of secured residential redemptions, £0.1bn of commercial redemptions, £0.1bn of unsecured loan redemptions and £0.3bn of other regular repayments. In addition, residential mortgages totalling £2.7bn were sold during the year.

# Financial review (continued)

### Liabilities

Statutory Debt and HM Treasury loans (excluding accrued interest) have reduced by £3.7bn to £34.6bn (2014: £38.3bn) due to repayments of principal in the year (NRAM: £1.3bn, B&B: £2.4bn). UKAR did not draw down any facility during the year. In addition, £5.9bn of other external wholesale funding was repaid in the year.

### Cash repayments

Repayment of the Statutory Debt and HM Treasury loans remains a primary objective of UKAR. In the year a further £3.7bn (12 months to March 2014: £4.6bn; 15 months to March 2014: £5.1bn) of HM Treasury debt was repaid. In addition, £0.7bn of other cash flows were generated for HM Treasury in the form of state guarantee fees, interest and taxes. The Board considers the total of all these cash flows paid to HM Treasury to be an important measure. Total cash payments in the year to HM Treasury were £4.4bn (12 months to March 2014: £5.6bn; 15 months to March 2014: £6.2bn). The reduction in the repayment of debt and other cash flows to HM Treasury is primarily due to cash being accumulated to repay a £1.0bn Covered Bond maturity in 2015 and a further £0.8bn used to repurchase third party debt.

## Capital

UKAR operates under a MIPRU regulatory status. While FCA rules require the regulated companies within the Group to hold capital in excess of 1% of total Balance Sheet assets plus any undrawn commitments, the Board believes it appropriate to hold a higher level of capital reflecting the increased risk in the business compared to a standard MIPRU firm. As at 31 March 2015 capital in B&B plc represented 7.7% of B&B Company assets and NRAM plc capital represented 10.6% of NRAM Company assets.

The Group's capital is provided by its shareholder (currently HM Treasury).

The regulated Group companies met their capital requirements in full throughout the year and have received no additional capital from HM Treasury.

### Capital resources - B&B plc

| | 2015 | 2014 |
|---|---|---|
| At 31 March | £m | £m |
| Share capital and reserves | **3,008.9** | 2,740.2 |
| Available-for-sale reserve adjustments | **(26.7)** | (25.8) |
| Cash flow hedge reserve adjustments | **(43.0)** | (56.9) |
| Net pension adjustment | **(85.7)** | - |
| Less: deductions [1] | **(512.7)** | (515.1) |
| **Tier 1 capital** | **2,340.8** | 2,142.4 |
| Capital instruments | **-** | 81.8 |
| **Total capital** | **2,340.8** | 2,224.2 |

*1 The deduction from B&B plc capital resources comprises £475.0m for the company's investment in MX and £37.7m for intangible assets.*

# Financial review (continued)

## Capital (continued)

### Capital resources - NRAM plc

| | 2015 | 2014 |
|---|---|---|
| At 31 March | £m | £m |
| Share capital and reserves | **3,864.5** | 3,337.2 |
| Available-for-sale reserve adjustments | **24.6** | 29.9 |
| Cash flow hedge reserve adjustments | **(194.1)** | (156.8) |
| Net pension adjustment | **(151.9)** | (65.3) |
| Reserve capital instruments | **-** | 101.4 |
| Tier one notes | **-** | 40.9 |
| Withheld coupons | **-** | 71.8 |
| Less: deductions [1] | **(0.7)** | (1.0) |
| **Tier 1 capital** | **3,542.4** | 3,358.1 |
| Subordinated notes | **-** | 23.4 |
| **Total capital** | **3,542.4** | 3,381.5 |

*1 The deduction from NRAM plc capital resources of £0.7m is primarily for intangible assets.*

B&B plc total capital resources of £2,340.8m are £116.6m higher than 2014, due to profits generated in the year, partly offset by the repurchase and cancellation of capital instruments.

NRAM plc total capital resources of £3,542.4m are £160.9m higher than 2014, mainly due to profits generated in the year, partly offset by the repurchase and cancellation of capital instruments.

# Key performance indicators ('KPIs') - B&B

In addition to the primary Financial Statements, we have adopted the following KPIs in managing business performance in the context of its strategic priorities.

| Strategic priorities | Financial measures | 12 months to 31 March 2015 | 12 months to 31 March 2014 | 15 months to 31 March 2014 | Commentary |
|---|---|---|---|---|---|
| Optimise the Balance Sheet | Total lending balances £bn | 27.3 | 30.2 | 30.2 | Lending balances reduced by 9.6% during the year primarily due to £1.9bn of residential redemptions. In addition, £1.0bn of residential mortgages were sold during the year. |
| | Residential mortgage redemption rate %<br>Residential redemptions £bn | 6.3<br>1.9 | 5.0<br>1.6 | 4.7<br>1.9 | Redemption rates have increased compared to 2014 reflecting increases in house prices and improved levels of remortgage activity across the market. |
| | Government loan repayments £bn<br>Government loan balance £bn | 2.4<br>21.0 | 1.8<br>23.4 | 2.0<br>23.4 | No drawdowns were made in the year from the WCF arranged with HM Treasury. The balance of £2.5bn, excluding accrued interest, is within the £11.5bn maximum facility level currently agreed with HM Treasury. Repayments of £2.4bn were made in the year against the WCF. No payments were made against the Statutory Debt and the balance remains at £18.4bn at 31 March 2015. |
| | Total cash payments to HM Treasury £bn | 2.8 | 2.2 | 2.5 | Total cash paid to HM Treasury during the year. This includes principal and interest repayments, State guarantee fees and corporation tax paid. The main driver of the increase is the higher principal repayment. |
| Minimise impairment and losses | Residential arrears balance: total residential mortgage balance %<br>Residential payments overdue £m | 0.07<br>19.3 | 0.08<br>23.7 | 0.08<br>23.7 | This represents the value of customers' missed payments as a proportion of the total balance of all residential mortgages and the reduction to 0.07% reflects that the level of overdue debt owed on mortgages is falling faster than the book. |
| | Residential arrears 3 months and over and possessions as % of the book:<br>- by value<br>- by number of accounts<br>Number of residential arrears 3 months and over and possessions cases | <br>1.84<br>1.54<br>3,525 | <br>1.99<br>1.60<br>4,174 | <br>1.99<br>1.60<br>4,174 | The reduction in arrears reflects both our continued focus on customers in financial difficulty and the continuing support provided to mortgage customers by low interest rates. |
| | Impairment provisions:<br>Residential secured £m<br>Cover %<br>Commercial / other £m<br>Cover % | <br>499.5<br>1.82<br>60.8<br>13.21 | <br>602.8<br>1.99<br>63.0<br>12.17 | <br>602.8<br>1.99<br>63.0<br>12.17 | The level of the residential impairment Balance Sheet provision reduced by £103.3m and the level of cover reduced to 1.82%. The level of the commercial impairment provision decreased by £2.2m and the level of cover increased by 1.04%. |
| Reduce costs | Ongoing costs £m<br>Ratio of costs to average interest-earning assets:<br>- ongoing % | 84.7<br><br>0.27 | 86.2<br><br>0.25 | 113.5<br><br>0.26 | Ongoing costs have reduced reflecting a full year benefit of lower IT costs following the transfer of our IT infrastructure to HCL that was completed last year and other cost reductions as the size of the Balance Sheet reduces. The ratio of costs to average interest-earning assets has remained broadly in line with the prior year. |

# Key performance indicators ('KPIs') - NRAM

In addition to the primary Financial Statements, we have adopted the following KPIs in managing business performance in the context of its strategic priorities.

| Strategic priorities | Financial measures | 12 months to 31 March 2015 | 12 months to 31 March 2014 | 15 months to 31 March 2014 | Commentary |
|---|---|---|---|---|---|
| Optimise the Balance Sheet | Total lending balances £bn<br>Secured £bn<br>Unsecured £bn | 25.4<br>24.3<br>1.1 | 31.0<br>29.8<br>1.3 | 31.0<br>29.8<br>1.3 | Lending balances reduced by 18.3% during the year due to £3.5bn of residential redemptions, £0.1bn of unsecured loan redemptions and £0.3bn of other capital repayments. In addition, £1.7bn of residential mortgages were sold during the year. |
| | Residential mortgage redemption rate %<br>Residential redemptions £bn | 11.7<br>3.5 | 9.8<br>3.4 | 9.3<br>4.0 | Redemption rates have increased compared to 2014 reflecting increases in house prices and improved levels of remortgage activity across the market. |
| | Government loan repayments £bn<br>Government loan balance £bn | 1.3<br>13.6 | 2.9<br>14.9 | 3.1<br>14.9 | During the year, £1.3bn was repaid against the NRAM government loan. |
| | Total cash payments to HM Treasury £bn | 1.6 | 3.4 | 3.7 | Total cash paid to HM Treasury during the year. This includes principal and interest repayments, State guarantee fees and corporation tax paid. The main drivers of the decrease are the build up of cash ahead of the maturity of other wholesale funding in 2015 and cash used to repurchase third party debt. |
| Minimise impairment and losses | Residential arrears balance: total residential mortgage balance %<br>Residential payments overdue £m | 0.30<br>71.3 | 0.33<br>97.5 | 0.33<br>97.5 | This represents the value of customers' missed payments as a proportion of the total balance of all residential mortgages and the reduction to 0.30% reflects that the level of overdue debt owed on mortgages is falling faster than the book. |
| | Residential arrears 3 months and over and possessions as % of the book:<br>- by value<br>- by number of accounts<br>Number of residential arrears 3 months and over and possessions cases | <br>5.03<br>3.75<br>8,451 | <br>5.66<br>4.21<br>11,309 | <br>5.66<br>4.21<br>11,309 | The reduction in arrears reflects both our continued focus on customers in financial difficulty and the continuing support provided to mortgage customers by low interest rates. |
| | Impairment provisions:<br>Residential secured £m<br>Cover %<br>Unsecured £m<br>Cover %<br>Commercial / other £m<br>Cover % | <br>388.5<br>1.58<br>205.1<br>16.20<br>15.9<br>10.40 | <br>549.0<br>1.82<br>214.7<br>14.35<br>27.9<br>14.23 | <br>549.0<br>1.82<br>214.7<br>14.35<br>27.9<br>14.23 | The level of the residential impairment Balance Sheet provision reduced by £160.5m and the level of cover decreased from 1.82% to 1.58% due to the improved arrears performance and improving house prices. |
| Reduce costs | Ongoing costs £m<br>Ratio of costs to average interest-earning assets:<br>- ongoing % | 89.5<br><br>0.26 | 101.8<br><br>0.26 | 131.0<br><br>0.26 | Ongoing costs have reduced reflecting a full year benefit of lower IT costs following the transfer of our IT infrastructure to HCL that was completed last year and other cost reductions as the size of the Balance Sheet reduces. The ratio of costs to average interest-earning assets has remained broadly in line with the prior year. |

# Risk management and control

Pages 69 to 74 form an integral part of the audited Financial Statements

## Introduction

In accordance with the requirements of the Framework Document which is referred to on page 20, the Group's approach to risk management is built on formal governance processes and relies on individual responsibility and collective oversight, informed by comprehensive reporting.

The following sections describe the Group's approach to risk management, including the risk governance structure and principal risk categories under management. Other than the risks described here, there are other factors which could also affect the Group's results, including economic factors. Therefore, the categories of risk described below should not be considered to represent all of the potential risks and uncertainties which could impact the Group's performance.

## Risk governance

The responsibility for the strategy and approach to risk governance and management lies with the Board. The Board is responsible for determining risk strategy, setting risk appetite and reviewing the effectiveness of risk and control processes in support of the Group's strategy. The Board is also responsible for establishing a clearly defined risk management structure with distinct roles and responsibilities. Under that structure, Internal Audit provides 'third line of defence' challenge and review of the management of risks and the adequacy and effectiveness of controls within the business. Management committees and the Risk Function provide 'second line of defence' oversight, challenge and review. Line managers have 'first line of defence' responsibility for the identification, measurement and management of the risks within their business areas.

The management of the risk framework, including oversight and challenge to the business on the effectiveness of its risk management activity and reporting of strategic, operational, conduct, regulatory and financial risk, is performed by specialist teams in the Risk Function. Second line of defence monitoring of the risk management framework is also performed by the Risk Function.

## Management committees

The management committees, under the authority delegated by the Board are described below:

### Executive Committee ('ExCo')

ExCo is an advisory committee which supports the CEO in managing the business to achieve its strategic objectives. ExCo will normally meet three times each month with a specific focus to each meeting of either a) Customers and Conduct, b) Change, or c) Board reporting.

The following are sub-committees of ExCo:

- Investment Advisory Committee ('IAC')
- Remediation Steering Committee ('RSC')
- Executive Risk Committee ('ERC')

Other management committees include: Health & Safety Committee, Treating Customers Fairly Management Committee and the Customer Steering Group.

### Investment Advisory Committee

The IAC supports, advises and makes recommendations to ExCo on the development and subsequent execution of proactive strategies that balance reduction of the UKAR Balance Sheet with the maximisation of taxpayer value.

### Remediation Steering Committee

The RSC supports ExCo in effectively executing its obligations of ensuring fair and timely remediation to customers in circumstances where customer redress is appropriate. This includes providing oversight and challenge of the delivery of customer remediation or redress activities across the Group.

# Risk management and control (continued)

Pages 69 to 74 form an integral part of the audited Financial Statements

## Management committees (continued)

### Executive Risk Committee

The ERC is a management sub-committee of ExCo with a reporting line to the Risk Committee ('RC'). The primary objective of the ERC is to provide technical oversight of key financial and operational risks and governance issues, including the review of the adequacy of risk mitigating actions, costs and capital effectiveness. The Committee supports, advises and makes recommendations to ExCo and the RC.

The following are sub-committees of the ERC:

- Asset & Liability Committee ('ALCO')
- Operational Risk Committee ('ORC')
- Credit Risk Committee ('CRC')
- Fraud & Professional Negligence Committee ('FPNC')

### Asset & Liability Committee

The primary objectives of ALCO are to support and advise the ERC on managing market, liquidity, wholesale credit and capital risk. It does this by recommending risk appetite levels and analysing and reporting exposures to these risks.

### Operational Risk Committee

Principally, ORC supports the ERC in its oversight of the Principal Subsidiaries' adherence to Operational Risk Framework elements including Operational Risk, Financial Crime, Information Security and Business Continuity Management policies and procedures. The Committee provides challenge on the content, accuracy and reliability of operational risk information and reports.

### Credit Risk Committee

The CRC's primary purpose is to review credit policies, procedures and credit related proposals that have a financial impact on the business and to ensure the proposals balance the risk and reward ratio in line with the credit risk appetite set by the Board.

### Fraud & Professional Negligence Committee

The FPNC determines and oversees the implementation of the strategy to mitigate the impacts of fraud and/or professional negligence and ensures that recoveries are maximised. The FPNC supports risk oversight of key fraud and professional negligence matters through reporting into the ERC. During 2015/16 the ERC will assume direct oversight of fraud and professional negligence reporting.

## Risk management oversight

The Risk Function provides oversight and independent challenge to the management of risk across the Group. The Function comprises a team of risk management specialists with responsibility for the embedding and oversight of operational, conduct, financial and strategic risk management, plus analysis and reporting of risk matters to the Board and the Board advisory and management committees. Key functional responsibilities include:

- development of the Enterprise Wide Risk Management Framework ('EWRMF') and policies for the identification, assessment and mitigation of financial, strategic and operational risks;
- provision of support to the Group business line management in the implementation of the EWRMF;
- aggregate analyses and review of risk concentrations and sensitivities across the Principal Subsidiaries;
- acting as a point of reference for risk and control matters, providing advice to management, sharing best practice and carrying out special reviews as directed by the Board, RC, ExCo and sub-committees of ExCo; and
- provision of independent assessment of, and challenge to, the business areas' risk management and profiles to ensure that they are maintained in a robust manner.

# Risk management and control (continued)

Pages 69 to 74 form an integral part of the audited Financial Statements

## Compliance

Compliance is provided through an in-house compliance team which operates in accordance with an RC approved annual compliance plan. The Head of Compliance is approved by the FCA and the RC to undertake this control function.

The role of Compliance is to:

- provide assurance to the Board and ExCo, through the RC, that control processes are in operation to manage all regulatory and conduct risks across the Group;
- contribute to the continuous improvement of regulatory compliance through provision of advice to the Group;
- support Executive management regarding conduct of the business in line with FCA principles and emerging conduct issues; and
- oversee and co-ordinate liaison with the FCA on a day to day basis to promote open and co-operative relationships.

## Internal Audit

Internal Audit activities are outsourced and are provided by Deloitte LLP. Deloitte services include the provision of a seconded Head of Internal Audit. This person is approved for the position by the FCA and the Audit Committee. However, the oversight of the Internal Audit function remains with the Group. The Head of Internal Audit reports to the Chairman of the Audit Committee and to the CEO.

The primary role of Internal Audit is to help the Board and Executive management to protect the assets, reputation and sustainability of the Group. The main objective of the Internal Audit department is to provide reliable, valued and timely assessment to the Board, Audit Committee and Executive management on the effectiveness of the system of internal controls in mitigating current and evolving key risks and in so doing, assist the organisation in enhancing the effectiveness of its approach to risk management.

Business and support activities of the Group are included in the scope of Internal Audit's responsibility and are subject to regular and appropriate internal audit review in accordance with Internal Audit's risk based Audit Plan.

Additional detail is contained in the Audit Committee Chairman's Report on page 47.

## Controls effectiveness

The role of Accounting Officer is held by our CEO, Richard Banks. The Accounting Officer has responsibility for maintaining and reviewing the effectiveness of the system of internal controls. He has confirmed that there were no significant control issues in the year under review.

In addition, in line with the recommendations set out by the Macpherson Report, the Accounting Officer has confirmed that an appropriate QA framework is in place and used for all business critical models. A list of business critical models is maintained and the annual review by the Accounting Officer has confirmed that there were no significant control issues associated with these models during the financial year.

## Risk categorisation

The Group categorises Risk under the following headings:

### (i) Credit risk

Credit risk is the potential for financial loss caused by a retail or commercial customer, or wholesale counterparty, failing to meet their obligations to the Principal Subsidiaries as they become due. As the Principal Subsidiaries are no longer making any new retail loans, the absolute level of retail credit risk is expected to decline as the current assets mature and wholesale credit risk will decline in line with the maturity profile of financial instruments and investments. Credit risk is the largest risk the Principal Subsidiaries face and the monitoring of the recoverability of loans and amounts due from counterparties is inherent across most of the Principal Subsidiaries' activities.

# Risk management and control (continued)

Pages 69 to 74 form an integral part of the audited Financial Statements

## Risk categorisation (continued)

### (i) Credit risk (continued)

The Principal Subsidiaries employ credit behavioural scoring and fraud detection techniques to support loss minimising strategies. As no new lending is now being undertaken, the focus of credit risk activities is on:

- a proactive approach to the identification and control of loan impairment in the residential and commercial credit risk and credit control areas;
- fraud and professional negligence investigation; and
- the use of credit behavioural scoring and other techniques to monitor the risk profile of the existing book.

Adverse changes in the credit quality of borrowers or a general deterioration in UK economic conditions could affect the recoverability and value of the Principal Subsidiaries' assets and therefore the financial performance of each subsidiary.

As credit risk is the main source of risk for the Principal Subsidiaries, a Credit Risk Framework has been established as part of the overall governance framework to measure, mitigate and manage credit risk within risk appetite. To a lesser degree, the Group is exposed to other forms of credit risk such as those arising from settlement activities where the risk is a consequence of a transaction, rather than a driver of it.

The extent to which the impact of credit risk on the Group's Balance Sheet is mitigated is shown by the following table of provisions for mark-downs on impaired assets:

| | Balance Sheet value | Provision | Balance Sheet value | Provision |
|---|---|---|---|---|
| | 2015 | 2015 | 2014 | 2014 |
| At 31 March | £m | £m | £m | £m |
| Loans secured on residential property | 51,085 | 888 | 59,345 | 1,152 |
| Other secured loans | 536 | 77 | 623 | 91 |
| Unsecured personal loans | 1,061 | 205 | 1,282 | 215 |
| Wholesale assets | 9,706 | 381 | 8,598 | 444 |

The Principal Subsidiaries' ability to influence the structure of their credit risk profiles, in the absence of asset sales, is largely restricted to the degree of control which they have over risk strategy, loan redemptions and credit collections activity. With the composition of the loan portfolio largely fixed in the short to medium term, the Principal Subsidiaries' credit risk profiles are now determined by the credit quality of the existing portfolio. Changes in credit quality will arise from changes in the underlying economic environment, assumptions about the future trends in the economy, changes in the specific characteristics of individual loans and the credit risk strategies developed to maintain and enhance the book whilst mitigating credit risk.

It is Group policy to monitor the profile of the Principal Subsidiaries' lending exposure quarterly. Changes in the risk profile are reported as part of the subsidiaries' stress tests. The stress tests forecast losses, impairment and capital requirements at a portfolio and product level over a 10 year horizon given a range of economic scenarios.

The Board receives a monthly update on changes in the key drivers of the lending credit risk profile, with more detailed information on the factors underlying these key drivers being reported monthly to the ERC.

Credit related policies and limits are developed and maintained within Credit Risk and are reviewed and approved annually by the Board, or when significant changes to policies are recommended. The ERC ensures that any exposure to credit risk remains within overall risk appetite levels as agreed by the Board.

Authorised credit risk limits for wholesale money market counterparties reflect their credit rating as well as size, depth and quality of their capital base. Wholesale credit related policies and limits are developed and maintained by Wholesale Risk and are approved by the Board at least annually, or when material changes to policies are recommended.

The Principal Subsidiaries each hold a structured finance portfolio that primarily consists of investments in Asset Backed Securities ('ABS'). The credit risk is determined by the quality of the underlying securitised assets. No new structured finance investments are permitted apart from the purchase of those issued by the Group's own secured funding vehicles.

# Risk management and control (continued)

Pages 69 to 74 form an integral part of the audited Financial Statements

## Risk categorisation (continued)

### (ii) Market risk

Market risk is the potential for change in Group income or Group net worth arising from movements in interest rates, foreign exchange rates or other market prices. Effective identification and management of market risk is essential for maintaining stable net interest income. The Principal Subsidiaries do not trade or make markets in any areas and market risk only arises either as a legacy of past business or from supporting core activities.

Market risk comprises interest rate risk and foreign exchange risk. Interest rate risk is principally managed via interest rate swaps and foreign exchange risk by foreign exchange contracts.

The Board's appetite for market risk is set out in the Board approved Market Risk Policy. Responsibility for staying within risk appetite is delegated to the Finance & Investment Director and exposures are reported daily by Finance to senior management and monthly by Wholesale Risk to ALCO. ALCO is responsible for ensuring that the Finance & Investment Director implements market risk strategies consistent with the Board's risk appetite.

### (iii) Liquidity risk

Liquidity risk is the risk of being unable to pay liabilities as they fall due and arises from both the mismatch in asset, liability, derivative and collateral cash flows and from unforeseen changes to these.

The Board's appetite for liquidity risk is low and is managed to ensure it has an adequate level of liquidity to meet its commitments at all times and maintained within agreed HM Treasury facilities, with minimum liquidity levels set out in the Board-approved Liquidity Risk Policy. Responsibility for managing liquidity risk is delegated to the Finance & Investment Director. Stress tests are used to assess the adequacy of liquidity both daily and monthly by Finance and Wholesale Risk and reported monthly to ALCO. ALCO is responsible for ensuring that the strategies of the Finance & Investment Director maintain liquidity risk within the Board's Risk Appetite.

Sterling liquidity is held as cash balances at the Bank of England. Euro and US dollar cash balances are held at a range of highly rated banks.

### (iv) Conduct risk

Conduct risk is defined as the 'risk of UKAR treating its customers unfairly and delivering inappropriate outcomes leading to customer detriment or impacting market integrity'.

This risk category is governed by a Conduct Risk Framework ('CRF') which was established during 2013. The CRF forms part of UKAR's existing Enterprise Wide Risk Management Framework ('EWRMF'). Through the EWRMF the approach to conduct risk is led by the Board and Senior Management. It ensures a joined-up and consistent approach to the management of conduct risk and is integrated into business strategy, management and decision making.

The CRF sets out the approach to the effective assessment, management and monitoring of conduct risk in accordance with our stated conduct risk appetite. UKAR has a zero risk appetite for systemic conduct risk that could lead to unfair customer outcomes or pose a risk to market integrity. Conduct risk is an integral part of the way UKAR does business, specifically, the interests of customers and market integrity are at the heart of UKAR's strategy, business and culture. With clear and visible leadership from the Board everyone takes responsibility for good conduct throughout our business model with established controls to deliver fair and appropriate outcomes to our customers. Our market conduct ensures that UKAR has no impact on market integrity. To support this annual mandatory conduct risk training has been introduced for all colleagues.

### (v) Regulatory risk

Regulatory risk is the risk of failing to comply with the legal and regulatory requirements applying to UKAR arrangements and activities. UKAR has a zero regulatory risk appetite and undertakes its activities in line with this. UKAR has established, implements and maintains policies and procedures designed to detect any risk of failure by UKAR to comply with its obligations under the regulatory system, as well as associated risks. UKAR has put in place adequate measures and procedures designed to minimise these risks and to enable the FCA (and any relevant regulator) to exercise its powers effectively under the regulatory system.

# Risk management and control (continued)

Pages 69 to 74 form an integral part of the audited Financial Statements

## Risk categorisation (continued)

### (vi) Operational risk

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

The Operational Risk Framework includes a balance of policies, appropriate procedures and internal controls to enable effective identification, assessment, monitoring and reporting of key operational risks. The Framework is overseen and reported on by the operational risk function. The key elements of the Framework are as follows:

- **Risk & Control Self Assessment**
  Provision of a consistent framework for the identification, assessment, monitoring and reporting of significant risks and key controls across the Group. Where controls are assessed as ineffective in design or operation, a defined Corrective Action Plan process is in place to develop, track and implement control improvements.

- **Operational risk event reporting**
  Provision of a consistent framework for the identification, investigation, assessment and reporting of operational risk events (losses, gains and near misses) across the Group. Root cause analysis performed as part of operational risk event reporting enhances the control environment by directing control improvement effort where there is a risk of event recurrence.

- **Key Risk Indicators**
  Key Risk Indicators are defined as measured metrics that track changes in the level of risk exposure and control effectiveness through reference to defined risk tolerances that are aligned to UKAR's risk appetite. These metrics provide an early warning of shifting risk exposures to identify emerging risks and enable control implementation before risks materialise.

- **Operational risk weighted financial impact analysis and scenario analysis**
  The Group undertakes operational risk weighted financial impact analysis and scenario analysis to calculate the financial impact of both expected and unexpected operational risk events. This analysis facilitates a comparison between operational risk, financial exposure and the operational risk capital allocation derived under the Group's capital adequacy assessment process.

### (vii) Strategic risk

Strategic risk is defined as the current or prospective risk to earnings and/or fair value, given the B&B Group and the NRAM Group Balance Sheet structure, arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.

UKAR considers the primary strategic risks to be macroeconomic environment, market pressures, structural asset/liability mix, political, regulatory and legal risk, infrastructure risk (including managing a mortgage book in wind down) and project risk.

UKAR's focus is on continuous assessment and measurement of movement in strategic risk status in order to ensure continuous monitoring of potential impacts on the Ten Year Plan, annual business and operating plans, and UKAR's overarching strategic objectives. Thus, close oversight of movements in strategic risk (proximity, financial impact, probability) is maintained via monthly reporting to ExCo and the Board. Where appropriate, and taking in to account the mainly external nature of strategic risk, risk management strategies can then be defined to mitigate the impact of a risk event arising.

# Corporate social responsibility report

UKAR aims to conduct its business in a socially responsible manner in respect of our customers, the workplace, the communities we operate in and the environment.

## Customers

The Group has almost 389,000 customers, making us one of the largest mortgage service providers in the UK.

We are committed to:

- ensuring that simplicity, integrity and truth applies to everything we do;
- supporting vulnerable customers; and
- supporting customers in financial difficulty.

## Workplace

UKAR's employment practices reflect international and national standards covering areas such as minimum working age, working hours, health and safety and discrimination.

UKAR aims to recruit high calibre employees from all sections of the community, ensuring that no employee or job applicant receives less favourable treatment on grounds which are not related to the job. We adopt best practice policies and procedures which form a key part of our induction programmes together with the standards of behaviour we should all abide by and expect from each other.

A comprehensive training and development programme for colleagues throughout UKAR provides colleagues with the skills and specialist development opportunities to achieve their potential in order to help them do their job today and for any future roles they may undertake. Since UKAR was formed, 257 colleagues have achieved an external qualification through the support of the UKAR training academy. In 2010 we introduced our Apprenticeship Scheme and we currently have 22 apprentices within the business and intend to recruit a further 20 this year. To date 52 apprentices have secured permanent roles at UKAR. Our Undergraduate and Graduate schemes continued with three and five more placements respectively in 2014. We plan to recruit four Graduates, four Undergraduates and four Summer Interns in 2015. We also support the government's Centre of Excellence initiatives.

UKAR believes that promoting both a diverse culture and diverse working practices will help retain and engage talent, maintain motivation and improve the wellbeing of all colleagues in the workplace. We build a working environment based on trust and openness and encourage effective and efficient communication throughout the organisation.

Colleague engagement is important to us and that is why 'Being a Great Place to Work' is one of our four strategic objectives. It is important to us that colleagues feel valued, are proud of the contribution they make and are given the opportunity to grow and learn new skills. We use a variety of channels for communicating with our colleagues including our intranet site, monthly team meetings, regular open surgeries with our CEO and members of ExCo and a quarterly magazine which is developed with the support of an editorial panel drawn from colleagues throughout the business. We have a very popular recognition scheme based around our core values and new ideas are encouraged via a suggestion scheme. We publish weekly 'blogs' from ExCo members to highlight the efforts we are making to encourage a 'One Team' culture both within and between different sites and departments. We believe that colleagues who enjoy working at UKAR strive to do the best they can and act in a professional way which will ensure that our customers receive the best possible outcomes and the organisation maximises value for the taxpayer.

We have a good relationship with the Unite union and colleagues also represent the business on the Health & Safety Committee. We are flexible in the way we approach the personal circumstances of colleagues, preventing discrimination for example on family grounds and ensuring the workplace needs of those with families are addressed. We report our sickness and stress absence data to the Board on a monthly basis and we remained below the national benchmark for stress-related absence throughout 2014/15.

# Corporate social responsibility report (continued)

## Workplace (continued)

### Off-payroll engagements

UKAR uses the services of a number of individuals to support its business, both to support business-as-usual and project work. Details of these individuals are below:

**Table 1 – Off-payroll engagements as at 31 March 2015 (for more than £220 per day and lasting longer than 6 months)**

| | No. Contractors |
|---|---|
| No. of existing engagements as of 31 March 2015: | 170 |
| **Of which:** | |
| No. that have existed for less than one year at the time of reporting: | 52 |
| No. that have existed for between one and two years at the time of reporting: | 44 |
| No. that have existed for between two and three years at the time of reporting: | 27 |
| No. that have existed for between three and four years at the time of reporting: | 37 |
| No. that have existed for four years or more at the time of reporting: | 10 |
| **Total** | **170** |

A risk-based assessment was carried out for off-payroll engagements and as a result a managed service arrangement was implemented with our main provider of contract resource, which includes contractual clauses stating that liability for tax and National Insurance sits with the provider.

**Table 2 – New off-payroll engagements, or those that reached six months in duration (for more than £220 per day and last longer than 6 months)**

| | No. Contractors |
|---|---|
| No. of new engagements, or those that reached six months duration, between 1 April 2014 and 31 March 2015: | 88 |
| No. of new engagements which include contractual clauses giving the department the right to request assurance in relation to income tax and National Insurance obligations: | 0 |
| No. for whom an assurance has been requested: | 0 |
| **Of which:** | |
| No. for whom assurance has been received: | 0 |
| No. for whom assurance has not been received: | 0 |
| No. that have been terminated as a result of assurance not being received: | 0 |
| **Total** | **0** |

**Table 3 – For any off-payroll engagements of board members and/or senior officials with significant financial responsibility during the year**

| | No. Contractors |
|---|---|
| No. of off-payroll engagements of board members and/or senior officials with significant financial responsibility during the year: | 0 |
| No. of individuals that have been deemed 'board members and/or senior officials with significant financial responsibility during the year': | 0 |

# Corporate social responsibility report (continued)

## Community

We are committed to:

- using the skills of the business to support education in our communities;
- building the skills of our colleagues through community engagement; and
- supporting colleagues with their own community and charity initiatives.

During 2014/15, UKAR supported MIND as our corporate charity.

At each major site we also supported a local charity chosen by our colleagues. These were Martin House Children's Hospice in Crossflatts and Daft as a Brush Cancer Patient Care in Doxford. The following amounts were raised for these charities in 2014/15:

- MIND £ 11,225
- Martin House Children's Hospice £ 30,834
- Daft as a Brush Cancer Patient Care £ 5,526

£18,022 was also raised for other charities in 2014/15.

In addition, UKAR supports other charitable fundraising activities by adding up to £250 to funds raised per employee and by matching employee donations to charity through a payroll giving programme. During 2014/15, in total, UKAR matched employee fundraising to the total of £33,823 and payroll giving totalled £16,246.

Colleagues in UKAR are given the opportunity to volunteer to help our communities by working with a number of charities including Young Enterprise, a charity set up to work with schools to inspire young people with the confidence, ability and ambition to succeed in a challenging and changing economy.

During 2014/15, 362 employees took part in volunteering events.

## Environment

We are committed to:

- reducing environmental impact wherever possible;
- increasing recycling programmes; and
- creating awareness of environmental programmes and engaging colleagues in these activities.

We seek to improve our environmental performance through a range of initiatives and in 2014/15 we achieved the following:

- Recycling 96.0% of waste recycled.
- Landfill 4.0% of waste sent to landfill.
- Carbon emissions * Reduced by 8.5%.

Wherever possible surplus furniture and equipment is donated to charitable organisations or is recycled in other ways.

## Corporate social responsibility in 2015/16

In 2015/16 our Community Investment Approach will focus on using the skills of the business to support youth education in our communities and address health as a social issue which affects our business and the communities we operate in.

We will support the following local charities as our Charities of the Year:

- Crossflatts Yorkshire Air Ambulance
- Doxford Children North East

** Carbon produced from utilities (Gas / Electric consumption).*

# Other matters

### Review of business, future developments and uncertainties

A review of the business, future developments and uncertainties is set out in the Strategic Report on pages 9 to 18.

### Principal risks

Principal risks of the UKAR Group are covered on pages 18 and 71 to 74.

### Dividends

The Directors do not propose the payment of any dividend in respect of the year ended 31 March 2015.

### Major shareholders

As at the date of this report, all shares in UKAR are held by HM Treasury and all shares in B&B and NRAM are held by UKAR.

### Employee involvement

The People Strategy of UKAR is detailed on pages 16 to 17.

The Group is committed to employment policies which follow best practice, based on equal opportunities for all employees, irrespective of sex, race, colour, disability or marital status. The Group gives full and fair consideration to applications for employment from disabled persons, having regard to their particular aptitudes and abilities. Appropriate arrangements are made for the continued employment and training, career development and promotion of disabled persons employed by the Group. If members of staff become disabled the Group continues employment, either in the same or an alternative position, with appropriate retraining being given if necessary.

### Directors' indemnities

The Articles of Association provide the power to indemnify any Director against liabilities incurred as a result of their office.

UKAR has also provided each Director with a Deed of Indemnity, which constituted 'qualifying third party indemnity provision' in accordance with the provisions of the Companies Act 2006. The Deeds were in force during the whole of the financial year ended 31 March 2015 and remain in force as at the date of approval of the Directors' Report. The Deeds were also in force for the benefit of Directors who resigned during the year.

The Deeds indemnify the Directors to the fullest extent permitted by law against all losses suffered or incurred in respect of acts and omissions arising as a result of holding office. The indemnities also extend to the reimbursement of each Director with the costs of defending all claims, actions and proceedings including regulatory investigation arising out of or connected with the exercise of, or failure to exercise, any of the Director's powers, duties or responsibilities as an officer, Director, trustee, agent or employee of the Group and any of its subsidiaries. Reimbursement is subject to the Director's obligation to repay the Company in accordance with the provisions of the Companies Act 2006. The payment obligations of the Company under each Deed of Indemnity are backed by a specific guarantee in favour of the Director entered into between each Director and HM Treasury.

UKAR has also arranged Directors' and Officers' Insurance on behalf of the Directors in accordance with the provisions of the Companies Act 2006.

### Annual General Meeting ('AGM')

It is proposed that the AGM of the Company will be held on 30 June 2015.

### Independent Auditors

A resolution to re-appoint PricewaterhouseCoopers LLP as the Group's auditors will be put to the Shareholder at the forthcoming AGM.

### Disclosure of information to the Auditors

As at the date of this report, each person who is a Director confirms that:

- So far as each Director is aware there is no relevant audit information of which the Company's auditors are unaware; and
- Each Director has taken such steps as he or she ought to have taken as a Director in order to make him or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 (2) of the Companies Act 2006.

# Statement of Directors' and Accounting Officer's responsibilities in respect of the Directors' Report and the Financial Statements

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the Financial Statements in accordance with applicable law and regulations. Company law requires the Directors to prepare Financial Statements for each financial period. Under that law the Directors have prepared the Group and Parent Company Financial Statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union. 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 the Company and of the profit or loss of the Group for that period. In preparing these 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 applicable IFRS as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company’s transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the Financial Statements and the Directors’ Remuneration Report comply with the Companies Act 2006 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company’s website and legislation in the United Kingdom governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

Each of the Directors confirms that, to the best of each person’s knowledge and belief:

- the Financial Statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Company; and
- the Directors’ Report contained in the Annual Report includes a fair review of the development and performance of the business and the position of the Company and Group, together with a description of the principal risks and uncertainties that they face.
- The Annual Report and Accounts, taken as a whole, is fair, balanced and understandable, providing the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

This report has been approved by the Board of Directors and is signed by the Chief Executive Officer on behalf of the Board of Directors.

The Accounting Officer of HM Treasury has designated UKAR's Chief Executive Officer as the Accounting Officer of UKAR. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding UKFI's assets, are set out in 'Managing Public Money', published by HM Treasury.

In preparing the Financial Statements, the Accounting Officer is required to comply with the requirements of the Government Financial Reporting Manual and in particular to:

- observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the Financial Statements; and
- prepare the Financial Statements on a going concern basis.

**Richard Banks**
Chief Executive Officer, on behalf of the Board
15 June 2015

# Independent Auditors' report to the Members of UK Asset Resolution Limited

## Report on the Group Financial Statements

### Our opinion

In our opinion, UK Asset Resolution Limited's Group financial statements (the "Financial Statements"):

- give a true and fair view of the state of the Group's affairs as at 31 March 2015 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

### What we have audited

UK Asset Resolution Limited's Financial Statements comprise:

- the Consolidated Balance Sheet as at 31 March 2015;
- the Consolidated Income Statement and Statement of Comprehensive Income for the year then ended;
- the Consolidated Cash Flow Statement for the year then ended;
- the Consolidated Statement of Changes in Equity for the year then ended; and
- the notes to the Financial Statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report & Accounts (the "Annual Report"), rather than in the notes to the Financial Statements. These are cross-referenced from the Financial Statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the Financial Statements is applicable law and IFRSs as adopted by the European Union.

### Our audit approach

*Overview*


- Overall Group materiality: £99 million which represents 0.15% of total assets of the Group.

- The significant components of the group are Bradford & Bingley plc and its subsidiaries and NRAM plc and its subsidiaries and were identified based on their contribution to the Group's total assets and key balances of the income statement. Components not subject to full scope audits were still subject to group level analytical reviews over their financial information. Our work performed on the individual components taken together accounted for 100% of Group Total Assets, and 99.7% of Group Net Operating Income.

- Loan loss provision judgemental assumptions and management overlays and adjustments.
- Provisions for customer redress.
- Hedge accounting may not be appropriate.

*The scope of our audit and our areas of focus*

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the Financial Statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

## Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

### Report on the Group Financial Statements (continued)

*The scope of our audit and our areas of focus (continued)*

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the Financial Statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

| *Area of focus* | *How our audit addressed the area of focus* |
|---|---|
| ***Loan loss provision assumptions and management overlays and adjustments***<br><br>Loan loss provisioning is a highly subjective area due to the level of judgement applied by management in determining the level of provisions. Loan loss provisions are calculated by management using internal models which use historic data and estimates and judgements in respect of future performance. Management's judgements include ones around macro-economic measures including future house price inflation.<br><br>We focused on the measurement of the provision, which differs based upon the type of lending and assessed whether, given the improving economic conditions, historic experience is appropriate when assessing the impairment in the portfolios.<br><br>Judgement is applied to determine appropriate parameters and assumptions for the models that are used to calculate the provision. The key assumptions are the probability of customer default and the valuation of any underlying security.<br><br>Management also apply adjustments or overlays where they believe the data driven parameters and calculations are not appropriate, either as a result of emerging trends or models not capturing the risks in the loan portfolio. These adjustments include an overlay to adjust for the impact of potential historic valuation fraud indicators in the portfolio and the impact of the low interest rate environment on the current performance of the portfolio. These adjustments and overlays require significant judgement to be applied by management. | We understood and evaluated the design and implementation and tested key controls focussing on:<br><br>- the identification of provision events;<br><br>- the transfer of data between underlying source systems and the impairment models that the Group operates; and<br><br>- the review and approval process that management has in place for the inputs, including the key assumptions, to the Group's impairment models, and the adjustments and overlays that are applied to the modelled outputs.<br><br>In addition to testing the key controls around the loan loss provision, we also performed the following procedures to obtain sufficient audit evidence:<br><br>• we understood management's basis for determining whether a loan was impaired and assessed the reasonableness using our understanding of the Group's loan portfolio and our broader industry knowledge. Where impairment was calculated using models we tested the completeness and accuracy of data to the underlying systems that were used in the models;<br><br>• we have reviewed the model calculation scripts and for any changes from prior periods we gained an understanding and critically assessed where adjustments had been made to the parameters and assumptions in the models used, the reasons for those adjustments and used our industry knowledge and experience to evaluate the appropriateness of these;<br><br>• we considered whether overlays to modelled provisions appropriately reflected the risks in the portfolios. We challenged management to provide explanations and objective evidence to support the overlay adjustments made. This included consideration of the current economic conditions and the extended low interest rate environment;<br><br>• where a provision was calculated on a portfolio basis, we tested a sample of loans and advances to ascertain whether the impairment event had been identified in a timely manner and whether the provision was reasonable given the specific provision indicators; and<br><br>• we assessed the judgements management use to identify provision events on performing loans including the likelihood of default based on historic data and future events such as interest rate rises and challenged management to provide objective evidence that the overlays were appropriate.<br><br>Based on the evidence we obtained we found that the impairment model assumptions, data used within the models and overlays to the modelled outputs were supportable and within our own independently determined ranges. However, the models are sensitive to the micro and macro-economic environment in the UK and other factors such as employment levels, interest base rates and house price inflation which could reasonably be expected to give rise to further provisions in the future. |

## Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

### Report on the Group Financial Statements (continued)

*The scope of our audit and our areas of focus (continued)*

| *Area of focus* | **How our audit addressed the area of focus** |
|---|---|
| ***Provisions for customer redress***<br>Given the continued regulatory focus on the financial services sector there is a significant risk that further claims or regulatory investigations will emerge that impact the Financial Statements.<br>There is a risk across the Group that based on historical actions taken by B&B and NRAM there may be further areas where customer redress is required due to customer detriment arising from historic sales processes, product design or documentation that have not yet been identified or appropriately assessed by management for financial reporting purposes. Where such conduct risk matters have been identified, judgement is required as to the appropriate accounting treatment including an assessment of whether a provision is required to be recognised or a contingent liability is required to be disclosed.<br>Where provisions or contingent liability disclosures have been made, judgement is required in measuring the liabilities due to a number of uncertain factors. Judgement is required in estimating future redress payments to be made to customers, and operational costs of processing complaints and reviewing past business. | We understood and evaluated the design and implementation of the controls and management's processes for:<br>- identifying conduct risk exposures and assessing whether provisions or disclosures are required; and<br>- the calculation and review of conduct provisions including governance processes and approvals of model assumptions and outputs.<br>We met with management to understand the emerging and potential issues that they had identified. We independently assessed emerging and potential areas where exposures might have arisen based upon our knowledge and experience of emerging industry issues and the regulatory environment. We used this to challenge the completeness of the issues identified by management and whether a provision was required. We also reviewed customer complaints data to assess if there were indicators of more systemic issues being present to further challenge management's assessment of the completeness of the issues identified.<br>We read the Group's correspondence with the Financial Conduct Authority and discussed the output of meetings held. We also met with the Chair of the Group Audit Committee.<br>We read legal correspondence and opinions issued to the Group by external legal advisers to assess and challenge management over the completeness of provisions and the disclosures made.<br>We read the minutes of key governance meetings including those of the Board, and of various management committees, as well as attending a number of Audit Committee meetings. We also understood the key activities of the Conduct and Compliance function.<br>The majority of our detailed audit work focussed on the two significant conduct provisions being:<br>• a provision for past sales of Payment Protection Insurance (PPI) policies; and<br>• a provision made for customer redress following a legal ruling received in December 2014.<br>We also examined other areas of compensation payments made to customers. For significant provisions made, we understood and challenged the provisioning methodologies and underlying assumptions used by management. For example, we challenged the basis that management used for forecasting the number of PPI complaints that will be received in the future.<br>For those assumptions based on historic information, we challenged whether this was appropriate for future experience. Where management made adjustments to historical experience, we challenged the basis for and appropriateness of such changes. For example where the start date at which remediation occurred was updated based on new information available to management; we examined a sample of these changes to ensure that they were consistent with available information and had been applied correctly.<br>Given the inherent uncertainty in the calculation of these provisions and their judgemental nature, we evaluated the disclosures made in the Financial Statements to ensure that this inherent uncertainty had been reflected. In particular, we focused on challenging management that the disclosures were sufficiently clear in highlighting the exposures that remain, significant uncertainties that exist in respect of the provisions and the sensitivity of the provisions to changes in the underlying assumptions.<br>We are comfortable from the audit work performed that the current valuation of provisions for customer redress held by management is appropriate. |

# Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

## Report on the Group Financial Statements (continued)

*The scope of our audit and our areas of focus (continued)*

| *Area of focus* | How our audit addressed the area of focus |
|---|---|
| ***Hedge accounting may not be appropriate***<br><br>In order to reduce the volatility of the income statement associated with the valuation of derivatives used for hedging interest rate and foreign currency risk, the Group has designated a number of hedge relationships; all of which were first designated as such in prior periods. Compliance with IAS 39 'Financial instruments: Recognition and measurement' requires a number of factors to be considered, including the demonstration of retrospective and prospective hedge effectiveness.<br><br>Complying with the detailed requirements of IAS 39 is complex, especially with regards to the models used to calculate historic hedge effectiveness. If compliance with IAS 39 cannot be demonstrated, there would be a material impact to the Financial Statements. | We understood and tested key controls focussing on:<br>- the reconciliation of inputs into hedge effectiveness tests to the valuation source system;<br>- the automated calculation of derivative values and hedge effectiveness within relevant systems; and<br>- the review and approval of market data inputs into the system that drive the financial instrument valuation.<br>The results of our controls testing enabled us to place reliance on these key controls for the purpose of our audit.<br>In addition to testing the key controls, we also performed the following procedures:<br>• we read the Group's hedge documentation and considered it to be appropriate in supporting the relationships designated as hedges. We read the hedge documentation in the context of the requirements of IAS 39 to ensure appropriate compliance, and challenged any judgements or assumptions included within each designation to ensure that they continue to remain appropriate; and<br>• we selected a sample of models used to demonstrate the hedge effectiveness requirements of IAS 39 and recalculated effectiveness based on the inputs from the underlying valuation system, or agreeing these inputs to third party sources.<br>Based on the results of our audit work, the judgements made by management were supportable and reasonable and the hedge accounting applied by the Group, and disclosures made in the Financial Statements, were in compliance with accounting standards. |

*How we tailored the audit scope*

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the Financial Statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group comprises Bradford & Bingley plc and its subsidiaries ("B&B"), NRAM plc and its subsidiaries ("NRAM") and UKAR Corporate Services Limited ("UKARcs"). The Group financial statements are a consolidation of these companies.

We performed an audit of the financial information of the significant components of the Group, identified as B&B and NRAM. In addition both these significant components require statutory audits and the work for these are carried out at the same time as the Group audit. All of the work on the significant components was performed by the Group engagement team.

Components not identified as significant and therefore not subjected to a full scope audit were still subject to Group level analytical review procedures over their financial information.

This, together with additional procedures performed on balances arising as a result of the Group's consolidation process gave us the evidence we needed for our opinion on the Financial Statements as a whole.

The components within our audit scope accounted for 100% of the Group total assets. The range of audit scope on Income Statement account balances was between 99.7% and 100%.

*Materiality*

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the Financial Statements as a whole.

## Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

### Report on the Group Financial Statements (continued)

*Materiality (continued)*

Based on our professional judgement, we determined materiality for the Financial Statements as a whole as follows:

| | |
|---|---|
| ***Overall Group materiality*** | £99 million (2014: £113 million). |
| ***How we determined it*** | 0.15% of total assets. |
| ***Rationale for benchmark applied*** | We have applied this benchmark as the key element of the financial statements is loans to customers, which represent a significant proportion of total assets. This is also supported by the nature of the Group's activities which involves servicing mortgage loans and the collection of customer balances in order to repay government funding. This is consistent with the Group's main strategic objective; to reduce, protect and optimise the balance sheet. |

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2.4 million (2014: £2.5 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

### Other required reporting

#### Consistency of other information

*Companies Act 2006 opinion*

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

*ISAs (UK & Ireland) reporting*

| The Directors have chosen to voluntarily comply with the UK Corporate Governance Code ("the Code") as if the company were a premium listed company. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion: | |
|---|---|
| • information in the Annual Report is:<br>– materially inconsistent with the information in the audited Financial Statements; or<br>– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or<br>– otherwise misleading. | We have no exceptions to report arising from this responsibility. |
| • the statement given by the Directors on page 79, in accordance with provision C.1.1 of the Code, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit. | We have no exceptions to report arising from this responsibility. |
| • the section of the Annual Report on page 45, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee. | We have no exceptions to report arising from this responsibility. |

#### Adequacy of information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

#### Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

# Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

## Other voluntary reporting

### Matter on which we have agreed to report by exception

*Corporate governance statement*

The company prepares a corporate governance statement in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority and has chosen voluntarily to comply with the UK Corporate Governance Code. The Directors have requested that we review the parts of the Corporate Governance Statement relating to the company's compliance with the ten provisions of the UK Corporate Governance Code specified for auditor review by the Listing Rules of the Financial Conduct Authority as if the company were a premium listed company. We have nothing to report having performed our review.

## Responsibilities for the Financial Statements and the audit

### Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 79, 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 ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### What an audit of Financial Statements involves

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the Financial Statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the Financial Statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Other matter

We have reported separately on the company financial statements of UK Asset Resolution Limited for the year ended 31 March 2015.

**Craig Gentle** (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

15 June 2015

# The Accounts



# Notes to the Financial Statements

## UKAR Limited Company Accounts



## Notes to the Company Financial Statements



## Appendix A

## CONSOLIDATED INCOME STATEMENT

| | Note | 12 months to 31 March 2015 £m | 15 months to 31 March 2014 £m |
|---|---|---|---|
| Interest receivable and similar income | 3 | **2,010.8** | 2,884.5 |
| Interest expense and similar charges | 3 | **(641.8)** | (1,053.9) |
| **Net interest income** | 3 | **1,369.0** | 1,830.6 |
| Fee and commission income | | **22.6** | 33.0 |
| Fee and commission expense | | **(12.1)** | (15.1) |
| **Net fee and commission income** | | **10.5** | 17.9 |
| Net realised gains less losses on investment securities | 4 | **12.8** | (12.5) |
| Unrealised fair value movements on financial instruments | 5 | **(8.1)** | (29.6) |
| Hedge ineffectiveness | 5 | **(74.9)** | (27.6) |
| Provision for customer redress | 24 | **(295.0)** | (115.8) |
| Other operating income | | **16.0** | 10.9 |
| **Non-interest income** | | **(338.7)** | (156.7) |
| **Net operating income** | | **1,030.3** | 1,673.9 |
| Administrative expenses | 6 | **(177.2)** | (246.3) |
| Impairment on loans to customers credit/(charge) | 13 | **150.6** | (95.1) |
| Net impairment release on investment securities | 10 | **16.4** | 17.7 |
| Profit on sale of loans | 12 | **22.3** | 21.2 |
| (Loss)/gain on repurchase of own liabilities | 7 | **(70.1)** | 2.9 |
| **Profit before taxation** | | **972.3** | 1,374.3 |
| Taxation | 8 | **(200.7)** | (308.3) |
| **Profit for the financial period** | | **771.6** | 1,066.0 |

The notes on pages 93 to 144 form an integral part of these Financial Statements.

The results above arise from continuing activities.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the 12 months to 31 March 2015

| | Gross of tax £m | Tax £m | Net of tax £m |
|---|---|---|---|
| **Profit for the financial year** | **972.3** | **(200.7)** | **771.6*** |
| **Other comprehensive income** | | | |
| Items that may be reclassified subsequently to profit or loss: | | | |
| Available-for-sale instruments: | | | |
| - net losses recognised in available-for-sale reserve during the year | **(6.6)** | **1.3** | **(5.3)** |
| - amounts transferred from available-for-sale reserve and recognised in profit during the year | **13.5** | **(2.8)** | **10.7** |
| Cash flow hedges: | | | |
| - net losses recognised in cash flow hedge reserve during the year | **(1,355.5)** | **352.1** | **(1,003.4)** |
| - amounts transferred from cash flow hedge reserve and recognised in profit during the year | **1,407.1** | **(358.0)** | **1,049.1** |
| | **58.5** | **(7.4)** | **51.1** |
| Items that will not be reclassified subsequently to profit or loss: | | | |
| - retirement benefit remeasurements | **107.9** | **(22.0)** | **85.9** |
| | **107.9** | **(22.0)** | **85.9** |
| **Total other comprehensive income** | **166.4** | **(29.4)** | **137.0** |
| **Total comprehensive income for the financial year** | **1,138.7** | **(230.1)** | **908.6*** |

For the 15 months to 31 March 2014

| | Gross of tax £m | Tax £m | Net of tax £m |
|---|---|---|---|
| Profit for the financial period | 1,374.3 | (308.3) | 1,066.0* |
| Other comprehensive income/(expense) | | | |
| Items that may be reclassified subsequently to profit or loss: | | | |
| Available-for-sale instruments: | | | |
| - net gains recognised in available-for-sale reserve during the period | 66.7 | (15.2) | 51.5 |
| - amounts transferred from available-for-sale reserve and recognised in profit during the period | (1.9) | 0.4 | (1.5) |
| Cash flow hedges: | | | |
| - net losses recognised in cash flow hedge reserve during the period | (435.8) | 165.4 | (270.4) |
| - amounts transferred from cash flow hedge reserve and recognised in profit during the period | 349.8 | (135.5) | 214.3 |
| | (21.2) | 15.1 | (6.1) |
| Items that will not be reclassified subsequently to profit or loss: | | | |
| - retirement benefit remeasurements | 4.5 | (1.7) | 2.8 |
| | 4.5 | (1.7) | 2.8 |
| Total other comprehensive expense | (16.7) | 13.4 | (3.3) |
| Total comprehensive income for the financial period | 1,357.6 | (294.9) | 1,062.7* |

** Of which £11.9m (2014: £18.0m) is attributable to the holders of the non-controlling interests, as detailed in note 29.*

## CONSOLIDATED BALANCE SHEET

| | Note | **31 March 2015 £m** | 31 March 2014 £m |
|---|---|---|---|
| **Assets** | | | |
| Balances with the Bank of England | 9 | **6,916.7** | 5,020.3 |
| Cash at bank and in hand | 11 | **2,266.4** | 2,503.2 |
| Investment securities | 10 | **522.7** | 1,074.7 |
| Loans to customers | 12 | **52,682.5** | 61,249.5 |
| Fair value adjustments on portfolio hedging | 12 | **467.7** | 308.8 |
| Derivative financial instruments | 33 (d) | **2,962.7** | 4,616.2 |
| Other assets | 16 | **28.0** | 37.4 |
| Retirement benefit assets | 17 | **237.6** | 65.3 |
| Property, plant and equipment | 18 | **16.6** | 21.9 |
| Intangible assets | 19 | **41.4** | 42.7 |
| **Total assets** | | **66,142.3** | 74,940.0 |
| | | | |
| **Liabilities** | | | |
| Amounts due to banks | 20 | **2,185.8** | 3,119.2 |
| Statutory Debt and HM Treasury loans | 21 | **34,619.4** | 38,350.5 |
| Derivative financial instruments | 33 (d) | **570.0** | 446.0 |
| Debt securities in issue | 22 | **20,946.7** | 25,886.0 |
| Other liabilities | 23 | **134.1** | 159.8 |
| Current tax liabilities | | **110.4** | 183.4 |
| Deferred tax liabilities | 15 | **103.3** | 50.8 |
| Retirement benefit obligations | 17 | **9.4** | 20.3 |
| Provisions | 24 | **393.0** | 167.7 |
| Capital instruments | 25 | **17.1** | 215.3 |
| **Total liabilities** | | **59,089.2** | 68,599.0 |
| | | | |
| **Equity** | | | |
| Issued capital and reserves attributable to owners of the parent: | | | |
| - share capital | 26 | **1.2** | 1.2 |
| - reserves | 27 | **1,364.3** | 1,313.2 |
| - retained earnings | | **5,687.6** | 4,830.0 |
| **Share capital and reserves attributable to owners of the parent** | | **7,053.1** | 6,144.4 |
| | | | |
| **Non-controlling interests*** | 29 | **-** | 196.6 |
| | | | |
| **Total equity** | | **7,053.1** | 6,341.0 |
| | | | |
| **Total equity and liabilities** | | **66,142.3** | 74,940.0 |

** 'Non-controlling interests' were previously described as 'non-shareholders' funds'.*

The notes on pages 93 to 144 form an integral part of these Financial Statements.

The Financial Statements on pages 88 to 144 were approved by the Board of Directors on 15 June 2015 and signed on its behalf by:

**Richard Banks**
Chief Executive Officer

**Ian Hares**
Finance & Investment Director

UK Asset Resolution Limited is registered in England and Wales under company number 07301961.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the 12 months to 31 March 2015

| | Share capital £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Merger reserve £m | Retained earnings £m | Total share capital and reserves £m | Non-controlling interests* £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| **At 1 April 2014** | **1.2** | **(3.4)** | **194.0** | **1,122.6** | **4,830.0** | **6,144.4** | **196.6** | **6,341.0** |
| Other comprehensive income/(expense): | | | | | | | | |
| - net movement in available-for-sale reserve | **-** | **6.9** | **-** | **-** | **-** | **6.9** | **-** | **6.9** |
| - net movement in cash flow hedge reserve | **-** | **-** | **51.6** | **-** | **-** | **51.6** | **-** | **51.6** |
| - retirement benefit remeasurements | **-** | **-** | **-** | **-** | **107.9** | **107.9** | **-** | **107.9** |
| - tax effects of the above | **-** | **(1.5)** | **(5.9)** | **-** | **(22.0)** | **(29.4)** | **-** | **(29.4)** |
| **Total other comprehensive income** | **-** | **5.4** | **45.7** | **-** | **85.9** | **137.0** | **-** | **137.0** |
| Profit for the financial year | **-** | **-** | **-** | **-** | **759.7** | **759.7** | **11.9** | **771.6** |
| **Total comprehensive income** | **-** | **5.4** | **45.7** | **-** | **845.6** | **896.7** | **11.9** | **908.6** |
| Loss on repurchase of equity (see note 7) | **-** | **-** | **-** | **-** | **12.0** | **12.0** | **(124.8)** | **(112.8)** |
| Release of withheld coupons (see note 29(c)) | **-** | **-** | **-** | **-** | **-** | **-** | **(83.7)** | **(83.7)** |
| **At 31 March 2015** | **1.2** | **2.0** | **239.7** | **1,122.6** | **5,687.6** | **7,053.1** | **-** | **7,053.1** |

For the 15 months to 31 March 2014

| | Share capital £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Merger reserve £m | Retained earnings £m | Total share capital and reserves £m | Non-controlling interests* £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| At 1 January 2013 | 1.2 | (53.4) | 250.1 | 1,122.6 | 3,766.0 | 5,086.5 | 178.6 | 5,265.1 |
| Other comprehensive income/(expense): | | | | | | | | |
| - net movement in available-for-sale reserve | - | 64.8 | - | - | - | 64.8 | - | 64.8 |
| - net movement in cash flow hedge reserve | - | - | (86.0) | - | - | (86.0) | - | (86.0) |
| - retirement benefit remeasurements | - | - | - | - | 4.5 | 4.5 | - | 4.5 |
| - tax effects of the above | - | (14.8) | 29.9 | - | (1.7) | 13.4 | - | 13.4 |
| Total other comprehensive income/(expense) | - | 50.0 | (56.1) | - | 2.8 | (3.3) | - | (3.3) |
| Profit for the financial period | - | - | - | - | 1,048.0 | 1,048.0 | 18.0 | 1,066.0 |
| Total comprehensive income/(expense) | - | 50.0 | (56.1) | - | 1,050.8 | 1,044.7 | 18.0 | 1,062.7 |
| Release of time-expired provision for unclaimed shares (see note 28) | - | - | - | - | 13.2 | 13.2 | - | 13.2 |
| At 31 March 2014 | 1.2 | (3.4) | 194.0 | 1,122.6 | 4,830.0 | 6,144.4 | 196.6 | 6,341.0 |

** 'Non-controlling interests' were previously described as 'non-shareholders' funds'.*

## CONSOLIDATED CASH FLOW STATEMENT

| | 12 months to 31 March 2015 £m | 15 months to 31 March 2014 £m |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Profit before taxation for the financial period | **972.3** | 1,374.3 |
| *Adjustments to reconcile profit to cash (used in)/from operating activities:* | | |
| - profit on sale of loans | **(22.3)** | (21.2) |
| - provision for customer redress | **295.0** | 115.8 |
| - depreciation and amortisation | **16.8** | 19.4 |
| - profit on sale of property, plant and equipment | **(9.6)** | (7.3) |
| - impairment on loans to customers | **(150.6)** | 95.1 |
| - net impairment release on investment securities | **(16.4)** | (17.7) |
| - loss/(gain) on repurchase of own liabilities | **70.1** | (2.9) |
| - fair value adjustments on financial instruments | **(417.2)** | (64.1) |
| - other non-cash movements | **(833.2)** | 254.2 |
| **Cash flows (used in)/from operating activities before changes in operating assets and liabilities** | **(95.1)** | 1,745.6 |
| *Net decrease in operating assets:* | | |
| - cash at bank with original maturity of three months or more | **-** | 6.0 |
| - loans to customers | **6,260.5** | 7,099.8 |
| - sale of loans | **2,478.7** | 308.7 |
| - derivative financial instruments receivable | **1,653.5** | 1,103.9 |
| - other assets | **27.8** | 41.2 |
| *Net (decrease)/increase in operating liabilities:* | | |
| - amounts due to banks | **(933.9)** | (1,675.7) |
| - derivative financial instruments payable | **124.0** | (337.7) |
| - debt securities in issue | **(3,204.9)** | (5,652.3) |
| - other liabilities | **(96.3)** | (86.8) |
| - provisions | **(72.8)** | (186.4) |
| Income tax paid | **(231.4)** | (168.7) |
| **Net cash generated from operating activities** | **5,910.1** | 2,197.6 |
| **Cash flows from investing activities:** | | |
| - purchase of property, plant and equipment and intangible assets | **(15.1)** | (10.7) |
| - proceeds from sale of property, plant and equipment | **14.5** | 10.0 |
| - proceeds from sale and redemption of investment securities | **309.1** | 881.1 |
| **Net cash generated from investing activities** | **308.5** | 880.4 |
| **Cash flows used in financing activities:** | | |
| - repayment of HM Treasury loans | **(3,717.2)** | (5,274.8) |
| - repurchase of own liabilities and equity | **(841.9)** | (3.2) |
| **Net cash used in financing activities** | **(4,559.1)** | (5,278.0) |
| **Net increase/(decrease) in cash and cash equivalents** | **1,659.5** | (2,200.0) |
| Cash and cash equivalents at beginning of period | **7,521.1** | 9,721.1 |
| **Cash and cash equivalents at end of period** | **9,180.6** | 7,521.1 |
| **Represented by cash and assets with original maturity of three months or less within:** | | |
| - balances with the Bank of England | **6,914.3** | 5,018.1 |
| - cash at bank and in hand | **2,266.3** | 2,503.0 |
| **Total cash and cash equivalents at end of period** | **9,180.6** | 7,521.1 |

## 1. Principal accounting policies

UK Asset Resolution Limited ('UKAR' or 'the Company') is a private limited company incorporated on 1 July 2010 and domiciled in the United Kingdom. UKAR acquired B&B and NRAM by a share-for-share exchange on 1 October 2010. These consolidated Financial Statements are prepared under the 'predecessor accounting' method, which presents the UKAR consolidated results as if the UKAR Group ('the Group') had always been in existence in its present form. In addition, the Company owns 100% of the share capital of UKAR Corporate Services Limited, which was incorporated on 20 June 2013 (see note E to the Parent Company Financial Statements). The Financial Statements of the UKAR Company are presented on pages 148 to 154, and form an integral part of these Financial Statements.

The Company's accounting reference date was changed to 31 March from 31 December to align to the year end of the Company's ultimate parent, HM Treasury, and consequently the 31 March 2014 Consolidated Income Statement was for a 15 month period. To aid year-on-year comparisons, Appendix A on page 155 includes an unaudited Consolidated Income Statement for the Group for the 12 months ended 31 March 2014. This unaudited information has been prepared using accounting bases and policies which are consistent with those used in the audited Financial Statements.

These Financial Statements were authorised for issue by the Directors on 15 June 2015 and will be put to the shareholder for approval at UKAR’s Annual General Meeting to be held on 30 June 2015.

**(a) Statement of compliance**

Both the UKAR Company Financial Statements and the Group (comprising UKAR and its subsidiaries) Financial Statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (‘IFRS’) as adopted by the European Union (‘EU’). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (‘IASB’) and those prefixed IAS which were issued by the IASB’s predecessor body, along with interpretations issued by the IFRS Interpretations Committee (‘IFRIC’) prefixed IFRIC and those prefixed SIC which were issued by the IFRIC’s predecessor body. In publishing the UKAR Company Financial Statements here together with the Group Financial Statements, the UKAR Company has taken advantage of the exemption in s408 of the Companies Act 2006 not to present its individual Income Statement and related notes.

For these 2015 Financial Statements, including the 2014 comparative financial information where applicable, the Group and Company have adopted the following statements for the first time:

- The June 2013 amendments to IAS 39 relating to 'Novation of Derivatives and Continuation of Hedge Accounting', which restrict the circumstances in which a novation of a derivative contract may be treated as a continuation of an existing hedge relationship. This amendment had no material impact on the Group or Company.
- IFRIC 21 ‘Levies’, issued May 2013 and mandatory for periods beginning on or after 1 January 2014. This statement had no material impact on the Group or Company.

For these 2015 Financial Statements the Group and Company have not adopted the following statements; the Group and Company are assessing the impacts of these statements on their Financial Statements:

- IFRS 9 ‘Financial Instruments’; on 24 July 2014 the IASB published the final version (excluding macro-hedging), replacing most of the guidance in IAS 39. The IASB intends that IFRS 9 will be effective for annual periods beginning on or after 1 January 2018, but the timing of EU endorsement is yet to be determined. The Group continues to monitor developments. IFRS 9 is expected to have major implications for the UKAR Group and companies, in relation to impairment of loans to customers, hedging and which assets are carried at amortised cost and which at fair value.
- IFRS 15 ‘Revenue from Contracts with Customers’, issued May 2014, effective for periods beginning on or after 1 January 2017, and yet to be endorsed by the EU. No material impacts are expected for the UKAR Group or companies.
- Amendments to IAS 16 and IAS 38: ‘Clarification of Acceptable Methods of Depreciation and Amortisation’, issued May 2014 and yet to be endorsed by the EU. The amendments clarify that a revenue-based method is not considered to be an appropriate manifestation of consumption. These amendments are mandatory for the Group and Company Financial Statements for the year to 31 March 2017. No material impacts are expected for the UKAR Group or companies.
- ‘Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)’, issued November 2013. These narrow scope amendments are effective from July 2014, however, they are not considered significant to the UKAR Group or companies as no further employee contributions are anticipated to be made to the Group’s defined benefit pension schemes.
- The Annual Improvements to IFRSs 2010-2012 Cycle, issued in December 2013. These changes are mandatory for the Group and Company Financial Statements for the year to 31 March 2016. No material impacts are expected for the UKAR Group or companies.
- The Annual Improvements to IFRSs 2011-2013 Cycle, issued in December 2013. These changes are mandatory for the Group and Company Financial Statements for the year to 31 March 2016. No material impacts are expected for the UKAR Group or companies.
- The Annual improvements to IFRS 2012-2014 Cycle, issued in September 2014 and yet to be endorsed by the EU. These changes are mandatory for the Group and Company Financial Statements for the year to 31 March 2017. No material impacts are expected for the UKAR Group or companies.

## 1. Principal accounting policies (continued)

**(a) Statement of compliance** (continued)
All other new standards, amendments to standards and interpretations are not considered relevant to, and have no impact upon, the Financial Statements of the Group or UKAR Company.

**(b) Basis of preparation**
The Financial Statements have been prepared on a going concern basis and using the historical cost convention except:

(i) the following assets and liabilities are carried at their fair value:
- derivative financial instruments; and
- financial instruments categorised under IAS 39 as 'available-for-sale'; and

(ii) where fair value hedge accounting has been applied, the carrying value of hedged items has been adjusted to take account of the fair value of the risk which has been hedged.

The validity of the going concern basis of accounting is dependent upon the funding position of the UKAR Company, B&B and NRAM. At the date of approval of these Financial Statements, the Group is reliant upon the financing facilities and also upon the guarantee arrangements provided to B&B and NRAM by HM Treasury. Withdrawal of the financing facilities or the guarantee arrangements would have a significant impact on the Group's operations and its ability to continue as a going concern, in which case adjustments may have to be made to reduce the carrying value of assets to recoverable amounts and to provide for further liabilities that might arise. At the signing date of these Financial Statements, HM Treasury has confirmed its intentions to continue to provide funding until at least 1 January 2017. It has also committed to convert up to £1.6bn of its loan to NRAM to meet regulatory capital requirements if so required.

The Directors consider that the accounting policies set out in this note are the most appropriate to the Group's and the UKAR Company's circumstances, have been consistently applied to both the Group and the Company in dealing with items which are considered material, and are supported by reasonable and prudent estimates and judgements.

The accounting policies have been applied to all periods presented in these Financial Statements, and are consistent with the accounting policies used by the B&B Group and the NRAM Group in preparing their Interim Financial Reports for the six months ended 30 September 2014.

B&B and NRAM are regulated by the Financial Conduct Authority ('FCA') as mortgage administration companies, and the Directors believe that those companies have appropriate and adequate levels of capital to support their activities subject to the continuing support of HM Treasury.

The Financial Statements have been prepared in accordance with EU-adopted IFRS, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of accounting policies is set out below. The preparation of the Financial Statements in conformity with these accounting policies and generally accepted accounting principles requires the use of estimates and assumptions that affect the reported values of assets and liabilities at the date of the Financial Statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amounts, events or actions, actual results ultimately may differ from those estimates (see note 2).

The Directors consider the business to comprise one operating and geographical segment due to the similarity of risks faced within its UK-based residential, commercial and unsecured portfolios.

**(c) Basis of consolidation**
The UKAR Group's Financial Statements are prepared in accordance with IFRS 10 'Consolidated Financial Statements', and incorporate on a fully consolidated line-by-line basis the Financial Statements of the UKAR Company and those entities (including special purpose structures) which are controlled by UKAR (its subsidiaries); the Group Financial Statements primarily comprise the transactions and balances of the B&B Group and the NRAM Group. The UKAR Company's acquisition of the entire issued share capital of B&B and NRAM in a share-for-share exchange has been accounted for under 'predecessor accounting'. The difference between the UKAR Company's carrying value of investments and merger reserves, and the share capital and non-distributable reserves of the B&B Group and the NRAM Group, has been accounted for in the UKAR Group as a 'merger reserve'.

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Where subsidiaries have been acquired during a period, their results are consolidated into the UKAR Group's Financial Statements from the date control is transferred to UKAR. Where subsidiaries have been disposed of, their results are consolidated to the date of disposal. On the acquisition of a business, fair values are attributed to the assets, liabilities and contingent liabilities acquired. Any difference between the consideration given and the fair value of the net assets acquired is capitalised as goodwill, which is subject to impairment testing in accordance with IAS 36 'Impairment of Assets'. Where necessary, the Group Financial Statements include adjustments to bring the financial statements of subsidiaries into alignment with the accounting policies used by the Group. All intra-group transactions and balances are eliminated on consolidation.

The UKAR Group has securitised various residential mortgage loans, generally by sale or transfer to Special Purpose Vehicles ('SPVs') which in turn have issued securities to investors. The SPVs are consolidated line-by-line into the UKAR Group Financial Statements if they are, in substance, controlled by UKAR; all of the Group's SPVs are fully consolidated.

## 1. Principal accounting policies (continued)

**(d) Interest income and expense**
For all interest-bearing financial instruments except derivatives, interest income and expense are recognised in the Income Statement on an Effective Interest Rate ('EIR') basis.

The EIR method calculates the amortised cost of a financial asset or financial liability and spreads interest income or interest expense on a level yield basis over the expected life of the instrument, or an appropriate shorter period. The calculation includes all directly attributable incremental fees and costs, premia on acquisition of mortgage portfolios and all other premia and discounts as well as interest. In respect of loans to customers, the elements other than interest are spread over the period to which the product reprices to a Standard or Product Variable Rate. The EIR is the rate which at the inception of the instrument exactly discounts expected future cash flows over the appropriate period to the initial carrying amount. When calculating the EIR, future cash flows are estimated, considering all contractual terms of the instrument (for example prepayment options), but potential future credit losses are not considered.

Interest on derivatives is included in interest income where the derivative is hedging interest income, and interest expense where the derivative is hedging interest expense.

When a financial asset or a group of similar financial assets is written down as a result of an impairment loss, interest income continues to be recognised by applying the applicable EIR to the reduced balance.

**(e) Fee and commission income**
Where Value Added Tax (‘VAT’) is charged, income is stated net of VAT.

Commission receivable from the renewal of third party regulated financial services products was recognised as income within ‘fee and commission income’ when the renewal policy went ‘on risk’, net of any provision for repayment in the event of early termination by the customer. If the commission is receivable on deferred terms, a deemed interest element of the commission is separated and recognised on an EIR basis over the deferred payment period.

Fees charged to existing borrowers, including arrears and redemption fees, are recognised in fee and commission income as they arise.

**(f) Bonuses payable**
An accrual is made for all bonuses which have been earned by the Balance Sheet date, even though these may not subsequently be payable due to clawback or the employee leaving the Group.

**(g) Financial instruments**
In accordance with IAS 39 each financial asset is classified at initial recognition into one of four categories:
(i) Financial assets at fair value through profit or loss;
(ii) Held-to-maturity;
(iii) Loans and receivables; or
(iv) Available-for-sale;
and each financial liability into one of two categories:
(v) Financial liabilities at fair value through profit or loss; or
(vi) Other liabilities.

Where the Directors believed it appropriate to do so, financial assets have been reclassified out of the ‘available-for-sale’ category to ‘loans and receivables’ in accordance with the revisions to IAS 39 issued by the IASB in October 2008. Such reclassifications are permitted only under certain restricted circumstances, including that there is no active market for the asset. The asset is reclassified using its fair value at the point of transfer and from that point on is accounted for on an EIR basis. The difference between the carrying value at the point of reclassification and the expected value at the redemption date is recognised in profit or loss on an EIR basis over the expected life of the asset and the asset’s carrying value accretes to the redemption amount over that period, except where the asset has become impaired. The balance in the available-for-sale reserve which related to the asset is amortised to profit or loss over the expected life of the asset; in the Income Statement the amortisation of the difference between value at reclassification and at redemption and the amortisation out of the available-for-sale reserve exactly offset each other.

Measurement of financial instruments is either at amortised cost (categories (ii), (iii) and (vi) above) or at fair value (categories (i), (iv) and (v) above), depending on the category of financial instrument.

Amortised cost is the amount measured at initial recognition adjusted for subsequent principal and other payments, less cumulative amortisation calculated using the EIR method; the amortisation is taken to interest income or expense depending on whether the instrument is an asset or a liability. For assets, the amortised cost balance is reduced where appropriate by an allowance for amounts which are considered to be impaired or uncollectible.

## 1. Principal accounting policies (continued)

**(g) Financial instruments** (continued)
IFRS 13 'Fair Value Measurement' defines 'fair value' as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. Where an active market is considered to exist, fair values are based on quoted prices or lead manager prices. For instruments which do not have active markets, fair value is calculated using present value models, which take individual cash flows together with assumptions based on market conditions and credit spreads, and are consistent with accepted economic methodologies for pricing financial instruments. Interest income and interest expense on instruments carried at fair value are included in the Income Statement in 'interest receivable and similar income' or 'interest expense and similar charges'. Movements in fair value are recognised in the 'unrealised fair value movements on financial instruments' line in the Income Statement, except in the case of instruments categorised as 'available-for-sale', in which case the fair value movements are taken to the 'available-for-sale' reserve. On sale or de-recognition of an available-for-sale instrument the accumulated fair value movements are transferred from the 'available-for-sale' reserve to the 'net realised gains less losses on investment securities' line of the Income Statement.

**(h) Offsetting financial instruments**
Financial assets and liabilities are offset and the net amount reported in the Balance Sheet when and only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

**(i) Derivative financial instruments and hedge accounting**
All of the Group's derivative contracts are used for commercial management of exposures to interest rate risks, foreign currency risks and risks arising from forecast transactions.

For many of the Group's derivative contracts hedge accounting is applied. However, in some cases natural offsets apply.

Each derivative is carried at fair value in the Balance Sheet; as an asset when the fair value is positive and as a liability when the fair value is negative. The fair value of a derivative includes any interest accrued on that derivative. Changes in the fair value of derivatives are charged to the Income Statement; however by applying the hedge accounting rules set out in IAS 39 the changes in fair value of derivatives which are used to hedge particular risks can either be mitigated in the Income Statement (fair value hedge accounting) or recognised in other comprehensive income (cash flow hedge accounting). The Group has adopted cash flow hedge accounting and fair value hedge accounting.

(i) Cash flow hedge accounting
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 affects profit and loss. The fair value gain or loss relating to the ineffective portion is recognised immediately in the Income Statement.

(ii) Fair value hedge accounting
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. The Group uses fair value hedge accounting on one-to-one relationship and portfolio hedging bases, as described below.

Where hedge accounting is not applied, changes in fair values are recognised immediately in the Income Statement.

(iii) One-to-one fair value hedges
Where one or more specific derivative financial instruments hedge the changes in fair value of a specific asset or liability, provided that the hedge arrangement meets the requirements of IAS 39 to be classed as 'highly effective', the associated hedged item is carried on the Balance Sheet at fair value in respect of the hedged risk. Fair value gains and losses are recognised in the Income Statement, mitigating the fair value movements on the associated derivative financial instruments. The Income Statement immediately recognises any hedge accounting 'ineffectiveness', that is any difference between the fair value movement on the hedging instrument and that on the hedged item.

(iv) Portfolio fair value hedges
Where a group of derivative financial instruments hedges the interest rate exposure of a group of assets or liabilities, and the hedge meets the requirements of IAS 39 to be classed as 'highly effective', the hedge relationship is accounted for in the same way as a one-to-one fair value hedge except that the Balance Sheet carrying value of the hedged items is not adjusted; instead the difference between the carrying value and the fair value in respect of the hedged risk is carried on the Balance Sheet in 'fair value adjustments on portfolio hedging'.

## 1. Principal accounting policies (continued)

### (i) Derivative financial instruments and hedge accounting (continued)

(v) Hedge effectiveness
At the inception of each hedging arrangement, the relationship between the hedging instruments and the hedged items is documented, as well as the risk management objective and strategy. Also documented is an assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in the hedging arrangement are 'highly effective' in offsetting changes in fair values or cash flows of the hedged items. Under IAS 39 a hedge is deemed to be 'highly effective' if effectiveness is forecast to fall, and is actually found to fall, within the 80% to 125% range. Any hedge relationship falling outside these limits is deemed to be ineffective and hedge accounting is discontinued.

(vi) Termination of hedges
Where a hedge relationship is terminated or deemed not to be highly effective (other than as a result of the hedged item being de-recognised from the Balance Sheet due to sale or other reason), the adjustment relating to the terminated hedge relationship is amortised to the Income Statement over the period that the hedged item affects profit and loss.

(vii) Embedded derivatives
Certain financial instruments have derivative features embedded within them. Where the economic characteristics and risks of the embedded derivative are not closely related to those of the host instrument, and where changes in value of the host instrument are not reflected in the Income Statement, the embedded derivative is separated from the host and carried on the Balance Sheet at fair value, with gains and losses on the embedded derivative being recognised in the Income Statement. In accordance with IFRIC 9 'Reassessment of Embedded Derivatives' the decision as to whether to separate and value an embedded derivative is reassessed when and only when the terms of the host contract are significantly modified.

### (j) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') continue to be reported as they were originally classified within the Balance Sheet, as the risks and rewards associated with that asset have been retained. The counterparty liability is included in 'amounts due to banks' or 'other deposits'. Securities purchased under agreements to resell ('reverse repos') are recorded as 'cash at bank and in hand'. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the EIR method.

### (k) Impairment losses

Financial assets which are not held at fair value through profit or loss are reviewed for indications of possible impairment throughout the period and at each published Balance Sheet date. An impairment loss is recognised if, and only if, there is objective evidence that a loss event (or events) has occurred after initial recognition and before the Balance Sheet date and has a reliably measurable impact on the estimated future cash flows of the financial asset or group of financial assets. Losses that are incurred as a result of events occurring after the Balance Sheet date are not recognised.

(i) Financial assets held at amortised cost
For each asset an assessment is made as to whether an impairment provision should be made on either an individual or a collective basis. Assets where an individual impairment assessment is made include all loans in possession or held for sale with a Law of Property Act ('LPA') receiver and others which management consider to be individually impaired, for example where a fraud has been uncovered. The carrying value of the asset at the Balance Sheet date is reduced, by applying an impairment allowance, to the net present value of the expected future cash flows associated with the asset, calculated at the asset's original EIR. These cash flows include, where appropriate, estimated amounts recoverable by possession and sale of a secured property taking into account a discount on property value to reflect a forced sale.

All assets that have been assessed as having no individual impairment are then collectively assessed for impairment, grouped by assets with similar characteristics. Assessment is made of impairment arising due to events which are believed to have occurred by the Balance Sheet date but have not yet been reported, taking into account the economic climate in the market. This collective impairment is reflected by reducing the carrying value by applying an impairment allowance.

Impairment of assets is charged in the Income Statement in the 'impairment on loans to customers' and 'net impairment on investment securities' lines.

For impaired loans to customers, interest is accrued for accounting purposes on the loan amount after any impairment adjustments, in accordance with IAS 39, using the original EIR of the loan. However, for the purposes of the amount legally due from the borrower, interest continues to accrue on the full outstanding balance, and it is this full balance plus full interest which is pursued for collection.

## 1. Principal accounting policies (continued)

**(k) Impairment losses** (continued)
A loan to a customer is written off and any associated impairment allowance released when and only when the property is sold or the account is redeemed, or in respect of unsecured loans where the collections process indicates a loan is not recoverable. Any subsequent proceeds are recognised on a cash basis and offset against 'impairment on loans to customers' in the Income Statement. An investment security is written off and any associated impairment allowance released when there is strong evidence to suggest that nothing will be recovered.

Where a property has been taken into possession, or an LPA receiver has been appointed to collect rental income on the property, the loan continues to be carried within 'loans to customers'.

(ii) Available-for-sale financial assets
Investment securities classified as available-for-sale are carried at fair value, which appropriately reflects any impairment. Impairment is recognised when the investment security exhibits objective evidence of impairment or is uncollectible. Such evidence may include:

- Significant financial difficulty;
- Payment defaults;
- Renegotiation of terms due to borrower difficulty;
- Sustained fall in credit rating or creditworthiness;
- Significant restructuring;
- Disappearance of an active market;
- Significant and sustained fall in market price; or
- Observable data indicating measurable decrease in the estimated future cash flows from a group of financial assets, although the decrease cannot yet be identified within individual assets in the group.

Movements in the fair value which are a reflection of impairment of the long term value of the investment security are charged to 'net impairment on investment securities' in the Income Statement. Impairment losses recognised against investment securities are reversed through 'net impairment on investment securities' in the Income Statement if the improvement relates to an event occurring after the initial impairment was recognised. An investment security is written off and any associated impairment allowance released when there is strong evidence to suggest that nothing will be recovered.

If there is a sustained increase in the fair value of an investment security where an impairment loss has previously been recognised, but no improvement can be attributed to a subsequent credit event, then the increase in value may be treated as a revaluation and recognised through other comprehensive income in the available-for-sale reserve.

**(l) Recognition and de-recognition of assets and liabilities**
Purchases and sales of assets are accounted for once the parties are legally committed to the contract and the risks and rewards of the loans have been transferred.

A financial asset is de-recognised (i.e., removed from the Balance Sheet) only when substantially all of the risks and rewards associated with that asset have been transferred to another party.

A financial liability is de-recognised only when the contractual obligation is discharged, cancelled or has expired.

In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', assets and liabilities are classified as 'held for sale' if they are available for immediate sale in their present condition and the sale is considered to be 'highly probable'.

**(m) Debt and equity securities in issue**
Issued securities, including capital instruments, are classified as liabilities where the contractual arrangements result in the issuer 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 issuer. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the issuer's assets on the holder of the securities. Issued securities include ordinary and preference share capital. Preference shares are classified as equity instruments where dividend payments and redemptions are discretionary.

On initial recognition, debt issued is measured at its fair value net of directly attributable issue and transaction costs. Subsequent measurement is at amortised cost using the EIR method to amortise attributable issue and transaction costs, premia and discounts over the life of the instrument. These costs are charged along with interest on the debt to 'interest expense and similar charges'. In the Balance Sheet the carrying value of the instrument includes the amount of these adjustments which still remains to be charged to the Income Statement.

Equity instruments (including share capital) are initially recognised at net proceeds, after deducting transaction costs and any related income tax.

## 1. Principal accounting policies (continued)

**(n) Foreign currencies**
The presentation and functional currency of the Company and the presentation currency of the Group is pounds sterling.

Transactions which are not denominated in pounds sterling are translated into sterling at the spot rate of exchange on the date of the transaction. Monetary assets and liabilities which are not denominated in pounds sterling are translated into pounds sterling at the closing rate of exchange 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.

**(o) Intangible assets**
Intangible assets comprise capitalised computer software systems and licences.

Purchased computer software licences are capitalised as intangible assets where it is probable that future benefits will flow to the Group. Thereafter they are carried at cost less accumulated amortisation. Amortisation is provided on a straight line basis over their useful economic lives, which may be up to five years. Those which have a life expectancy at the outset of less than two years are not capitalised but instead their costs are charged to the Income Statement as they arise.

Costs that are directly associated with developing identifiable computer software systems are capitalised if the criteria in IAS 38 'Intangible Assets' are satisfied; the main criteria are that the successful completion of the development project is reasonably certain and that the software is expected to generate future economic benefits. Each item of capitalised developed computer software is carried at cost less accumulated amortisation; amortisation is provided on a straight line basis over its estimated useful life. Costs that do not qualify for capitalisation or are associated with maintaining software are charged to the Income Statement as they arise.

Intangible assets in the course of construction are not amortised until they have been completed. The costs of financing intangible assets in the course of construction are not included in the costs of the assets. Intangible assets in the course of construction are included in the impairment test referred to below, where appropriate.

All items of intangible assets are reviewed at each published Balance Sheet date for any indication of impairment. If there is indication of impairment, the carrying value is reviewed. If any impairment is identified, the asset is written down to the impaired value, being the higher of value in use and estimated net proceeds of sale, with the impairment being charged immediately to the Income Statement. In addition, the estimated useful lives are also reassessed annually, and if they are judged to have changed then the rate of amortisation charged in periods after the date of the change reflects the revised estimates.

**(p) Cash and cash equivalents**
Cash and cash equivalents comprise balances which are highly liquid and have an original maturity of three months or less.

**(q) Taxation**
(i) Current tax
The charge for taxation is based on the result for the period and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes. Tax relating to items which are taken directly to reserves is also taken directly to reserves.

(ii) Deferred tax
Deferred tax is calculated using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the Balance Sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. The principal temporary differences arise from depreciation of property, plant and equipment; revaluation of certain financial assets and liabilities including derivative contracts; provisions for pensions and other post-retirement benefits; tax losses carried forward; and changes in accounting basis on adoption of IFRS.

Deferred tax assets are recognised when it is probable that future taxable profits will be available against which these temporary differences can be utilised.

Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are recognised in other comprehensive income, is also recognised in other comprehensive income, and subsequently in the consolidated Income Statement together with the associated gain or loss.

## 1. Principal accounting policies (continued)

**(r) Retirement benefits**

The Group operates a number of retirement benefit plans for its employees, including defined contribution plans, defined benefit plans and post-retirement healthcare benefits. The costs of these plans are charged to the 'administrative expenses' line of the Income Statement and to other comprehensive income in accordance with IAS 19 'Employee Benefits' and IFRIC 14 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'.

A defined contribution plan is a pension arrangement where the employer pays fixed contributions into a separate fund. The contributions are charged to the Income Statement when employees have rendered the related services, which is generally in the period of contribution. The Group has no further payment obligations once the contributions have been paid. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

A defined benefit plan is a pension arrangement that defines an amount of pension benefit that an employee will receive during retirement, usually dependent on one or more factors such as age, years of service and salary.

A full actuarial valuation of the Group's defined benefit sections of the existing schemes is undertaken every three years, with interim reviews in the intervening years; these valuations are updated at each published balance sheet date by qualified independent actuaries. For the purpose of these updates, scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method. The inflation assumption used to determine B&B's benefit obligations is CPI, and to determine NRAM's is RPI. Details of the actuarial assumptions made are provided in note 17. The resulting net surplus or deficit is included in full in the Balance Sheet. A surplus on one scheme cannot be used to offset a deficit on another. Retirement benefit remeasurements are charged to retained earnings in full in the period in which they occur, and pass through other comprehensive income rather than the Income Statement. The Income Statement includes, for each scheme, the current service cost of providing pension benefits, the expected return on the scheme's assets, net of administration costs, and the interest cost on the scheme's liabilities. Following closure of the schemes, the current service cost is nil.

Though the schemes are in surplus on an accounting basis, they are in deficit on a trustee's funding basis. The Group is committed to funding plans to address these deficits. Surpluses on an accounting basis are only recognised on the Balance Sheet to the extent that they are recoverable through reduced contributions in the future or through refunds from the scheme.

In B&B, post-retirement healthcare benefits are accounted for in the same way as pension benefits, with the present value of the defined benefit obligation being carried as a liability on the Balance Sheet. NRAM does not provide post-retirement healthcare benefits.

**(s) Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, as appropriate. 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 expenditure is regarded as repairs and maintenance and is charged to the Income Statement in the period in which it is incurred. Depreciation is provided so as to write off the cost less the estimated residual value of each significant component of each item of property, plant and equipment over that component's estimated useful life, as follows:

- Freehold land is not depreciated
- Freehold and leasehold buildings 6.7% pa on a straight line basis
- Motor vehicles 25% pa on a reducing balance basis
- Computer equipment 20% - 33% pa on a straight line basis
- Fixtures and fittings 20% pa on a straight line basis
- Other plant and equipment and major alterations to buildings 10% pa on a straight line basis or over the remaining life of the building if shorter.

All items of property, plant and equipment are reviewed at each published balance sheet date for any indication of impairment. If there is indication of impairment, the carrying value is reviewed. If any impairment is identified, the asset is written down to the higher of value in use and estimated net proceeds of sale, with the impairment being charged immediately in the Income Statement. In addition, the estimated useful lives and estimated residual values are also reassessed annually, and if they are judged to have changed then the rate of depreciation charged in periods after the date of the change reflects the revised estimates.

Assets in the course of construction are not depreciated until they have been completed and transferred to the appropriate category of property, plant and equipment. The costs of financing assets in the course of construction are not included in the costs of the assets. Assets in the course of construction are included within the impairment test referred to above where appropriate.

A previously recognised impairment charge on an 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 asset will not be increased above the carrying value at which it would have been held had the impairment not been recognised.

## 1. Principal accounting policies (continued)

**(t) Leases**

Rentals under operating leases are charged to 'administrative expenses' on a straight line basis to the date of change in the rental amount. Typically operating leases have rent review dates in their terms, several years apart, and between those dates the annual rent remains constant. Any initial rent-free period and any lease premia paid are amortised over the full lease period on a straight line basis.

If a 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 and fair value. The asset is then depreciated in the same way as an owned asset, over the shorter of the useful life and the term of the lease. The finance element of the lease cost is charged to the Income Statement in 'interest expense and similar charges'. 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.

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.

Where the Group leases assets out under an operating lease agreement, the asset is included in the Balance Sheet based on the nature of the asset. Lease income is recognised over the term of the lease on a straight line basis.

Where the Group sells and leases back an asset, provided the sale and the lease are each on arm's length terms, the two elements of the transaction are accounted for separately, with a profit or loss being immediately recognised on the sale.

**(u) Provisions and contingent liabilities**

Provisions are recognised when, and only when, the following criteria are all met:

- there is a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

Provisions are reviewed at each Balance Sheet date and are released if they no longer meet the above criteria.

Provisions are discounted to net present value using rates which reflect the risks specific to the provision, if the effect of discounting is material.

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 Balance Sheet but are disclosed unless they are remote.

**(v) Investment securities held**

Investment securities intended for use on a continuing basis in the Group's activities are categorised either as 'available-for-sale' or as 'loans and receivables'; for each instrument, the Directors adopt the category which they consider to be the most appropriate.

Investment securities categorised as available-for-sale are carried at fair value with movements in fair value, excluding impairment provisions, being taken to the available-for-sale reserve. If an investment security which has been categorised as available-for-sale becomes impaired, the impairment is charged to the Income Statement in the 'net impairment on investment securities' line.

Investment securities categorised as loans and receivables are carried at amortised cost less any impairment, with any impairment being charged to the Income Statement in the 'net impairment on investment securities' line.

Where the Directors believe it appropriate to do so, investment securities which were initially categorised as 'available-for-sale' have subsequently been re-categorised to 'loans and receivables' in accordance with the revisions to IAS 39 issued by the IASB in October 2008.

**(w) Financial guarantees**

The Group applies insurance accounting to financial guarantee contracts, and provides against any claims arising under such contracts.

**(x) Loan commitments**

Loan commitments are disclosed, but are accounted for only if there is an onerous commitment; there were no onerous loan commitments in the period or the previous year. The commitment ceases to be disclosed once it is advanced or expires. Loan commitments comprise commitments to advance cash sums and to allow drawdown of monies previously overpaid (where the terms of the loan specifically allow). In respect of monthly drawdown products, the commitment reflects an estimate of the future drawdowns to redemption.

## 2. Critical judgements and accounting estimates

In preparing the Financial Statements, management are required to make a series of judgements and estimates. Judgements involve an interpretation of requirements to decide how to allocate, value or recognise an item. Estimates arise from using assumptions which result in a range of possible outcomes. The most important judgements and estimates used in preparing these Financial Statements are described below.

**(a) Impairment of investment securities**
For investment securities carried at fair value, judgement is applied in determining whether any fall in value represents impairment and whether any increase represents a reversal of impairment. Factors considered in determining whether an asset is impaired, or impairment has reversed, are detailed in note 1(k).

**(b) Impairment losses on loans**
The Group reviews its loan impairment on a monthly basis and assesses individual impairment losses by reference to an individual review of the underlying asset and utilises actual loss experience to provide both probabilities of defaults and property forced sale discounts across a portfolio of products. Collective impairment losses on loans are calculated using a statistical model. The key assumptions used in this model are: the probability of any balance entering into default 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 estimated subsequent loss incurred. These key assumptions are based on observed data trends and are updated on a regular basis within agreed methodology to ensure the impairment allowance is entirely representative 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 house prices were to change by +/- 10%, the residential impairment allowance would be an estimated £76.4m lower (2014: £108.7m) or £87.3m higher (2014: £115.5m) respectively.

**(c) Provisions**
Provisions are carried in respect of certain known or forecast future expenditure, as described in note 24. Where the future payment amount is unknown, provisions are set at a level which covers the estimated number of future payments and the estimated average payment amount. Provisions are calculated using the best available information but the actual future outcomes of items provided for may differ from expectations.

**(d) Fair value calculations**
For the majority of instruments carried at fair value, fair value is determined by reference to quoted market prices or lead manager prices. Where these are not available, fair value is calculated using discounted cash flows, applying independently sourced market parameters including interest rates and currency rates. Other factors are also considered, such as counterparty credit quality and liquidity. Management must use judgement to arrive at 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 may, therefore, be affected by unexpected market movements or variations in actual outcomes when compared to estimates and assumptions used for modelling purposes. For example, if management were to use a tightening in the credit spread of 10 basis points, the fair value of derivatives would increase from the reported fair values by £4.3m (2014: £9.4m decrease).

**(e) Assets and liabilities held for sale**
In March 2015 the Group announced that the Board would seek expressions of interest in respect of potential divestments of assets and liabilities including options around the Granite securitisation vehicle originally established by Northern Rock in 2001. In parallel, the Group would also explore potential options for the divestment of the mortgage servicing activities. Any transactions will be contingent on achieving value for money for the taxpayer. In the opinion of the Directors, significant further work is required to separate out the assets, liabilities and operations in preparation for any sale. Also these potential transactions are not sufficiently advanced so as to consider a sale 'highly probable'. Hence no assets or liabilities have been classified as held for sale as at 31 March 2015.

## 3. Net interest income

| | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| **Interest receivable and similar income** | | |
| On secured loans | **1,909.1** | 2,714.9 |
| On other lending | **54.3** | 89.6 |
| On investment securities and deposits | **47.4** | 80.0 |
| **Total interest receivable and similar income** | **2,010.8** | 2,884.5 |
| | | |
| **Interest expense and similar charges** | | |
| On amounts due to banks and HM Treasury | **(402.5)** | (741.9) |
| State guarantee fee* | **(31.2)** | (46.9) |
| On debt securities and other | **(208.1)** | (265.1) |
| **Total interest expense and similar charges** | **(641.8)** | (1,053.9) |
| | | |
| **Net interest income** | **1,369.0** | 1,830.6 |
| | | |
| **Average balances** | | |
| Interest-earning assets ('IEA') | **66,376** | 75,489 |
| | | |
| **Financed by:** | | |
| - interest-bearing funding | **41,313** | 50,805 |
| - interest-free funding** | **25,063** | 24,684 |
| | | |
| **Average rates:** | **%** | % |
| - gross yield on IEA | **3.03** | 3.07 |
| - cost of interest-bearing funding** | **(1.48)** | (1.59) |
| **Interest spread** | **1.55** | 1.48 |
| State guarantee fee* | **(0.05)** | (0.05) |
| Contribution of interest-free funding** | **0.56** | 0.52 |
| **Net interest margin on average IEA** | **2.06** | 1.95 |
| | | |
| Average Bank Base Rate | **0.50** | 0.50 |
| Average 1-month LIBOR | **0.50** | 0.49 |
| Average 3-month LIBOR | **0.55** | 0.51 |

* *At the time of the nationalisation of B&B, HM Treasury provided guarantees with regard to certain wholesale borrowings and derivative transactions existing at that time. The amount of this fee is dependent on balances outstanding, and hence it is included within 'interest expense and similar charges'. The cost of interest-bearing funding is shown excluding this state guarantee fee. At the time of the nationalisation of NRAM, HM Treasury provided a guarantee with regard to certain wholesale borrowings and derivative transactions existing at that time. The amount of this fee is currently £12.0m pa. It is not dependent on balances outstanding and hence it is included within 'fee and commission expense'.*

** *Interest-free funding is calculated as an average over the financial period and includes the Statutory Debt and share capital and reserves.*

Total interest receivable and similar income includes interest accrued on individually impaired assets of £18.3m (2014: £37.4m).

## 4. Net realised gains less losses on investment securities

Net realised gains less losses on investment securities recognised in the Income Statement comprised the following:

| | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Net realised gains on available-for-sale instruments | **4.5** | 11.6 |
| Net realised gains/(losses) on instruments at amortised cost | **8.3** | (24.1) |
| **Total net realised gains/(losses) on investment securities** | **12.8** | (12.5) |

## 5. Unrealised fair value movements on financial instruments and hedge ineffectiveness

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Net gain/(loss) in fair value: | | |
| - translation gains/(losses) on underlying instruments | **31.2** | (38.8) |
| - fair value movements on derivatives which are economic hedges but are not in hedge accounting relationships | **(39.3)** | 9.2 |
| **Unrealised fair value movements** | **(8.1)** | (29.6) |
| | | |
| Net gains on fair value hedging instruments | **206.3** | 180.4 |
| Net losses on fair value hedged items attributable to hedged risk | **(232.0)** | (188.6) |
| Hedge adjustment release | **(51.4)** | (9.1) |
| Ineffectiveness on cash flow hedges | **2.2** | (10.3) |
| **Net hedge ineffectiveness losses** | **(74.9)** | (27.6) |
| **Total** | **(83.0)** | (57.2) |

Following reassessment of the lifetime mortgage portfolio there has been a release of deferred adjustments pertaining to hedged risk, reflecting a proportional reduction in lifetime mortgage balances.

## 6. Administrative expenses

Employees of B&B provide services to NRAM, UKAR and UKARcs. NRAM, UKAR and UKARcs had no direct employees during the periods presented.

The monthly average number of persons employed by B&B during the period was as follows:

| | **12 months to 31 Mar 2015 Number** | 15 months to 31 Mar 2014 Number |
|---|---|---|
| **Average headcount:** | | |
| Full time | **1,710** | 1,830 |
| Part time | **411** | 418 |
| **Total employed** | **2,121** | 2,248 |
| **Total average full time equivalent** | **1,993** | 2,111 |

The full time equivalent is based on the average hours worked by employees in the period.

The number of persons employed by B&B at the end of the period was as follows:

| | **31 Mar 2015 Number** | 31 Mar 2014 Number |
|---|---|---|
| Full time | **1,648** | 1,741 |
| Part time | **430** | 401 |
| **Total employed** | **2,078** | 2,142 |
| **Total full time equivalent headcount** | **1,949** | 2,014 |

Staff numbers include Executive but not Non-Executive Directors.

In addition to the permanent staff above, the Group had engaged a full time equivalent of 221 temporary staff and specialist contractors at 31 March 2015 (31 March 2014: 334).

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| The Group's aggregate costs of permanent staff were as follows: | | |
| Wages and salaries | **58.6** | 71.3 |
| Social security costs | **5.9** | 7.4 |
| Defined benefit pension costs (see note 17) | **(4.3)** | (0.8) |
| Defined contribution pension costs (see note 17) | **4.1** | 4.2 |
| Other retirement benefit costs (see note 17) | **0.4** | 0.6 |
| **Total staff costs** | **64.7** | 82.7 |
| IT costs | **35.0** | 63.0 |
| Outsourced and professional services | **19.6** | 30.4 |
| Depreciation and amortisation (see notes 18 and 19) | **16.8** | 19.4 |
| Other administrative expenses | **41.1** | 50.8 |
| **Total administrative expenses** | **177.2** | 246.3 |

## 6. Administrative expenses (continued)

**Exit packages**

No exit packages were paid in respect of Directors in the year or previous period.

For other employees, redundancy and other departure costs have been paid in accordance with the Group's policies and with legal requirements.

Exit costs are provided for in accordance with IAS 37 when there is a present obligation and it is probable that an exit payment will be made.

| **Exit package cost band** | | **12 months to 31 Mar 2015** | | | 12 months to 31 Mar 2014* | |
|---|---|---|---|---|---|---|
| | **Number of compulsory redundancies** | **Number of other departures agreed** | **Total number of exit packages by cost band** | Number of compulsory redundancies | Number of other departures agreed | Total number of exit packages by cost band |
| **< £10,000** | **2** | **10** | **12** | 52 | 27 | 79 |
| **£10,001 - £25,000** | **8** | **3** | **11** | 105 | 6 | 111 |
| **£25,001 - £50,000** | **9** | **-** | **9** | 43 | - | 43 |
| **£50,001 - £100,000** | **-** | **1** | **1** | 11 | 1 | 12 |
| **£100,001 - £150,000** | **-** | **2** | **2** | 6 | 2 | 8 |
| **£150,001 - £200,000** | **-** | **-** | **-** | 2 | 1 | 3 |
| **£200,001 - £250,000** | **-** | **1** | **1** | 3 | 3 | 6 |
| **Total number of exit packages** | **19** | **17** | **36** | 222 | 40 | 262 |
| **Total cost (£'000)** | **450** | **610** | **1,060** | 5,958 | 1,435 | 7,393 |

** The comparative period disclosed is the 12 months to 31 March 2014 as this is the comparative accounting period of HM Treasury.*

**Auditors' remuneration**

The following costs are included within administrative expenses:

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Fees payable to Company auditors for the statutory audit of the UKAR Company and Group Financial Statements | **0.1** | 0.1 |
| Fees payable to Company auditors and their associates for other services: | | |
| - the audit of the Company's subsidiaries pursuant to legislation | **0.6** | 0.6 |
| - audit-related assurance services | **0.3** | 0.3 |
| **Total** | **1.0** | 1.0 |

Amounts shown in the above analysis are exclusive of VAT.

No separate disclosure has been provided of fees payable in respect of the Company as the consolidated Financial Statements are required to disclose these fees on a consolidated basis, as shown in the above table.

## 7. (Loss)/gain on repurchase of own liabilities and equity

| 12 months to 31 March 2015 | Reserve capital instruments £m | Subordinated notes £m | Total losses taken to reserves £m | Capital instruments £m | Debt securities in issue £m | Total Income Statement losses £m |
|---|---|---|---|---|---|---|
| Principal amount of instruments repurchased | 101.4 | 23.4 | 124.8 | 152.1 | 431.7 | 583.8 |
| Amount paid to repurchase instruments | (176.8) | (40.9) | (217.7) | (253.2) | (371.0) | (624.2) |
| Other net gains/(losses) resulting from the repurchase* | 68.9 | 16.9 | 85.8 | 50.2 | (79.9) | (29.7) |
| **Loss on repurchase** | **(6.5)** | **(0.6)** | **(7.1)** | **(50.9)** | **(19.2)** | **(70.1)** |

A tax credit of £19.1m applies to the £7.1m loss on reserve capital instruments and subordinated notes, giving a post-tax gain of £12.0m.

| 15 months to 31 March 2014 | Reserve capital instruments £m | Subordinated notes £m | Total gains taken to reserves £m | Capital instruments £m | Debt securities in issue £m | Total Income Statement gains £m |
|---|---|---|---|---|---|---|
| Principal amount of instruments repurchased | - | - | - | 5.3 | - | 5.3 |
| Amount paid to repurchase instruments | - | - | - | (3.2) | - | (3.2) |
| Other net gains resulting from the repurchase* | - | - | - | 0.8 | - | 0.8 |
| Gain on repurchase | - | - | - | 2.9 | - | 2.9 |

** The other net gains and losses taken to reserves were principally release of deferred coupons of £83.7m. The other net gains and losses taken to the Income Statement were principally hedge adjustments, accelerated amortisation of the discounting effect of deferral of coupons and fees.*

In January 2015 the Group bought back the majority of the capital instruments and non-controlling interests in issue (see notes 25 and 29). During the year, the Group also bought back certain debt securities (see note 22). The losses on repurchase of reserve capital instruments and subordinated notes are reported in reserves as these instruments were accounted for as equity; the capital instruments and debt securities in issue were accounted for as liabilities.

## 8. Taxation

| The tax charge for the period comprises: | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Current tax: | | |
| - on profit for the period | **(180.9)** | (291.3) |
| - adjustments in respect of prior periods | **4.8** | 19.1 |
| Total current tax | **(176.1)** | (272.2) |
| | | |
| Deferred tax (see note 15): | | |
| - origination and reversal of temporary differences | **(24.6)** | (36.9) |
| - change in rate on deferred tax items | **-** | 0.8 |
| Total deferred tax | **(24.6)** | (36.1) |
| **Total taxation charge per the Income Statement** | **(200.7)** | (308.3) |

| The following tax amounts have been (charged)/credited to equity: | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Current tax: | | |
| - relating to available-for-sale investments | **(1.5)** | (15.8) |
| - relating to repurchase of equity (see note 7) | **19.1** | - |
| Deferred tax: | | |
| - relating to cash flow hedge reserve | **(5.9)** | 29.9 |
| - relating to retirement benefit remeasurements | **(22.0)** | 1.0 |
| - relating to available-for-sale investments | **-** | (1.7) |
| **Net (charge)/credit to equity** | **(10.3)** | 13.4 |

There was no foreign tax charged in the year (2014: £nil).

The tax charge 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 21% (2014: 23.2%) as follows:

| | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| **Profit before taxation** | **972.3** | 1,374.3 |
| | | |
| Tax calculated at rate of 21% (2014: 23.2%) | **(204.2)** | (318.8) |
| Effects of: | | |
| - change in rate on deferred tax items | **-** | 0.8 |
| - expenses not deductible for tax purposes | **(1.6)** | (7.4) |
| - adjustments in respect of prior periods | **5.1** | 17.1 |
| **Total taxation charge for the period** | **(200.7)** | (308.3) |

Taxation appropriately reflects changes in tax rates which had been substantively enacted by the Balance Sheet date, as detailed in note 15.

## 9. Balances with the Bank of England

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Balances for liquidity purposes | **5,637.5** | 3,213.5 |
| Collateral balances | **1,279.2** | 1,806.8 |
| **Total** | **6,916.7** | 5,020.3 |

Balances with the Bank of England represent cash liquidity and collateral held on account which earn Bank Base Rate.

## 10. Investment securities

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Available-for-sale securities | **158.1** | 321.3 |
| Investment securities held as loans and receivables | **364.6** | 679.4 |
| Unsecured investment loans | **-** | 74.0 |
| **Total** | **522.7** | 1,074.7 |

In the Balance Sheet the carrying values of impaired assets are presented net of the impairment allowances shown in note 11.

Net impairment release on investment securities for the period comprised:

| | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Net impairment reversals on available-for-sale securities | **2.1** | 14.0 |
| Net impairment reversals on investment securities held as loans and receivables and unsecured investment loans | **14.3** | 3.7 |
| **Total net impairment release** | **16.4** | 17.7 |

| **(a) Available-for-sale securities** | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| At fair value: | | |
| Listed | **157.7** | 303.1 |
| Unlisted | **0.4** | 18.2 |
| **Total** | **158.1** | 321.3 |

The movement in available-for-sale securities was as follows:

| | 12 months to 31 Mar 2015 £m | 15 months to 31 Mar 2014 £m |
|---|---|---|
| **At start of period** | **321.3** | 635.5 |
| Disposals (sales and redemptions) | **(160.4)** | (327.3) |
| Exchange differences | **(5.1)** | 3.2 |
| Net gains on changes in fair value | **2.3** | 9.9 |
| **At end of period** | **158.1** | 321.3 |

The net gains on changes in fair value include net impairment reversals.

| **(b) Investment securities held as loans and receivables** | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Carrying value | **364.6** | 679.4 |
| Fair value | **397.8** | 688.7 |
| Listed | **354.7** | 668.0 |
| Unlisted | **9.9** | 11.4 |
| **Total** | **364.6** | 679.4 |

Note 33(a) provides further information regarding investment securities which have been reclassified as loans and receivables.

| **(c) Unsecured investment loans** | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Carrying value | **-** | 74.0 |
| Fair value | **16.0** | 85.1 |
| Listed | **-** | 74.0 |
| **Total** | **-** | 74.0 |

## 11. Wholesale assets

The assets in the following tables are of a wholesale nature as opposed to individual customer assets. The credit and concentration risk characteristics of these portfolios should, therefore, be considered together.

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Balances with the Bank of England (see note 9) | **6,916.7** | 5,020.3 |
| Cash at bank and in hand | **2,266.4** | 2,503.2 |
| Investment securities (see note 10) | **522.7** | 1,074.7 |
| **Total** | **9,705.8** | 8,598.2 |

The Group had no collateral or other credit enhancements in respect of these assets.

**(a) Credit risk**

Impairment is set out in the table below:

| At 31 March 2015 | Balances with the Bank of England £m | Cash at bank and in hand £m | Available-for-sale securities £m | Investment securities held as loans and receivables £m | Unsecured investment loans £m | Total £m |
|---|---|---|---|---|---|---|
| Neither past due nor impaired | **6,916.7** | **2,266.4** | **59.5** | **338.5** | **-** | **9,581.1** |
| Impaired | **-** | **-** | **352.7** | **65.7** | **87.5** | **505.9** |
| | **6,916.7** | **2,266.4** | **412.2** | **404.2** | **87.5** | **10,087.0** |
| Provisions | **-** | **-** | **(254.1)** | **(39.6)** | **(87.5)** | **(381.2)** |
| **Total** | **6,916.7** | **2,266.4** | **158.1** | **364.6** | **-** | **9,705.8** |

| At 31 March 2014 | Balances with the Bank of England £m | Cash at bank and in hand £m | Available-for-sale securities £m | Investment securities held as loans and receivables £m | Unsecured investment loans £m | Total £m |
|---|---|---|---|---|---|---|
| Neither past due nor impaired | 5,020.3 | 2,503.2 | 181.6 | 661.1 | - | 8,366.2 |
| Impaired | - | - | 374.1 | 85.1 | 216.9 | 676.1 |
| | 5,020.3 | 2,503.2 | 555.7 | 746.2 | 216.9 | 9,042.3 |
| Provisions | - | - | (234.4) | (66.8) | (142.9) | (444.1) |
| Total | 5,020.3 | 2,503.2 | 321.3 | 679.4 | 74.0 | 8,598.2 |

The credit quality of wholesale assets by reference to credit ratings is set out in the table below:

| At 31 March 2015 | £m | AAA % | AA % | A % | BBB to B % | CCC and below % |
|---|---|---|---|---|---|---|
| Balances with the Bank of England | **6,916.7** | **-** | **100** | **-** | **-** | **-** |
| Cash at bank and in hand | **2,266.4** | **8** | **53** | **26** | **13** | **-** |
| Investment securities: | | | | | | |
| - available-for-sale securities | **158.1** | **35** | **1** | **46** | **2** | **16** |
| - investment securities held as loans and receivables | **364.6** | **5** | **22** | **24** | **44** | **5** |
| Total investment securities | **522.7** | **14** | **16** | **31** | **31** | **8** |
| **Total** | **9,705.8** | **3** | **84** | **8** | **5** | **-** |

## 11. Wholesale assets (continued)

### (a) Credit risk (continued)

| At 31 March 2014 | £m | AAA % | AA % | A % | BBB to B % | CCC and below % |
|---|---|---|---|---|---|---|
| Balances with the Bank of England | 5,020.3 | 100 | - | - | - | - |
| Cash at bank and in hand | 2,503.2 | 13 | 52 | 28 | 7 | - |
| Investment securities: | | | | | | |
| - available-for-sale securities | 321.3 | 42 | 1 | 27 | 4 | 26 |
| - investment securities held as loans and receivables | 679.4 | 3 | 23 | 31 | 32 | 11 |
| - unsecured investment loans | 74.0 | - | - | - | - | 100 |
| Total investment securities | 1,074.7 | 15 | 16 | 30 | 23 | 16 |
| Total | 8,598.2 | 64 | 17 | 12 | 5 | 2 |

Additional information in respect of impairment of investment securities is provided in note 10.

### (b) Concentration risk

Wholesale assets are analysed by geographical region at their carrying amounts in the table below:

| **At 31 March 2015** | **UK £m** | **Europe £m** | **US £m** | **Other countries £m** | **Total £m** |
|---|---|---|---|---|---|
| Balances with the Bank of England | **6,916.7** | **-** | **-** | **-** | **6,916.7** |
| Cash at bank and in hand | **1,876.1** | **345.1** | **45.2** | **-** | **2,266.4** |
| Investment securities: | | | | | |
| - available-for-sale securities | **49.9** | **93.8** | **7.5** | **6.9** | **158.1** |
| - investment securities held as loans and receivables | **195.5** | **130.6** | **23.6** | **14.9** | **364.6** |
| Total investment securities | **245.4** | **224.4** | **31.1** | **21.8** | **522.7** |
| **Total** | **9,038.2** | **569.5** | **76.3** | **21.8** | **9,705.8** |

| At 31 March 2014 | UK £m | Europe £m | US £m | Other countries £m | Total £m |
|---|---|---|---|---|---|
| Balances with the Bank of England | 5,020.3 | - | - | - | 5,020.3 |
| Cash at bank and in hand | 1,809.8 | 520.3 | 173.1 | - | 2,503.2 |
| Investment securities: | | | | | |
| - available-for-sale securities | 70.5 | 202.6 | 7.7 | 40.5 | 321.3 |
| - investment securities held as loans and receivables | 269.7 | 36.2 | 11.4 | 362.1 | 679.4 |
| - unsecured investment loans | - | - | - | 74.0 | 74.0 |
| Total investment securities | 340.2 | 238.8 | 19.1 | 476.6 | 1,074.7 |
| Total | 7,170.3 | 759.1 | 192.2 | 476.6 | 8,598.2 |

At 31 March 2015 and 31 March 2014 the Group held no investment securities issued by the governments of Portugal, the Republic of Ireland, Italy, Greece or Spain.

## 12. Loans to customers

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Residential mortgages | **51,085.1** | 59,344.6 |
| Commercial loans | **536.3** | 623.0 |
| Total secured loans | **51,621.4** | 59,967.6 |
| Unsecured loans | **1,061.1** | 1,281.9 |
| **Total** | **52,682.5** | 61,249.5 |

Residential mortgages include all of the Group's buy-to-let loans. Commercial loans comprise loans secured on commercial properties. The 'Together' product, previously offered by NRAM, combines a secured and unsecured loan all at one interest rate. Outstanding secured balances in respect of this product are included within total residential mortgages while outstanding unsecured balances are included within unsecured loans.

All of the Group's loans to customers are to UK customers.

Balances include accounting adjustments in respect of provisioning requirements.

Loans to customers include loans amounting to £34,665.6m (31 March 2014: £40,570.4m) which have been sold to bankruptcy-remote SPVs whereby substantially all of the risks and rewards of the portfolio are retained by the Group. Accordingly, all of these loans are retained on the Group's Balance Sheet. Further details are provided in note 22.

Fair value adjustments on portfolio hedging amounting to £467.7m (2014: £308.8m) relate to interest rate derivatives designated in a fair value portfolio hedge relationship.

Loans to customers and redemptions comprise the following product types:

| | Balances At 31 Mar 2015 £m | % | Redemptions 12 months to 31 Mar 2015 £m | Balances At 31 Mar 2014 £m | % | Redemptions 15 months to 31 Mar 2014 £m |
|---|---|---|---|---|---|---|
| **Residential mortgages** | | | | | | |
| Buy-to-let | **21,629.1** | **42** | **(1,396.1)** | 23,061.9 | 39 | (1,299.5) |
| Self Cert | **5,591.8** | **11** | **(427.0)** | 5,983.6 | 10 | (400.6) |
| Together | **9,962.5** | **20** | **(1,485.1)** | 11,615.4 | 20 | (1,379.2) |
| Standard and other | **13,901.7** | **27** | **(2,011.9)** | 18,683.7 | 31 | (2,739.3) |
| **Total residential mortgages** | **51,085.1** | **100** | **(5,320.1)** | 59,344.6 | 100 | (5,818.6) |
| Residential loans | **51,085.1** | **97** | **(5,320.1)** | 59,344.6 | 97 | (5,818.6) |
| Commercial loans | **536.3** | **1** | **(90.0)** | 623.0 | 1 | (150.2) |
| **Total secured loans** | **51,621.4** | **98** | **(5,410.1)** | 59,967.6 | 98 | (5,968.8) |
| Unsecured loans | **1,061.1** | **2** | **(104.6)** | 1,281.9 | 2 | (88.4) |
| **Total** | **52,682.5** | **100** | **(5,514.7)** | 61,249.5 | 100 | (6,057.2) |

At 31 March 2015 46% (2014: 46%) of the Group's residential mortgage accounts (excluding buy-to-let) held by 122,000 (2014: 152,000) customers were 'interest only' with 75% (2014: 73%) of these having more than ten years until maturity.

Redemptions comprise full redemptions, voluntary partial redemptions and cash receipts from possessions but exclude overpayments and regular monthly payments.

In October 2014 the Group sold a portfolio of standard mortgages for £2.7bn, at which point the buyer assumed the position that it would have been in had it acquired the portfolio at the end of May 2014. Settlement proceeds were received on 27 October 2014. The accounting profit on the sale was £18.3m. During the year the Group also released £4.0m of provisions relating to sales in earlier periods, as those provisions were no longer required. In July 2013 NRAM sold its standalone unsecured personal loan book realising a profit on sale of £21.2m. These sales are excluded from the redemptions disclosed in the above table.

## 13. Impairment on loans to customers

Allowances for credit losses against loans to customers have been made as follows:

| | **On residential mortgages** | **On commercial loans** | **On unsecured loans** | **Total** |
|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** |
| **At 1 April 2014** | **1,151.8** | **90.9** | **214.7** | **1,457.4** |
| Movements during the year: | | | | |
| - write-offs | **(154.2)** | **(12.0)** | **(32.3)** | **(198.5)** |
| - loan impairment (credit)/charge | **(109.6)** | **(2.2)** | **22.7** | **(89.1)** |
| Net movements during the year | **(263.8)** | **(14.2)** | **(9.6)** | **(287.6)** |
| **At 31 March 2015** | **888.0** | **76.7** | **205.1** | **1,169.8** |
| The Income Statement credit comprises: | | | | |
| - loan impairment (credit)/charge | **(109.6)** | **(2.2)** | **22.7** | **(89.1)** |
| - recoveries net of costs | **(60.8)** | **(0.7)** | **-** | **(61.5)** |
| **Total Income Statement (credit)/charge** | **(170.4)** | **(2.9)** | **22.7** | **(150.6)** |

| | On residential mortgages | On commercial loans | On unsecured loans | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| At 1 January 2013 | 1,411.1 | 100.0 | 403.8 | 1,914.9 |
| Movements during the period: | | | | |
| - write-offs | (374.1) | (19.4) | (82.2) | (475.7) |
| - loan impairment charge | 114.8 | 10.3 | 41.4 | 166.5 |
| - sale of unsecured loans (see note 12) | - | - | (148.3) | (148.3) |
| Net movements during the period | (259.3) | (9.1) | (189.1) | (457.5) |
| At 31 March 2014 | 1,151.8 | 90.9 | 214.7 | 1,457.4 |
| The Income Statement charge comprises: | | | | |
| - loan impairment charge | 114.8 | 10.3 | 41.4 | 166.5 |
| - recoveries net of costs | (62.0) | (4.4) | (5.0) | (71.4) |
| Total Income Statement charge | 52.8 | 5.9 | 36.4 | 95.1 |

In respect of lifetime mortgages, the allowances include an additional provision reflecting estimated future impairment up to redemption. In the Balance Sheet the carrying values of loans to customers are presented net of these allowances.

## 14. Credit quality of loans to customers

In respect of loans to residential customers, the Group holds collateral in the form of mortgages over residential properties. The fair value of this collateral was as follows:

| | **31 Mar 2015** | 31 Mar 2014 |
|---|---|---|
| | **£m** | £m |
| Neither past due nor impaired | **74,689.0** | 80,744.9 |
| Past due but not impaired | **4,078.5** | 4,651.8 |
| Impaired | **659.2** | 784.9 |
| **Total** | **79,426.7** | 86,181.6 |

If the collateral amount on each individual loan were capped at the amount of the balance outstanding and any surplus of collateral values over balances outstanding ignored, the fair value of collateral held would be as follows:

| | **31 Mar 2015** | 31 Mar 2014 |
|---|---|---|
| | **£m** | £m |
| Neither past due nor impaired | **47,989.3** | 55,139.6 |
| Past due but not impaired | **3,025.3** | 3,757.9 |
| Impaired | **539.4** | 695.5 |
| **Total** | **51,554.0** | 59,593.0 |
| The impaired balances above include the following carrying amount of assets in possession, capped at the balance outstanding | **107.2** | 147.0 |

The fair value of the collateral is estimated by taking the most recent valuation of the property and adjusting for house price inflation or deflation up to the Balance Sheet date.

## 14 Credit quality of loans to customers (continued)

The indexed loan to value ('LTV') of residential loan balances, weighted by loan balance, falls into the following ranges:

| | **31 March 2015** | 31 March 2014 |
|---|---|---|
| | **%** | % |
| To 50% | **9.5** | 7.6 |
| 50% to 75% | **34.0** | 21.8 |
| 75% to 100% | **47.9** | 52.7 |
| Over 100% | **8.6** | 17.9 |
| **Total** | **100.0** | 100.0 |

The average indexed LTV based on a simple average is 65.4% (31 March 2014: 70.2%) and on a weighted average is 76.4% (31 March 2014: 82.9%).

| | **At 31 March 2015** | | | | At 31 March 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Residential mortgages** | **Commercial loans** | **Unsecured loans** | **Total** | Residential mortgages | Commercial loans | Unsecured loans | Total |
| | **£m** | **£m** | **£m** | **£m** | £m | £m | £m | £m |
| Neither past due nor impaired | **48,315.6** | **443.8** | **1,054.8** | **49,814.2** | 55,856.3 | 446.4 | 1,225.8 | 57,528.5 |
| Past due but not impaired: | | | | | | | | |
| - less than 3 months | **1,874.2** | **2.4** | **48.1** | **1,924.7** | 2,303.3 | 1.5 | 84.0 | 2,388.8 |
| - 3 to 6 months | **705.7** | **-** | **16.7** | **722.4** | 919.3 | - | 26.9 | 946.2 |
| - over 6 months | **490.2** | **-** | **117.7** | **607.9** | 643.3 | - | 130.8 | 774.1 |
| Impaired | **587.4** | **166.8** | **28.9** | **783.1** | 774.2 | 266.0 | 29.1 | 1,069.3 |
| | **51,973.1** | **613.0** | **1,266.2** | **53,852.3** | 60,496.4 | 713.9 | 1,496.6 | 62,706.9 |
| Impairment allowances | **(888.0)** | **(76.7)** | **(205.1)** | **(1,169.8)** | (1,151.8) | (90.9) | (214.7) | (1,457.4) |
| **Loans to customers net of impairment allowances** | **51,085.1** | **536.3** | **1,061.1** | **52,682.5** | 59,344.6 | 623.0 | 1,281.9 | 61,249.5 |
| Impairment allowances: | | | | | | | | |
| - individual | **83.8** | **76.7** | **38.1** | **198.6** | 146.4 | 90.9 | 44.0 | 281.3 |
| - collective | **804.2** | **-** | **167.0** | **971.2** | 1,005.4 | - | 170.7 | 1,176.1 |
| **Total impairment allowances** | **888.0** | **76.7** | **205.1** | **1,169.8** | 1,151.8 | 90.9 | 214.7 | 1,457.4 |

The above table includes balances within 'neither past due nor impaired' which would have been shown as past due or impaired other than due to renegotiation; these were loans where arrears were capitalised during the previous 12 months. These loans amounted to £4.0m (2014: £9.9m). A loan is eligible for capitalisation of arrears only once the borrower has complied with stringent terms for a set period.

## 14 Credit quality of loans to customers (continued)

**Arrears and possessions on residential mortgages and unsecured loans**

Arrears and possessions are monitored for the Group as a whole and also split by type of product.

| | | **At 31 March 2015** | | At 31 March 2014 | |
|---|---|---|---|---|---|
| | | **Residential** | **Unsecured** | Residential | Unsecured |
| **Arrears 3 months and over** | | | | | |
| Number of cases | No. | **11,005** | **8,877** | 14,139 | 10,445 |
| Proportion of total cases | % | **2.43** | **8.38** | 2.68 | 8.76 |
| Asset value | £m | **1,575.5** | **147.8** | 2,067.5 | 172.7 |
| Proportion of book | % | **3.09** | **13.92** | 3.48 | 13.47 |
| Total value of payments overdue | £m | **62.8** | **26.3** | 84.3 | 23.0 |
| Proportion of total book | % | **0.12** | **2.48** | 0.14 | 1.80 |
| **Possessions** | | | | | |
| Number of cases | No. | **971** | **-** | 1,344 | - |
| Proportion of total cases | % | **0.21** | **-** | 0.25 | - |
| Asset value | £m | **133.9** | **-** | 199.0 | - |
| Proportion of book | % | **0.26** | **-** | 0.34 | - |
| Total value of payments overdue | £m | **8.8** | **-** | 14.0 | - |
| Proportion of total book | % | **0.02** | **-** | 0.02 | - |
| New possessions * | No. | **2,856** | **-** | 6,996 | - |
| **Total arrears 3 months and over and possessions** | | | | | |
| Number of cases | No. | **11,976** | **8,877** | 15,483 | 10,445 |
| Proportion of total cases | % | **2.64** | **8.38** | 2.93 | 8.76 |
| Asset value | £m | **1,709.4** | **147.8** | 2,266.5 | 172.7 |
| Proportion of book | % | **3.35** | **13.92** | 3.82 | 13.47 |
| Total value of payments overdue | £m | **71.6** | **26.3** | 98.3 | 23.0 |
| Proportion of total book | % | **0.14** | **2.48** | 0.16 | 1.80 |

In respect of all arrears (including those which are less than 3 months in arrears) together with possessions, the total value of payments overdue was:

| | | | | | |
|---|---|---|---|---|---|
| **Payments overdue** | | | | | |
| Total value of payments overdue | £m | **90.6** | **26.8** | 121.2 | 23.8 |
| Proportion of total book | % | **0.18** | **2.53** | 0.20 | 1.86 |
| **Loan impairment provision** | | | | | |
| As % of total balances | % | **1.71** | **16.20** | 1.90 | 14.35 |

** New possessions for the 12 months to 31 March 2015 and the 15 months to 31 March 2014.*

## 14. Credit quality of loans to customers (continued)

**Analysis of residential mortgages and unsecured loans 3 months and over in arrears by product**

| | | At 31 March 2015 | | At 31 March 2014 | |
|---|---|---|---|---|---|
| | | **Residential** | **Unsecured** | Residential | Unsecured |
| **Buy-to-let** | | | | | |
| Number of cases | No. | **1,590** | **-** | 2,138 | - |
| Proportion of total cases | % | **0.87** | **-** | 1.11 | - |
| Asset value | £m | **235.9** | **-** | 324.8 | - |
| Proportion of book | % | **1.09** | **-** | 1.41 | - |
| Total value of payments overdue | £m | **8.3** | **-** | 12.1 | - |
| Proportion of total book | % | **0.04** | **-** | 0.05 | - |
| **Self Cert** | | | | | |
| Number of cases | No. | **1,048** | **-** | 1,166 | - |
| Proportion of total cases | % | **2.76** | **-** | 2.86 | - |
| Asset value | £m | **179.0** | **-** | 202.3 | - |
| Proportion of book | % | **3.20** | **-** | 3.38 | - |
| Total value of payments overdue | £m | **4.9** | **-** | 5.4 | - |
| Proportion of total book | % | **0.09** | **-** | 0.09 | - |
| **Together** | | | | | |
| Number of cases | No. | **3,652** | **8,877** | 4,761 | 10,445 |
| Proportion of total cases | % | **3.55** | **8.38** | 4.08 | 8.76 |
| Asset value | £m | **409.3** | **147.8** | 546.9 | 172.7 |
| Proportion of book | % | **4.11** | **13.92** | 4.71 | 13.47 |
| Total value of payments overdue | £m | **17.3** | **26.3** | 23.7 | 23.0 |
| Proportion of total book | % | **0.17** | **2.48** | 0.20 | 1.80 |
| **Standard and other** | | | | | |
| Number of cases | No. | **4,715** | **-** | 6,074 | - |
| Proportion of total cases | % | **3.62** | **-** | 3.42 | - |
| Asset value | £m | **751.3** | **-** | 993.5 | - |
| Proportion of book | % | **5.41** | **-** | 5.34 | - |
| Total value of payments overdue | £m | **32.3** | **-** | 43.1 | - |
| Proportion of total book | % | **0.23** | **-** | 0.23 | - |

## 15. Deferred taxation

The net deferred taxation liability is attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | **31 Mar 2015** | 31 Mar 2014 | **31 Mar 2015** | 31 Mar 2014 | **31 Mar 2015** | 31 Mar 2014 |
| | **£m** | £m | **£m** | £m | **£m** | £m |
| Changes in accounting basis on adoption of IFRS | **7.0** | 17.7 | **(3.2)** | (9.6) | **3.8** | 8.1 |
| Cash flow hedges | **-** | - | **(59.5)** | (53.6) | **(59.5)** | (53.6) |
| Accelerated tax depreciation | **1.4** | 1.1 | **(3.2)** | (2.4) | **(1.8)** | (1.3) |
| Available-for-sale reserve and fair value | **-** | - | **(3.5)** | (5.2) | **(3.5)** | (5.2) |
| Employee benefits | **2.3** | 7.3 | **(44.6)** | (13.0) | **(42.3)** | (5.7) |
| Taxation value of losses carried forward | **-** | 6.9 | **-** | - | **-** | 6.9 |
| | **10.7** | 33.0 | **(114.0)** | (83.8) | **(103.3)** | (50.8) |
| Offset | **(10.7)** | (33.0) | **10.7** | 33.0 | **-** | - |
| **Total** | **-** | - | **(103.3)** | (50.8) | **(103.3)** | (50.8) |

There were no deferred tax assets unrecognised at 31 March 2015 (2014: £nil).

## 15. Deferred taxation (continued)

The movements in the Group's temporary differences during the year and previous period were as follows:

| | At 1 April 2014 £m | Recognised in income £m | Recognised in equity £m | At 31 March 2015 £m |
|---|---|---|---|---|
| Changes in accounting basis on adoption of IFRS | **8.1** | **(4.3)** | **-** | **3.8** |
| Cash flow hedges | **(53.6)** | **-** | **(5.9)** | **(59.5)** |
| Accelerated tax depreciation | **(1.3)** | **(0.5)** | **-** | **(1.8)** |
| Available-for-sale reserve and fair value | **(5.2)** | **1.7** | **-** | **(3.5)** |
| Employee benefits | **(5.7)** | **(14.6)** | **(22.0)** | **(42.3)** |
| Taxation value of losses carried forward | **6.9** | **(6.9)** | **-** | **-** |
| **Total** | **(50.8)** | **(24.6)** | **(27.9)** | **(103.3)** |

| | At 1 January 2013 £m | Recognised in income £m | Recognised in equity £m | At 31 March 2014 £m |
|---|---|---|---|---|
| Changes in accounting basis on adoption of IFRS | 16.0 | (7.9) | - | 8.1 |
| Cash flow hedges | (83.5) | - | 29.9 | (53.6) |
| Accelerated tax depreciation | 1.3 | (2.6) | - | (1.3) |
| Available-for-sale reserve and fair value | (9.6) | 3.4 | 1.0 | (5.2) |
| Employee benefits | 9.4 | (13.4) | (1.7) | (5.7) |
| Taxation value of losses carried forward | 22.5 | (15.6) | - | 6.9 |
| **Total** | (43.9) | (36.1) | 29.2 | (50.8) |

The announced UK corporation tax rate reduction to 20% with effect from 1 April 2015 has been reflected in the 31 March 2015 and 31 March 2014 deferred tax balances.

## 16. Other assets

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| Prepayments and accrued income | **8.6** | 7.5 |
| Other | **19.4** | 29.9 |
| **Total** | **28.0** | 37.4 |

## 17. Retirement benefit assets and obligations

The UKAR Group operates a number of retirement benefit plans for its current and former employees, including defined benefit pension plans, a defined contribution pension plan and post-retirement healthcare benefits. Further details in respect of the Group's schemes are given in sections (a) (B&B schemes) and (b) (NRAM schemes) below. The 'administrative expenses' line of the Income Statement includes the cost of contributions to the healthcare and defined contribution pension schemes, the current service cost of providing pension benefits for each defined benefit scheme and the interest cost on the scheme's net asset or liability. The current service cost of the Group's defined benefit schemes is nil, as the schemes are now closed to future service accrual. The full net surplus or deficit in respect of the healthcare scheme and each defined benefit pension scheme is carried on the UKAR Group Balance Sheet, and gains and losses arising due to actuarial revaluations are taken to UKAR Group other comprehensive income rather than being credited or charged in the Income Statement.

### (a) Bradford & Bingley schemes

*(i) Defined benefit pension scheme*

The Group operated a defined benefit pension scheme, the Bradford & Bingley Staff Pension Scheme ('the B&B Scheme'), which is administered by 'the Trustee'. The Trustee is responsible for ensuring the B&B scheme meets its Statutory Funding Objective which is set by The Pensions Regulator. The B&B Scheme provided benefits to members on a final salary basis. On 31 December 2009 the B&B Scheme was closed to future service accrual; all members became deferred members and were given the option to join the Group's defined contribution scheme from 1 January 2010. The normal pension age of members of the B&B Scheme is 65 for those who left before 6 April 2005 and 60 for the other members. In respect of deferred members, deferred pension entitlement increases are calculated by reference to the Consumer Prices Index ('CPI').

## 17. Retirement benefit assets and obligations (continued)

**(a) Bradford & Bingley schemes** (continued)

*(i) Defined benefit pension scheme (continued)*
The credit or cost to the Group of funding the B&B Scheme guaranteed benefits varies over time, dependent on market conditions and life expectancies. The credit in the period was £0.6m (31 March 2014: £2.4m cost) and the re-measurement gain recognised in other comprehensive income during the period was £62.2m (2014: £18.9m).

The assets of the B&B Scheme are held in a separate trustee-administered fund. The Trustee of the B&B Scheme has passed a resolution for the ultimate refund to B&B of any future surpluses on the B&B Scheme.

Under an agreed recovery plan to address the deficit on the B&B Scheme, the Group is committed to making annual contributions to the B&B Scheme up to and including June 2019. Under this plan the Group has contributed £35.1m in the year to 31 March 2015 and future contributions will increase at a compounding annual rate of 10%. The recovery plan will be reassessed following the next formal triennial valuation in June 2015.

The Trustee manages the volatility in the value of the B&B Scheme's assets by limiting the exposure to return-seeking assets and using liability-driven investment strategies to increase the level of hedging against investment risks. The two key investment risks are interest rate risk and inflation risk relating to the B&B Scheme's obligations. By holding swaps, fixed interest gilts, index-linked gilts and corporate bonds, approximately 70% of the interest rate risk and approximately 72% of the inflation risk has been hedged. The holding of return-seeking assets is close to the target level required to achieve the investment return assumed within the deficit recovery plan.

The B&B Scheme has a written guarantee from HM Treasury that benefits will be paid in full to the members.

*(ii) Defined contribution pension scheme*
The Group also operates a defined contribution pension scheme, the UKAR Pension Plan, into which both employees and the Group make contributions. The assets of this scheme are independent from those of the Group. The Group and Company had no liabilities or prepayments associated with this scheme at 31 March 2015 (2014: £nil). The cost in the period to the Group of this scheme was £4.1m (2014: £4.2m). The cost to the Group varies according to the number of employees in the Group and their salary levels but the Group has no risk of being required to provide additional funding to the scheme.

*(iii) Healthcare scheme*
The Group provides healthcare benefits to some of its pensioners. The healthcare benefits are provided through a scheme into which the Group contributes 100% towards the cost of providing the benefits for members who retired before 1 January 1996 and 50% for members who retired after this date. The value of the Group's obligation is assessed in accordance with the advice of a qualified actuary. The cost in the period to the Group of this scheme was £0.4m (2014: £0.6m) and the re-measurement loss recognised in the B&B Group's other comprehensive income during the period was £1.4m (2014: gain £1.5m).

*Defined benefit obligations*
The amounts carried on the UKAR Group Balance Sheet are as follows:

| | Defined benefit pension plan | | Post-retirement medical benefits | | Total | |
|---|---|---|---|---|---|---|
| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
| Present value of defined benefit obligations | **(960.0)** | (782.2) | **(9.4)** | (8.0) | **(969.4)** | (790.2) |
| Fair value of defined benefit assets | **1,045.7** | 769.9 | **-** | - | **1,045.7** | 769.9 |
| **Net defined benefit surplus/(liability)** | **85.7** | (12.3) | **(9.4)** | (8.0) | **76.3** | (20.3) |

The amounts recognised in the UKAR Group Income Statement were as follows:

| | Defined benefit pension plan | | Post-retirement medical benefits | | Total | |
|---|---|---|---|---|---|---|
| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
| Net interest (income)/expense | **(0.6)** | 2.4 | **0.4** | 0.6 | **(0.2)** | 3.0 |
| **Total recognised in the Income Statement** | **(0.6)** | 2.4 | **0.4** | 0.6 | **(0.2)** | 3.0 |

## 17. Retirement benefit assets and obligations (continued)

**(a) Bradford & Bingley schemes** (continued)

*Defined benefit obligations (continued)*

Movements in the present value of defined benefit obligations were as follows:

| | **Defined benefit pension plan** | | **Post-retirement medical benefits** | | **Total** | |
|---|---|---|---|---|---|---|
| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
| **At start of period** | **782.2** | 730.8 | **8.0** | 9.6 | **790.2** | 740.4 |
| Interest on defined benefit obligations | **35.6** | 40.4 | **0.4** | 0.6 | **36.0** | 41.0 |
| Remeasurements: | | | | | | |
| - effect of changes in financial assumptions | **165.8** | 34.8 | **1.4** | (1.7) | **167.2** | 33.1 |
| - effect of experience adjustments | **-** | 1.4 | **-** | 0.2 | **-** | 1.6 |
| Administrative expenses included within defined benefit obligation | **-** | (1.4) | **-** | - | **-** | (1.4) |
| Benefits paid from plan | **(23.6)** | (23.8) | **(0.4)** | (0.7) | **(24.0)** | (24.5) |
| **At end of period** | **960.0** | 782.2 | **9.4** | 8.0 | **969.4** | 790.2 |

Movements in the fair value of defined benefit assets were as follows:

| | **Defined benefit pension plan** | | **Post-retirement Medical benefits** | | **Total** | |
|---|---|---|---|---|---|---|
| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
| **At start of period** | **769.9** | 669.9 | **-** | - | **769.9** | 669.9 |
| Interest income on defined benefit assets | **37.2** | 38.0 | **-** | - | **37.2** | 38.0 |
| Defined benefit company contributions | **35.1** | 32.1 | **0.4** | 0.7 | **35.5** | 32.8 |
| Remeasurements | | | | | | |
| - return on plan assets (excluding interest income) | **228.0** | 55.1 | **-** | - | **228.0** | 55.1 |
| Administrative expenses paid from plan assets | **(1.0)** | (1.4) | **-** | - | **(1.0)** | (1.4) |
| Benefits paid from plan | **(23.5)** | (23.8) | **(0.4)** | (0.7) | **(23.9)** | (24.5) |
| **At end of period** | **1,045.7** | 769.9 | **-** | - | **1,045.7** | 769.9 |

The major categories of defined benefit assets at the end of the period were as follows:

| | **31 March 2015** | | | 31 March 2014 | | |
|---|---|---|---|---|---|---|
| | **Quoted £m** | **Unquoted £m** | **Total £m** | Quoted £m | Unquoted £m | Total £m |
| Equity instruments | **178.1** | **5.8** | **183.9** | 155.3 | 5.5 | 160.8 |
| Property | **1.5** | **37.9** | **39.4** | 2.1 | 40.5 | 42.6 |
| Bonds: | | | | | | |
| - of which UK | **6.2** | **213.4** | **219.6** | 8.4 | 116.3 | 124.7 |
| - of which overseas | **55.8** | **-** | **55.8** | 48.5 | 98.7 | 147.2 |
| Liability hedging investments | **3.8** | **523.2** | **527.0** | 3.1 | 253.3 | 256.4 |
| Cash and cash equivalents | **-** | **20.0** | **20.0** | - | 38.2 | 38.2 |
| **Total** | **245.4** | **800.3** | **1,045.7** | 217.4 | 552.5 | 769.9 |

Summary actuarial assumptions (expressed as weighted averages) were as follows:

| | **31 Mar 2015** | 31 Mar 2014 |
|---|---|---|
| **To determine benefit obligations:** | | |
| Discount rate | **3.4%** | 4.6% |
| Inflation (RPI) | **3.1%** | 3.5% |
| Inflation (CPI) | **2.3%** | 2.7% |
| Future pension increases | **3.0%** | 3.3% |
| **To determine net pension cost:** | | |
| Discount rate | **4.6%** | 4.5% |
| **For post-retirement medical plan:** | | |
| Discount rate | **3.4%** | 4.6% |
| Medical cost trend for duration of liability | **5.5%** | 5.5% |

## 17. Retirement benefit assets and obligations (continued)

### (a) Bradford & Bingley schemes (continued)

*Defined benefit obligations (continued)*

In determining the expected long-term return on defined benefit assets, the Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns on each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term return for the portfolio.

The table below shows the life expectancy assumptions from age 60:

| | **At 31 March 2015** | | At 31 March 2014 | |
|---|---|---|---|---|
| | **Pensioner** | **Non-retired member** | Pensioner | Non-retired member |
| Male | **28.6** | **30.1** | 28.5 | 30.0 |
| Female | **31.4** | **32.9** | 31.2 | 32.8 |

*Maturity profile of the obligation*

The defined benefit pension scheme has a weighted average maturity of around 24 years.

*Sensitivity*

The following table illustrates the sensitivity of the defined benefit pension scheme obligations to three key assumptions: the discount rate, the rate of inflation and the mortality assumption:

| Assumption | Change in assumption | Impact on obligations |
|---|---|---|
| Discount rate | Decrease by 0.5% | Increase by 13% |
| Inflation | Increase by 0.5% | Increase by 11% |
| Mortality | Decrease by 1 year | Increase by 2% |

If the assumptions were to change by the same amount in the opposite direction to those illustrated, the obligations would decrease by a similar percentage to those shown in the table in each case.

Assumed healthcare cost trend rates have an effect on the amounts recognised in staff costs. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| Effect on interest cost | **0.1** | 0.1 |
| Effect on defined benefit obligation | **1.5** | 1.2 |

### (b) NRAM schemes

*(i) Defined benefit pension scheme*

Northern Rock plc operated a staff pension scheme, which was closed in 2010 and is now known as the NRAM Scheme. The assets of the NRAM Scheme are held in a separate trustee-administered fund. The normal pension age of members in this NRAM Scheme is 60. The NRAM Scheme provided benefits to the majority of members on a final salary basis. Deferred pension entitlement increases are calculated by reference to the Retail Prices Index ('RPI'). The Trustee of the NRAM Scheme is responsible for ensuring the Scheme meets its Statutory Funding Objective which is set by The Pensions Regulator. The Trustee of the NRAM Scheme has passed a resolution for the ultimate refund to NRAM of any future surpluses on the NRAM Scheme.

The cost to the Group of funding the NRAM Scheme guaranteed benefits varies over time, dependent on market conditions and life expectancies. The credit in the year was £3.7m (2014: £4.2m) and the re-measurement gain recognised in other comprehensive income during the year was £48.9m (2014: loss £16.2m).

As at 31 March 2015 and 31 March 2014 the NRAM Scheme was in surplus on an accounting basis, but in deficit on a trustee's funding basis. Under an agreed recovery plan to address this deficit, the Group is committed to making annual contributions to the NRAM Scheme up to and including April 2019. Under this plan the Group has contributed £34.0m in the year, and the level of contributions will be re-assessed each year.

Following the nationalisation of Northern Rock plc in 2007, the NRAM Scheme Trustee disposed of the majority of the return-seeking assets, retaining a small holding in private equity funds; the remaining assets are split between gilts and corporate bonds. The NRAM Scheme has instigated a liability-driven investment programme to hedge approximately 82% of the interest rate risk and 82% of the inflation risk.

## 17. Retirement benefit assets and obligations (continued)

(**b) NRAM schemes** (continued)

*(ii) Defined contribution pension scheme*
Of the members who transferred to the Northern Rock (2010) Pension Scheme, 1,254 subsequently transferred to B&B on 1 November 2010 and were eligible to join that company's defined contribution pension scheme, the UKAR Pension Plan, into which both members and the Group make contributions. The Group and Company had no liabilities or prepayments associated with the UKAR Pension Plan as at 31 March 2015 (2014: £nil). The cost in the period to the Group arising from amounts recharged by B&B in respect of employees providing services to the Group who participate in this scheme was £nil (2014: £2.6m).

*(iii) Defined benefit section of the Scheme*
The amounts carried on the UKAR Group Balance Sheet are as follows:

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| Present value of defined benefit obligations | **(606.2)** | (480.7) |
| Fair value of defined benefit assets | **758.1** | 546.0 |
| **Net defined benefit asset** | **151.9** | 65.3 |

The amounts recognised in the UKAR Group Income Statement were as follows:

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Net interest income | **3.7** | 4.2 |
| **Total recognised in the Income Statement** | **3.7** | 4.2 |

Movements in the present value of defined benefit obligations were as follows:

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| **At start of period** | **480.7** | 459.2 |
| Interest on defined benefit obligations | **21.8** | 25.6 |
| Remeasurements: | | |
| - effect of changes in financial assumptions | **119.3** | 11.3 |
| - effect of experience adjustments | **(3.3)** | (1.4) |
| Benefits paid from plan | **(12.3)** | (14.0) |
| **At end of period** | **606.2** | 480.7 |

Movements in the fair value of defined benefit assets were as follows:

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| **At start of period** | **546.0** | 502.2 |
| Interest income on defined benefit assets | **25.5** | 29.8 |
| Defined benefit company contributions | **34.0** | 34.3 |
| Remeasurements: | | |
| - return on plan assets (excluding interest income) | **164.9** | (6.3) |
| Benefits paid from plan | **(12.3)** | (14.0) |
| **At end of period** | **758.1** | 546.0 |

## 17. Retirement benefit assets and obligations (continued)

**(b) NRAM schemes** (continued)

*(iii) Defined benefit section of the Scheme (continued)*

The major categories of defined benefit assets at the end of the period were as follows:

| | **31 March 2015** | | | 31 March 2014 | | |
|---|---|---|---|---|---|---|
| | **Quoted £m** | **Unquoted £m** | **Total £m** | Quoted £m | Unquoted £m | Total £m |
| Equity instruments | **-** | **225.9** | **225.9** | - | 13.7 | 13.7 |
| Bonds: | | | | | | |
| - of which UK | **65.2** | **-** | **65.2** | 84.2 | - | 84.2 |
| - of which overseas | **-** | **-** | **-** | 31.2 | - | 31.2 |
| Liability hedging investments | **419.2** | **-** | **419.2** | 195.6 | - | 195.6 |
| Bulk annuity contract | **-** | **-** | **-** | - | 186.5 | 186.5 |
| Cash and cash equivalents | **47.8** | **-** | **47.8** | 34.8 | - | 34.8 |
| **Total** | **532.2** | **225.9** | **758.1** | 345.8 | 200.2 | 546.0 |

Summary actuarial assumptions (expressed as weighted averages) were as follows:

| | **31 Mar 2015** | 31 Mar 2014 |
|---|---|---|
| **To determine benefit obligations:** | | |
| Discount rate | **3.4%** | 4.6% |
| Inflation (RPI) | **3.1%** | 3.5% |
| Future pension increases | **3.0% - 3.55%** | 3.0% - 3.75% |
| **To determine net pension cost:** | | |
| Discount rate | **4.6%** | 4.5% |

In determining the expected long-term return on defined benefit assets, the UKAR Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns on each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term return for the portfolio.

The table below shows the life expectancy assumptions from age 60:

| | **At 31 March 2015** | | At 31 March 2014 | |
|---|---|---|---|---|
| | **Pensioner** | **Non-retired member** | Pensioner | Non-retired member |
| Male | **27.8** | **29.3** | 27.7 | 29.2 |
| Female | **30.2** | **31.8** | 30.1 | 31.7 |

*Maturity profile of the obligation*

The defined benefit pension scheme has a weighted average maturity of around 21 years.

*Sensitivity*

The following table illustrates the sensitivity of the defined benefit pension scheme obligations to three key assumptions: the discount rate, the rate of inflation and the mortality assumption:

| Assumption | Change in assumption | Impact on obligations |
|---|---|---|
| Discount rate | Decrease by 0.5% | Increase by 12% |
| Inflation | Increase by 0.5% | Increase by 8% |
| Mortality | Decrease by 1 year | Increase by 2% |

If the assumptions were to change by the same amount in the opposite direction to those illustrated, the obligations would decrease by a similar percentage to those shown in the table in each case.

## 18. Property, plant and equipment

| | Land and buildings £m | Plant, equipment, fixtures, fittings and vehicles £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 1 April 2014 | **23.1** | **71.9** | **95.0** |
| Additions | **0.3** | **4.1** | **4.4** |
| Disposals | **(16.4)** | **(16.9)** | **(33.3)** |
| **At 31 March 2015** | **7.0** | **59.1** | **66.1** |
| | | | |
| **Depreciation** | | | |
| At 1 April 2014 | **15.4** | **57.7** | **73.1** |
| Charged in year | **0.2** | **4.6** | **4.8** |
| Disposals | **(11.5)** | **(16.9)** | **(28.4)** |
| **At 31 March 2015** | **4.1** | **45.4** | **49.5** |
| | | | |
| **Net book amount:** | | | |
| At 1 April 2014 | **7.7** | **14.2** | **21.9** |
| **At 31 March 2015** | **2.9** | **13.7** | **16.6** |

| | Land and buildings £m | Plant, equipment, fixtures, fittings and vehicles £m | Total £m |
|---|---|---|---|
| Cost | | | |
| At 1 January 2013 | 37.7 | 70.9 | 108.6 |
| Additions | - | 1.8 | 1.8 |
| Disposals | (14.6) | (0.8) | (15.4) |
| At 31 March 2014 | 23.1 | 71.9 | 95.0 |
| | | | |
| Depreciation | | | |
| At 1 January 2013 | 26.6 | 53.3 | 79.9 |
| Charged in period | 0.7 | 5.2 | 5.9 |
| Disposals | (11.9) | (0.8) | (12.7) |
| At 31 March 2014 | 15.4 | 57.7 | 73.1 |
| | | | |
| Net book amount: | | | |
| At 1 January 2013 | 11.1 | 17.6 | 28.7 |
| At 31 March 2014 | 7.7 | 14.2 | 21.9 |

At 31 March 2015, work in progress of £4.0m (2014: £nil) has been capitalised and is not being depreciated. The work in progress relates to an IT investment programme to simplify existing infrastructure and reduce ongoing costs.

Sale proceeds from asset disposals were £14.5m (2014: £10.0m) resulting in a profit on sale of £9.6m (2014: £7.3m profit). B&B's Crossflatts building was disposed of in a sale and leaseback transaction in October 2014. NRAM's Doxford site (including Solar House) was disposed of in a sale and leaseback transaction in September 2013.

## 19. Intangible assets

| | **£m** |
|---|---|
| **Cost** | |
| At 1 April 2014 | **84.1** |
| Additions | **10.7** |
| Disposals | **(5.7)** |
| **At 31 March 2015** | **89.1** |
| | |
| **Impairment and amortisation** | |
| At 1 April 2014 | **41.4** |
| Amortisation charged in year | **12.0** |
| Disposals | **(5.7)** |
| **At 31 March 2015** | **47.7** |
| | |
| **Net book amount:** | |
| At 1 April 2014 | **42.7** |
| **At 31 March 2015** | **41.4** |

| | £m |
|---|---|
| Cost | |
| At 1 January 2013 | 75.2 |
| Additions | 8.9 |
| At 31 March 2014 | 84.1 |
| | |
| Impairment and amortisation | |
| At 1 January 2013 | 27.9 |
| Amortisation charged in period | 13.5 |
| At 31 March 2014 | 41.4 |
| | |
| Net book amount: | |
| At 1 January 2013 | 47.3 |
| At 31 March 2014 | 42.7 |

Intangible assets comprise capitalised computer software systems and licences.

At 31 March 2015, work in progress of £13.8m (2014: £5.2m) has been capitalised and is not being amortised. The work in progress relates to an IT investment programme to simplify existing infrastructure and reduce ongoing costs.

All assets sold in the year had already been fully amortised and no sale proceeds were received. Hence there was no profit or loss on the sales.

## 20. Amounts due to banks

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| Cash collateral received (see note 34) | **2,185.8** | 3,119.1 |
| Other | **-** | 0.1 |
| **Total** | **2,185.8** | 3,119.2 |

## 21. Statutory Debt and HM Treasury loans

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| HM Treasury loan to NRAM | **13,656.1** | 14,935.2 |
| B&B Statutory Debt | **18,416.2** | 18,416.2 |
| HM Treasury Working Capital Facility to B&B | **2,547.1** | 4,999.1 |
| **Total** | **34,619.4** | 38,350.5 |

The HM Treasury loan to NRAM is repayable on demand. Interest has been charged at Bank of England Base Rate + 100 bps since 4 May 2012 (prior to that date interest was charged at Bank of England Base Rate + 25 bps). At the signing date of these Financial Statements, HM Treasury has confirmed its intentions to continue to fund NRAM as a going concern, and to enable NRAM to meet its debts as and when they fall due until at least 1 January 2017. It has also committed to convert up to £1.6bn of its loan to NRAM to meet regulatory capital requirements if so required. It is expected that the HM Treasury loan will be repaid out of the cash flows generated by NRAM during its wind-down. These cash flows will principally comprise interest and redemptions arising on loans to customers, along with proceeds of asset sales. The redemption profile of loans to customers is uncertain; many of these loans have contractual maturities of 25 years or more from the date of advance but experience has been that most loans to customers redeem earlier than their contractual maturity dates. Consequently, the timing of the repayment of the HM Treasury loan to NRAM is uncertain.

B&B has an interest-free Statutory Debt of £18,416.2m as at 31 March 2015 and 31 March 2014. This replaced B&B's savings-related assets and liabilities which were transferred to Banco Santander Group on 29 September 2008. £15,654.5m of the Statutory Debt is owed to the Financial Services Compensation Scheme ('FSCS'). At the time of nationalisation, the FSCS covered the first £35,000 per depositor; HM Treasury agreed to cover the excess over £35,000, amounting to a total of £2,761.7m. It is expected that the Statutory Debt will be repaid out of the cash flows generated by B&B during its wind-down. These cash flows will principally comprise interest and redemptions arising on loans to customers, along with proceeds of asset sales. The redemption profile of loans to customers is uncertain; many of these loans have contractual maturities of 25 years or more from the date of advance but experience has been that most loans to customers redeem earlier than their contractual maturity dates. Consequently, the timing of the repayment of the Statutory Debt is uncertain.

B&B has an interest-bearing Working Capital Facility ('WCF') provided by HM Treasury. Interest is charged at Bank of England Base Rate + 500bps. HM Treasury has the option to vary the rate charged. At 31 March 2015 B&B had drawn £2,535.3m (2014: £4,975.0m) of this facility; £2,547.1m including accrued interest (2014: £4,999.1m). HM Treasury has confirmed its intentions to continue to fund B&B as a going concern and to enable B&B to meet its debts as and when they fall due, until at least 1 January 2017. HM Treasury has indicated that it expects the WCF to be repaid out of the cash flows generated by B&B during its wind-down. These cash flows will principally comprise interest and redemptions arising on loans to customers, along with proceeds of asset sales. The redemption profile of loans to customers is uncertain; many of these loans have contractual maturities of 25 years or more from the date of advance but experience has been that most loans to customers redeem earlier than their contractual maturity dates. Consequently, the timing of the repayment of the WCF is uncertain.

## 22. Debt securities in issue

| | **Securitised notes £m** | **Covered Bonds £m** | **Other £m** | **Total £m** |
|---|---|---|---|---|
| **At 1 April 2014** | **16,178.6** | **9,163.9** | **543.5** | **25,886.0** |
| Repayments | **(2,943.7)** | **-** | **(261.2)** | **(3,204.9)** |
| Repurchases | **(223.0)** | **(208.7)** | **-** | **(431.7)** |
| Other movements | **(281.8)** | **(1,008.3)** | **(12.6)** | **(1,302.7)** |
| **At 31 March 2015** | **12,730.1** | **7,946.9** | **269.7** | **20,946.7** |
| **Securitised assets** | **23,248.6** | **16,221.0** | **-** | **39,469.6** |
| **Reserve fund** | **1,384.6** | **18.1** | **-** | **1,402.7** |

| | Securitised notes £m | Covered Bonds £m | Other £m | Total £m |
|---|---|---|---|---|
| At 1 January 2013 | 19,624.7 | 11,083.4 | 912.0 | 31,620.1 |
| Repayments | (3,461.0) | (1,828.2) | (363.1) | (5,652.3) |
| Other movements | 14.9 | (91.3) | (5.4) | (81.8) |
| At 31 March 2014 | 16,178.6 | 9,163.9 | 543.5 | 25,886.0 |
| Securitised assets | 26,293.8 | 18,712.7 | - | 45,006.5 |
| Reserve fund | 1,388.5 | 22.9 | - | 1,411.4 |

Other movements comprise exchange rate movements, accrued interest and hedge accounting adjustments.

## 22. Debt securities in issue (continued)

During the year the Group purchased debt securities which had been issued by certain of the Group's securitisation vehicles and Covered Bonds, generating a loss of £19.2m as shown in note 7. No such purchases were made in 2013/14. The repurchases provide the benefit of reduced future funding costs. On 30 March 2015 NRAM announced a tender offer in relation to the outstanding €2bn 3.875% Covered Bonds due 2020 (see note 37).

The B&B and NRAM Groups issued debt securities to securitise loans to customers through SPVs and Covered Bonds and also raised unsecured medium term funding, the amounts of which are shown above. Certain of these were subject to fair value hedge designation and the carrying values of these instruments include unamortised adjustments in respect of the notes that were hedged.

HM Treasury has provided guarantees with regard to certain wholesale borrowings of the B&B and NRAM Groups; the Group pays fees for these guarantees, as detailed in note 3.

Securitised assets represent loans to customers which have been used to securitise issued notes, including notes which are held by other companies in the UKAR Group, and cash balances. B&B and NRAM pass cash received in relation to the securitised assets to their SPVs. The SPVs use the cash to service the bonds, retain a margin specified under the terms of the issue and return any surplus cash to B&B and NRAM. To the extent that the total cash receipts in relation to the securitised assets are insufficient to satisfy interest and principal payments in relation to the bonds, the holders of the bonds have no recourse against the Group. Provided that the total cash receipts in relation to the securitised assets are sufficient to satisfy interest and principal payments in relation to the bonds, B&B/NRAM bear the cost of any impairment of the securitised assets. While the assets remain securitised the Group may not use, sell or pledge these assets.

In respect of Covered Bonds, B&B and NRAM pass to Bradford & Bingley Covered Bonds LLP and NRAM Covered Bond LLP all cash received in relation to the securitised assets. Bradford & Bingley Covered Bonds LLP and NRAM Covered Bond LLP use cash receipts to service the bonds and return any surplus cash to B&B/NRAM. B&B and NRAM bear the cost of any impairment of the securitised assets. While the assets remain securitised, the Group may not use, sell or pledge these assets.

Further details of debt securities in issue are provided in the Annual Reports and Accounts of B&B and NRAM, copies of which are available on the corporate website of each of these companies.

At 31 March 2015 the SPVs had cash deposits (including accrued interest) amounting to £2,932.0m, including collateral deposits of £943.6m (2014: £3,254.4m, including collateral deposits of £1,275.0m). These balances (excluding the collateral deposits) are restricted in use to the servicing of the debt securities issued by the SPVs and other legal obligations.

On 10 May 2012 a Non-Asset Trigger Event (as defined in the Offering Circular) occurred within B&B's Master Trust securitisation structure due to the aggregate current balance of loans comprising the Trust Property falling below the minimum trust size of £10.7bn. The impact of this event is to change the order of priority of the Funding 1 Available Principal Receipts. As a result of the Non-Asset Trigger Event, all principal receipts from customers are allocated to Funding 1 and will continue to be so allocated until all holders of Aire Valley residential mortgage-backed securities have been repaid in full if sufficient funds are ultimately available. The principal is then passed to the Issuers based on their respective notes outstanding. Each Issuer then utilises this principal to pay down notes pro-rata and sequentially by class. The timing of future redemptions will be dependent on the availability of funds.

On 11 November 2008, as a result of a breach of a non-asset trigger, the Granite Master Trust moved into pass through. The main consequence of this is that the repayments of the loan notes no longer adhere to the controlled amortisation schedules detailed in the SPVs' offering circulars. All principal cash received by the Trust is allocated between Granite Finance Funding Limited and Granite Finance Funding 2 Limited in accordance with their respective shares of the Trust's property as at 1 November 2008, this being the last determination date prior to the breach of the non-asset trigger. The principal cash allocated to Granite Finance Funding Limited is then distributed pro-rata between the relevant issuers in the Granite Finance Funding Limited group by reference to the size of their inter-company loans outstanding with Granite Finance Funding Limited at each determination date. The principal cash received by the issuers is utilised in full on each quarterly payment date to make repayments in respect of the loan notes. The priority of loan note repayment is by reference to their original credit ratings on issue, with AAA notes repaid first, then AA notes, then A notes and finally BBB notes. The principal cash allocated to Granite Finance Funding 2 Limited is used to repay the loan from Granite Master Issuer plc, which in turn uses the cash to repay the loan notes in issue by reference to their original credit ratings on issue in the same manner as detailed above. The average time taken to repay the loan notes is now expected to be significantly extended beyond the maturity profiles envisaged by the original controlled amortisation schedules.

As a result of the change in repayment process as detailed above, the repayment of the loans did not occur ahead of the step-up dates and as such an increased amount of interest on the loan notes is now being made. Also as a result of this, some of the reserve funds have had additional amounts applied to them to cover the increased payment risk.

Other debt securities in issue comprise notes issued under B&B's and NRAM's Medium Term Notes programmes.

## 23. Other liabilities

| | At 31 Mar 2015 £m | At 31 Mar 2014 £m |
|---|---|---|
| Accruals and deferred income | **69.5** | 72.4 |
| Other | **64.6** | 87.4 |
| **Total** | **134.1** | 159.8 |

## 24. Provisions

| | Customer redress £m | Onerous contracts £m | Restructuring £m | Total £m |
|---|---|---|---|---|
| **At 1 April 2014** | **156.7** | **4.6** | **6.4** | **167.7** |
| Utilised in the year | **(66.8)** | **(1.6)** | **(4.4)** | **(72.8)** |
| Charged in the year | **298.1** | **-** | **-** | **298.1** |
| **At 31 March 2015** | **388.0** | **3.0** | **2.0** | **393.0** |

| | Customer redress £m | Onerous contracts £m | Restructuring £m | Total £m |
|---|---|---|---|---|
| At 1 January 2013 | 168.8 | 8.4 | 50.4 | 227.6 |
| Utilised in the period | (144.1) | (3.1) | (39.2) | (186.4) |
| Charged in the period | 132.0 | - | - | 132.0 |
| Released in the period | - | (0.7) | (4.8) | (5.5) |
| At 31 March 2014 | 156.7 | 4.6 | 6.4 | 167.7 |

UKAR defines conduct risk as the risk of UKAR treating its customers unfairly and delivering inappropriate outcomes leading to customer detriment or impacting market integrity. Since the creation of UKAR the Group has been remediating a series of conduct issues inherited from the legacy business including the mis-selling of Payment Protection Insurance ('PPI') by Northern Rock and the issue of non-compliant CCA loan documentation to certain customers.

During 2014/15 the level of PPI claims has not reduced as much as anticipated and as a result PPI provisions have been increased by £33.2m.

In December 2014 the High Court ruled that customers with loans over £25,000, who had historically been sent incorrect documentation stating that their loans were regulated under the Consumer Credit Act ('CCA'), should receive remediation in line with that provided in 2012 on CCA loans of less than £25,000. Therefore, a charge of £268.3m has been recognised in the year. However, NRAM has sought clarification of this decision through the Court of Appeal and we are waiting for the outcome to be announced. Should this appeal be successful, this charge will be reversed.

In addition, we have released certain provisions for other remediation activities during the year.

The timing and total value of future PPI payments and other remediation payments are uncertain and dependent on a number of external factors; it has been assumed that the value of PPI and other remediation claims will continue to decline over time and beyond 31 March 2018 will not be material.

The onerous contracts provision relates to empty leasehold premises which, as at the Balance Sheet date, were no longer used by the business but were subject to lease agreements. The rental payments are due to be made during the period to 2030.

The restructuring provision relates primarily to the ongoing organisational restructure.

## 25. Capital instruments

| | Initial interest rate | First due or callable | Final maturity | Issuer | 31 March 2015 Carrying amount £m | 31 March 2015 Principal £m | 31 March 2014 Carrying amount £m | 31 March 2014 Principal £m |
|---|---|---|---|---|---|---|---|---|
| Dated subordinated notes | 7.625% | 2010 | 2049 | B&B | **7.8** | **5.0** | 17.6 | 12.2 |
| Dated fixed rate step-up subordinated notes | 5.50% | 2018 | 2018 | B&B | - | - | 5.6 | 4.4 |
| Callable perpetual subordinated notes | 5.625% | 2013 | Undated | B&B | - | - | 22.5 | 18.1 |
| Callable perpetual subordinated notes | 6.00% | 2019 | Undated | B&B | - | - | 18.2 | 14.7 |
| Undated perpetual subordinated bonds | 13.00% | Perpetual | Undated | B&B | - | - | 51.1 | 41.5 |
| Undated perpetual subordinated bonds | 11.625% | Perpetual | Undated | B&B | - | - | 44.1 | 35.7 |
| Subordinated loan | 11.734% | See below | 2016 | NRAM | **9.3** | **8.0** | 14.1 | 12.0 |
| Tier one notes | 7.053% | 2027 | Undated | NRAM | - | - | 42.1 | 30.5 |
| **Total** | | | | | **17.1** | **13.0** | 215.3 | 169.1 |

These capital instruments are all denominated in sterling.

The carrying values of these instruments are on an EIR basis. Carrying values include hedge accounting adjustments.

As detailed in note 7, in January 2015 the Group bought back substantially all of the capital instruments in issue. Certain capital instruments were also bought back during 2013/14.

The 7.625% dated subordinated notes have no call dates. B&B has made no payment of interest in respect of these notes since February 2009.

Of the subordinated loans, £4.0m was repaid during the year and the remaining £8.0m is repayable in two equal annual instalments from 2015 to 2016.

Redemptions of any capital instruments prior to their final maturity date are subject to obtaining prior consent of the FCA.

The rights of repayment of holders of capital instruments are subordinated to the claims of other creditors.

Further details of capital instruments are provided in the Annual Reports and Accounts of B&B and NRAM, copies of which are available on the corporate website of each of these companies.

## 26. Share capital

| Group and Company | 25p Ordinary shares Number | 25p Preference shares Number | 25p Ordinary shares £ | 25p Preference shares £ | Total share capital £ |
|---|---|---|---|---|---|
| **At 1 January 2013, 31 March 2014 and 31 March 2015** | **4,955,595** | **4,000** | **1,238,899** | **1,000** | **1,239,899** |

In accordance with the Companies Act 2006, the Company does not have authorised capital other than its issued capital.

The Ordinary shares rank equally in respect of rights attached to voting, dividends and in the event of a winding up.

Dividends on Preference shares are discretionary and, subject to Board approval, are payable annually on 4 July at a rate of 6.8509% based on a principal amount of £1,000 per share.

No dividends were declared or paid in 2014/15 or 2013/14 on the Company's Ordinary or Preference shares. No dividends had been proposed by the date of approval of these Financial Statements.

## 27. Reserves

**Reserves comprise the following:**

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| Available-for-sale reserve | **2.0** | (3.4) |
| Cash flow hedge reserve | **239.7** | 194.0 |
| Merger reserve | **1,122.6** | 1,122.6 |
| **Total** | **1,364.3** | 1,313.2 |

**Available-for-sale reserve**

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| **At start of period** | **(3.4)** | (53.4) |
| Amounts recognised in equity | **(5.3)** | 51.5 |
| Amounts transferred to net income | **10.7** | (1.5) |
| **At end of period** | **2.0** | (3.4) |

The available-for-sale reserve represents cumulative fair value movements on assets classified as available-for-sale.

**Cash flow hedge reserve**

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| **At start of period** | **194.0** | 250.1 |
| Amounts recognised in equity | **(1,003.4)** | (270.4) |
| Amounts transferred to net income | **1,049.1** | 214.3 |
| **At end of period** | **239.7** | 194.0 |

The cash flow hedge reserve represents cumulative fair value movements on financial instruments which are effective cash flow hedges.

**Merger reserve**

| | 31 Mar 2015 £m | 31 Mar 2014 £m |
|---|---|---|
| **At start and end of period** | **1,122.6** | 1,122.6 |
| Generated on acquisition of B&B | **589.3** | 589.3 |
| Generated on acquisition of NRAM | **533.3** | 533.3 |
| **Total** | **1,122.6** | 1,122.6 |

The merger reserve was generated on 1 October 2010 when the Company acquired all the issued shares of B&B and NRAM from the Treasury Solicitor via a share-for-share exchange. The merger reserve represents the difference between the value attributed to the Company's investment in each company and the capital and non-distributable reserves of the acquired groups.

## 28. Release of time-expired provision for unclaimed shares

Following demutualisation of Bradford & Bingley Building Society in 2000, a number of shares in B&B were unclaimed as the Registered Holders could not be traced. In accordance with B&B's Articles of Association, these shares were sold in March 2004 and the proceeds held by B&B for a further period of nine years to satisfy any claims received from the Registered Holders who were originally entitled to the shares. During the period from demutualisation to 31 March 2013, B&B sought periodically to trace the Registered Holders. The Registered Holders' entitlement to the proceeds of the sale of the unclaimed shares expired in March 2013 and the remaining provision of £13.2m was, therefore, released to retained earnings.

## 29. Non-controlling interests (previously described as 'non-shareholders' funds')

In accordance with the requirements of IAS 32, the following instruments were classified as equity:

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| Reserve capital instruments | - | 101.4 |
| Subordinated notes | - | 23.4 |
| | - | 124.8 |
| Withheld coupons (see note 29(c) below) | - | 71.8 |
| **Total non-controlling interests** | - | 196.6 |

### (a) Reserve capital instruments

Reserve capital instruments were issued by NRAM for a value of £200.0m in September 2000 and for £100.0m in May 2001 and were undated but callable on 21 September 2015. They carried a coupon of 8.399% payable annually in arrears on 21 September. At each payment date NRAM decided whether to declare or defer the coupon.

As detailed in note 7, in January 2015 the Group bought back all of the remaining reserve capital instruments.

### (b) Subordinated notes

| | Interest rate | Terms | Denomination | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|---|---|---|
| Perpetual subordinated notes | 12.625% | Not redeemable | Sterling | - | 13.5 |
| Perpetual fixed to floating rate subordinated notes | 6.594% | Not redeemable before 28/06/17 | US$ | - | 1.2 |
| Undated subordinated notes | 5.60% | Not redeemable before 30/04/14 | US$ | - | 8.7 |
| **Total** | | | | - | 23.4 |

As detailed in note 7, in January 2015 the Group bought back all of the remaining subordinated notes.

### (c) Appropriations

Coupons on non-controlling interests were treated as appropriations.

Until 22 September 2014, one of the conditions resulting from NRAM's State Aid approval in October 2009 required NRAM to withhold coupon payments on all subordinated instruments where possible. Consequently no appropriations were made in respect of NRAM's reserve capital instruments or subordinated notes during 2014/15 (2013/14: £nil). Following an amendment made to the NRAM State Aid conditions on 22 September 2014 by the European Commission, NRAM was able to exercise discretion (where the original terms of the instrument so allowed) to pay interest, arrears of interest and principal to holders of its subordinated instruments, and was allowed to make market purchases and utilise any relevant calls set out in the subordinated instruments provided certain conditions were complied with.

In the table above, the cumulative amount of withheld coupons is presented as part of non-controlling interests. £11.9m of withheld coupons accrued during the year up to the point of buyback of the notes at which point the total £83.7m of withheld coupons was released.

## 30. Off-Balance Sheet commitments payable

| **At 31 March 2015** | **Within one year £m** | **In one to five years £m** | **Over five years £m** | **Total £m** |
|---|---|---|---|---|
| Loan commitments: | | | | |
| - lifetime mortgages | **0.7** | **2.3** | **3.6** | **6.6** |
| - other loans | **1,423.8** | **-** | **-** | **1,423.8** |
| Total loan commitments | **1,424.5** | **2.3** | **3.6** | **1,430.4** |
| Operating lease commitments: | | | | |
| - land and buildings | **2.3** | **8.6** | **13.0** | **23.9** |
| Capital commitments | **5.2** | **-** | **-** | **5.2** |
| **Total** | **1,432.0** | **10.9** | **16.6** | **1,459.5** |

| At 31 March 2014 | Within one year £m | In one to five years £m | Over five years £m | Total £m |
|---|---|---|---|---|
| Loan commitments: | | | | |
| - lifetime mortgages | 0.8 | 2.8 | 4.5 | 8.1 |
| - other loans | 1,749.2 | - | - | 1,749.2 |
| Total loan commitments | 1,750.0 | 2.8 | 4.5 | 1,757.3 |
| Operating lease commitments: | | | | |
| - land and buildings | 1.1 | 4.0 | 8.5 | 13.6 |
| Capital commitments | 0.7 | - | - | 0.7 |
| Total | 1,751.8 | 6.8 | 13.0 | 1,771.6 |

Loan commitments represent contractual amounts to which the Group is committed for extension of credit to customers. In respect of lifetime mortgages, the commitment reflects estimates of future drawdowns. On other loans, the commitment comprises cash which could be drawn down by customers in respect of further advances and re-drawal of amounts voluntarily overpaid.

Operating lease commitments represent minimum future lease payments under non-cancellable operating leases.

Capital commitments represent contractual amounts to which the Group is committed in respect of IT infrastructure investment.

## 31. Related party disclosures

**(a) Key management personnel**

The Group considers the Boards of Directors and the members of the Executive Committees of UKAR, B&B and NRAM to be the key management personnel. There were no amounts owed to or by key management personnel at any time during the period (2014: £nil).

A summary of the Group's remuneration of the 15 (2014: 16) key management personnel is set out in the table below. These amounts include the remuneration of the Directors which is set out in more detail in the Directors' Remuneration Report on pages 30 to 44. The Directors' Remuneration Report gives details of the UKAR Group's Directors' salaries, fees, bonuses, pension benefits, other incentives and other benefits.

| **Remuneration of key management personnel** | **12 months to 31 Mar 2015 £000** | 15 months to 31 Mar 2014 £000 |
|---|---|---|
| Short-term employee benefits | **2,835** | 4,333 |
| Post-employment benefits | **299** | 370 |
| **Total** | **3,134** | 4,703 |

Further details of the accounting treatment of pensions and of the Group's transactions and balances with the Group's pension schemes are given in note 17. There were no amounts due to or from the schemes at 31 March 2015 (31 March 2014: £nil). The key management personnel contributed £42,000 (2014: £35,000) to Group pension schemes during the period.

## 31. Related party disclosures (continued)

### (a) Key management personnel (continued)

Included in the Group's Income Statement, the aggregate Directors' emoluments and the emoluments of the highest paid Director amounted to £1,459,251 and £653,227 respectively (2014: £1,952,323 and £980,771 respectively). Included in these amounts are £nil (2014: £36,256) which the Group paid into the Group's money purchase pension scheme. In addition, Directors paid £nil (2014: £7,251) into this scheme. The Group did not make any loss of office payments to Directors in the year (2014: £nil).

### (b) UK government

As described in note I to the Parent Company Financial Statements, the Company considers the UK government to be its ultimate controlling party. The Group's material balances with departments and bodies of the government comprise deposits with the Bank of England (see note 9), loans from HM Treasury (see note 21) and the Statutory Debt (see note 21). HM Treasury has also provided guarantee arrangements to the Group, for which the Group pays fees (see note 3). In addition to these loans and guarantees, the Group has balances and transactions with numerous government bodies on an arm's length basis in relation to the payment of corporation tax, VAT and employee taxes and the payment of regulatory fees and levies. The Group has balances and transactions with UKFI and with banks over which the UK government has significant influence; these were made in the ordinary course of business and are not unusual in their nature or conditions. In the year, the Group paid £0.5m (2014: £nil) relating to advisors to UKFI on UKAR's future strategy.

### (c) UKAR Company

The UKAR Company's balances and transactions with related parties are detailed in note G to the Parent Company Financial Statements.

## 32. Capital structure

The UK financial regulator the FCA regulates three of the Company's principal subsidiaries, B&B, NRAM and Mortgage Express, under the MIPRU regime which applies to mortgage administration companies. Each of these companies manages its capital resources in order to meet the FCA's regulatory requirements. Capital adequacy is monitored on an ongoing basis by the Group's executive management and Board based on the regulations established by the FCA. Each of these three companies met its capital requirements in full throughout 2014/15 and 2013/14; further information is available in the Annual Reports and Accounts of each company, which do not form part of these Financial Statements. The Board considers core equity, formerly Tier 1 capital, to be of pre-eminent importance in the capital structure of the regulated companies and continues to monitor this closely in addition to the total level of capital. The Directors believe that each regulated Group company has an appropriate and adequate level of capital to support its activities, subject to the continuing support of HM Treasury. While FCA rules require the regulated companies within the Group to hold capital in excess of 1% of total Balance Sheet assets plus any undrawn commitments, the Board believes it appropriate that they should hold a higher level of capital and as at 31 March 2015, capital in B&B represented 7.7% of B&B assets and NRAM capital represented 10.6% of NRAM assets.

The primary objectives of the Group's capital management are to maintain capital resources to support the objectives of the business, to cover risks inherent in its activities and to ensure compliance with externally imposed capital requirements. The capital structure is managed in response to changes in the nature of the Group's activities and economic conditions.

The Group defines equity and certain other capital instruments as capital. Capital excludes accounting reserves for available-for-sale assets and cash flow hedges. The Group's capital adequacy and capital resources are managed and monitored in accordance with the regulatory capital rules of the FCA. The Group must at all times monitor and demonstrate compliance with the relevant regulatory capital requirements of the FCA. The required capital information is filed with the FCA on a quarterly basis.

The Company's capital is represented by the capital and reserves attributable to the equity holder. The Company is not subject to externally imposed capital requirements other than the minimum share capital required by the Companies Act, with which it complies. The Company manages its capital and reserves in order that there is sufficient capital to meet the needs of the Company in its operations.

## 33. Financial instruments

**(a) Categories of financial assets and financial liabilities: carrying value compared to fair value**

The following table summarises the carrying amounts and fair values of financial assets and liabilities. Assets are generally presented at bid prices, whereas offer prices are used for liabilities. The accounting policy note 1(g) sets out the key principles used for estimating the fair values of financial instruments. Note 33(e) provides some additional information in respect of the methodologies used.

| **At 31 March 2015** | **Available-for-sale £m** | **Assets at fair value through profit or loss £m** | **Loans and receivables £m** | **Hedging adjustments £m** | **Total carrying value £m** | **Fair value £m** |
|---|---|---|---|---|---|---|
| **Financial assets:** | | | | | | |
| Balances with the Bank of England | **-** | **-** | **6,916.7** | **-** | **6,916.7** | **6,916.7** |
| Cash at bank and in hand | **-** | **-** | **2,266.4** | **-** | **2,266.4** | **2,266.4** |
| Investment securities | **158.1** | **-** | **364.6** | **-** | **522.7** | **571.9** |
| Loans to customers | **-** | **-** | **52,681.1** | **1.4** | **52,682.5** | **49,932.7** |
| Fair value adjustments on portfolio hedging | **-** | **-** | **-** | **467.7** | **467.7** | **-** |
| Derivative financial instruments | **-** | **2,962.7** | **-** | **-** | **2,962.7** | **2,962.7** |
| Other financial assets | **-** | **-** | **19.4** | **-** | **19.4** | **19.4** |
| **Total financial assets** | **158.1** | **2,962.7** | **62,248.2** | **469.1** | **65,838.1** | **62,669.8** |

| | **Liabilities at fair value through profit or loss £m** | **Liabilities at amortised cost £m** | **Hedging adjustments £m** | **Total carrying value £m** | **Fair value £m** |
|---|---|---|---|---|---|
| **Financial liabilities:** | | | | | |
| Amounts due to banks | **-** | **2,185.8** | **-** | **2,185.8** | **2,185.8** |
| Statutory Debt and HM Treasury loans | **-** | **34,619.4** | **-** | **34,619.4** | **34,619.4** |
| Derivative financial instruments | **570.0** | **-** | **-** | **570.0** | **570.0** |
| Debt securities in issue | **-** | **20,562.5** | **384.2** | **20,946.7** | **21,438.5** |
| Capital instruments | **-** | **16.0** | **1.1** | **17.1** | **22.3** |
| Other financial liabilities | **-** | **107.2** | **-** | **107.2** | **107.2** |
| **Total financial liabilities** | **570.0** | **57,490.9** | **385.3** | **58,446.2** | **58,943.2** |

| At 31 March 2014 | Available-for-sale £m | Assets at fair value through profit or loss £m | Loans and receivables £m | Hedging adjustments £m | Total carrying value £m | Fair value £m |
|---|---|---|---|---|---|---|
| Financial assets: | | | | | | |
| Balances with the Bank of England | - | - | 5,020.3 | - | 5,020.3 | 5,020.3 |
| Cash at bank and in hand | - | - | 2,503.2 | - | 2,503.2 | 2,503.2 |
| Investment securities | 317.2 | - | 753.4 | 4.1 | 1,074.7 | 1,095.1 |
| Loans to customers | - | - | 61,247.3 | 2.2 | 61,249.5 | 57,354.6 |
| Fair value adjustments on portfolio hedging | - | - | - | 308.8 | 308.8 | - |
| Derivative financial instruments | - | 4,616.2 | - | - | 4,616.2 | 4,616.2 |
| Other financial assets | - | - | 29.9 | - | 29.9 | 29.9 |
| Total financial assets | 317.2 | 4,616.2 | 69,554.1 | 315.1 | 74,802.6 | 70,619.3 |

| | Liabilities at fair value through profit or loss £m | Liabilities at amortised cost £m | Hedging adjustments £m | Total carrying value £m | Fair value £m |
|---|---|---|---|---|---|
| Financial liabilities: | | | | | |
| Amounts due to banks | - | 3,119.2 | - | 3,119.2 | 3,119.2 |
| Statutory Debt and HM Treasury loans | - | 38,350.5 | - | 38,350.5 | 38,350.5 |
| Derivative financial instruments | 446.0 | - | - | 446.0 | 446.0 |
| Debt securities in issue | - | 25,250.4 | 635.6 | 25,886.0 | 27,063.4 |
| Capital instruments | - | 202.5 | 12.8 | 215.3 | 189.9 |
| Other financial liabilities | - | 126.1 | - | 126.1 | 126.1 |
| Total financial liabilities | 446.0 | 67,048.7 | 648.4 | 68,143.1 | 69,295.1 |

## 33. Financial instruments (continued)

**(a) Categories of financial assets and financial liabilities: carrying value compared to fair value** (continued)

No financial assets or liabilities were reclassified during the period between amortised cost and fair value categories (2014: none).

At 31 March 2015 assets carried by NRAM at amortised cost which were previously carried at fair value were carried at £430.6m (31 March 2014: £653.4m). The difference between the carrying value at the date of reclassification and the expected value at the redemption date is recognised in profit and loss on an effective interest rate basis over the expected lives of the assets; their carrying amounts will accrete up to their redemption amounts over their expected lives. The amount recognised in profit and loss during the period was a gain of £7.3m (2014: £55.8m), which was exactly offset by losses transferred from the available-for-sale reserve during the year. If the assets had not been reclassified, it is estimated that fair value gains of £25.5m would have been reflected in the available-for-sale reserve during 2014/15 in respect of these assets (2013/14: gains of £160.4m). The expected redemption value of the remaining assets is £481.5m (2014: £833.7m). The fair value of these assets at 31 March 2015 was £418.0m (31 March 2014: £731.4m).

**(b) Interest income and expense on financial instruments that are not at fair value through profit or loss**

| | **12 months to 31 Mar 2015 £m** | 15 months to 31 Mar 2014 £m |
|---|---|---|
| Interest income | **2,117.4** | 3,092.7 |
| Interest expense | **(902.9)** | (1,428.7) |
| **Net interest income** | **1,214.5** | 1,664.0 |

These amounts represent interest income and expense before hedging arrangements.

**(c) Impaired financial assets**

Allowance accounts for credit losses in respect of impairment of loans to customers are detailed in note 13 and in respect of investment securities in note 11. No impairment loss has been recognised in respect of any other class of financial asset and no other class of financial asset includes assets that are past due.

**(d) Hedge accounting**

**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 and exchange rates. 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 only to use derivatives to create economically effective hedges. However IAS 39 requires certain tests to be satisfied before hedge accounting is permitted. Consequently not all economic hedges are designated as accounting hedges, either because natural accounting offsets are expected or because obtaining hedge accounting would be especially onerous.

## 33. Financial instruments (continued)

**(d) Hedge accounting** (continued)

**(i) Fair value hedges**
The Group designates a number of derivatives as fair value hedges. In particular, the Group has three approaches establishing relationships for:

- Hedging the interest rate and foreign currency exchange rate 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.
- 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 with vanilla fixed/floating or floating/fixed interest rate swaps.
- 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. The Group believes this solution is consistent with its policy for hedging fixed rate mortgages on an economic basis.

**(ii) Cash flow hedges**
The Group designates a number of derivatives as cash flow hedges. In particular, the Group adopts the following approaches:

- Using fixed interest rate swaps to hedge floating rate sterling liabilities.
- To address the volatility generated by floating/floating cross currency swaps, they are placed into cash flow hedges; the accounting hedge relationship is to hedge the foreign currency exchange rate risk of the foreign currency denominated asset/liability.
- Fixed/floating cross currency swaps are split into their separate risk components and separately designated into cash flow hedges.
- Basis swaps are split into their separate risk components and separately designated into cash flow hedges.

**(iii) Net investment hedges**
The Group has not designated any derivatives as net investment hedges in 2014/15 or 2013/14.

The Group had the following types of hedges:

| **At 31 March 2015** | **Fair value hedges £m** | **Cash flow hedges £m** | **Economic hedges £m** | **Total £m** | **Notional amounts £m** |
|---|---|---|---|---|---|
| Exchange rate contracts | **7.1** | **2,883.7** | **70.6** | **2,961.4** | **16,232.6** |
| Interest rate contracts | **1.1** | **0.2** | **-** | **1.3** | **28.0** |
| **Total asset balances** | **8.2** | **2,883.9** | **70.6** | **2,962.7** | |
| Exchange rate contracts | **-** | **-** | **5.5** | **5.5** | **593.2** |
| Interest rate contracts | **498.9** | **47.6** | **18.0** | **564.5** | **19,634.5** |
| **Total liability balances** | **498.9** | **47.6** | **23.5** | **570.0** | |
| **Fair value of hedging instruments** | **(490.7)** | **2,836.3** | **47.1** | **2,392.7** | |

| At 31 March 2014 | Fair value hedges £m | Cash flow hedges £m | Economic hedges £m | Total £m | Notional amounts £m |
|---|---|---|---|---|---|
| Exchange rate contracts | 4.6 | 4,603.1 | 1.6 | 4,609.3 | 17,432.4 |
| Interest rate contracts | 2.1 | 1.4 | 3.4 | 6.9 | 6,677.5 |
| Total asset balances | 6.7 | 4,604.5 | 5.0 | 4,616.2 | |
| Exchange rate contracts | - | 7.0 | 22.6 | 29.6 | 1,421.0 |
| Interest rate contracts | 320.8 | 80.0 | 15.6 | 416.4 | 22,199.0 |
| Total liability balances | 320.8 | 87.0 | 38.2 | 446.0 | |
| Fair value of hedging instruments | (314.1) | 4,517.5 | (33.2) | 4,170.2 | |

## 33. Financial instruments (continued)

**(e) Fair value measurement**

Financial assets and liabilities carried at fair value are valued on the following bases:

| **At 31 March 2015** | **Level 1 £m** | **Level 2 £m** | **Level 3 £m** | **Total £m** |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Investment securities - available-for-sale | **31.8** | **126.3** | **-** | **158.1** |
| Derivative financial instruments | **-** | **2,962.7** | **-** | **2,962.7** |
| **Financial liabilities:** | | | | |
| Derivative financial instruments | **-** | **(570.0)** | **-** | **(570.0)** |
| **Net financial assets** | **31.8** | **2,519.0** | **-** | **2,550.8** |

| At 31 March 2014 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| Financial assets: | | | | |
| Investment securities - available-for-sale | 106.3 | 215.0 | - | 321.3 |
| Derivative financial instruments | - | 4,616.2 | - | 4,616.2 |
| Financial liabilities: | | | | |
| Derivative financial instruments | - | (446.0) | - | (446.0) |
| Net financial assets | 106.3 | 4,385.2 | - | 4,491.5 |

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

Level 2: Inputs other than quoted prices that are observable for the asset or liability, whether directly (i.e. as price) or indirectly (i.e. derived from the implications of prices).

Level 3: Inputs for the asset or liability that are not based on observable market data, or have significant unobservable inputs.

There were no transfers between Level 1 and Level 2 during the period (2014: none).

Available-for-sale investment securities which are categorised as Level 1 are valued based on quoted market prices.

Available-for-sale investment securities which are categorised as Level 2 are those which are less frequently traded, hence trade prices cannot always be relied on as evidence of fair value. For such securities, fair value is estimated by the securities' lead managers, taking into account recent trades, similar assets adjusted for credit spreads and where applicable the underlying performance of assets backing the securities (so unobservable inputs are not considered significant). These prices are reviewed against quoted prices where available.

Derivative financial instruments which are categorised as Level 2 are those which either:

(a) Have future cash flows which are on known dates and for which the cash flow amounts are known or calculable by reference to observable interest and foreign currency exchange rates; or

(b) Have future cash flows which are not pre-defined but for which the fair value of the instrument has very low sensitivity to unobservable inputs.

In each case the fair value is calculated by discounting future cash flows using observable market parameters including swap rates, interest rates and currency rates.

## 33. Financial instruments (continued)

**(e) Fair value measurement** (continued)

For financial assets and liabilities which are not carried at fair value, the fair values disclosed in note 33(a) are calculated on the following bases:

| **At 31 March 2015** | **Level 1 £m** | **Level 2 £m** | **Level 3 £m** | **Total £m** |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Balances with the Bank of England | **6,916.7** | **-** | **-** | **6,916.7** |
| Cash at bank and in hand | **2,266.4** | **-** | **-** | **2,266.4** |
| Investment securities | **-** | **413.8** | **-** | **413.8** |
| Loans to customers | **-** | **-** | **49,932.7** | **49,932.7** |
| Other financial assets | **-** | **19.4** | **-** | **19.4** |
| | **9,183.1** | **433.2** | **49,932.7** | **59,549.0** |
| **Financial liabilities:** | | | | |
| Amounts due to banks | **2,185.8** | **-** | **-** | **2,185.8** |
| Statutory Debt and HM Treasury loans | **34,619.4** | **-** | **-** | **34,619.4** |
| Debt securities in issue | **-** | **21,438.5** | **-** | **21,438.5** |
| Capital instruments | **-** | **22.3** | **-** | **22.3** |
| Other financial liabilities | **-** | **107.2** | **-** | **107.2** |
| | **36,805.2** | **21,568.0** | **-** | **58,373.2** |

| At 31 March 2014 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| Financial assets: | | | | |
| Balances with the Bank of England | 5,020.3 | - | - | 5,020.3 |
| Cash at bank and in hand | 2,503.2 | - | - | 2,503.2 |
| Investment securities | - | 773.8 | - | 773.8 |
| Loans to customers | - | - | 57,354.6 | 57,354.6 |
| Other financial assets | - | 29.9 | - | 29.9 |
| | 7,523.5 | 803.7 | 57,354.6 | 65,681.8 |
| Financial liabilities: | | | | |
| Amounts due to banks | 3,119.2 | - | - | 3,119.2 |
| Statutory Debt and HM Treasury loans | 38,350.5 | - | - | 38,350.5 |
| Debt securities in issue | - | 27,063.4 | - | 27,063.4 |
| Capital instruments | - | 189.9 | - | 189.9 |
| Other financial liabilities | - | 126.1 | - | 126.1 |
| | 41,469.7 | 27,379.4 | - | 68,849.1 |

Valuation methods for calculations of fair values in the table above are as follows:

*Balances with the Bank of England*

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

*Cash at bank and in hand*

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

*Investment securities*

The fair values of investment securities held as loans and receivables are based on quoted prices or lead manager prices where available or by using discounted cash flows applying independently sourced market parameters including interest rates and currency rates. The fair value of unsecured investment loans is based on prices supplied by third parties.

*Loans to customers*

Loans to customers include loans of varying rates and maturities. Fair value is estimated by discounting expected future cash flows using market interest rates. Expected future cash flows take account of estimated future losses. Market interest rates are based on current lending activity in the mortgage market. In respect of the majority of the Group's fixed interest rate loans, the change in interest rates since inception 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, the Group has no material exposure to this difference in fair value.

## 33. Financial instruments (continued)

**(e) Fair value measurement** (continued)

*Amounts due to banks*

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 estimated to be their carrying amount. The fair value of all other deposit liabilities is estimated using discounted cash flows, applying independently sourced market parameters including interest rates and currency rates.

*Statutory Debt and HM Treasury loans*

The fair value is estimated to be the carrying amount as the interest rate charged varies in line with changes in market rates, or the loans are considered to be repayable on demand subject to timing of repayment of loans to customers.

*Debt securities in issue and capital instruments*

Fair values are based on quoted prices or lead manager prices where available, or by using discounted cash flows, applying independently sourced market parameters including interest rates and currency rates.

*Other financial assets and liabilities*

Fair value approximates to carrying value because the balances are short term in nature.

**(f) Transferred financial assets**

As set out in note 22, the Group has transferred financial assets (loans and receivables) to securitisation structures. The Group retains all of the risks and rewards associated with these loans and they are, therefore, retained on the Group's Balance Sheet.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For securitisation structures, the associated liabilities represent the external notes in issue (see note 22). None of these notes have recourse to the transferred assets.

| **At 31 March 2015** | **Transferred assets Carrying amount £m** | **Associated liabilities Carrying amount £m** |
|---|---|---|
| **Loans to customers securitised** | **38,988.3** | **20,677.0** |

| At 31 March 2014 | Transferred assets Carrying amount £m | Associated liabilities Carrying amount £m |
|---|---|---|
| Loans to customers securitised | 44,424.2 | 25,342.5 |

**(g) Offsetting**

No financial assets have been offset against financial liabilities. Balances which are subject to enforceable master netting arrangements or similar agreements are as follows:

| **At 31 March 2015** | **Gross and net amounts, as reported on the Balance Sheet** | **Amounts available to be offset (but not offset on the Balance Sheet)** | | **Net amounts after offsetting under IFRS 7** |
|---|---|---|---|---|
| | | **Master netting arrangements** | **Financial collateral** | |
| | **£m** | **£m** | **£m** | **£m** |
| **Derivative financial assets** | **2,962.7** | **(23.2)** | **(1,800.1)** | **1,139.4** |
| **Derivative financial liabilities** | **(570.0)** | **23.2** | **531.6** | **(15.2)** |
| | **2,392.7** | **-** | **(1,268.5)** | **1,124.2** |

| At 31 March 2014 | Gross and net amounts, as reported on the Balance Sheet | Amounts available to be offset (but not offset on the Balance Sheet) | | Net amounts after offsetting under IFRS 7 |
|---|---|---|---|---|
| | | Master netting arrangements | Financial collateral | |
| | £m | £m | £m | £m |
| Derivative financial assets | 4,616.2 | (33.0) | (2,734.6) | 1,848.6 |
| Derivative financial liabilities | (446.0) | 33.0 | 394.4 | (18.6) |
| | 4,170.2 | - | (2,340.2) | 1,830.0 |

## 34. Collateral pledged and received

| | At 31 Mar 2015 £m | At 31 Mar 2014 £m |
|---|---|---|
| Cash collateral which the Group has provided in respect of derivative contracts | **549.1** | 414.8 |
| **Total collateral pledged** | **549.1** | 414.8 |

| | At 31 Mar 2015 £m | At 31 Mar 2014 £m |
|---|---|---|
| Cash collateral which the Group has received in respect of derivative contracts | **2,185.8** | 3,119.1 |
| Securities collateral held | **147.2** | 235.4 |
| **Total collateral received** | **2,333.0** | 3,354.5 |

In addition to the collateral amounts shown above, certain loans to customers provide security in respect of securitised note and Covered Bond funding as detailed in note 22. These loans and also cash collateral pledged shown above are carried on the Balance Sheet. The liability to repay the cash collateral received is included within amounts due to banks in the Balance Sheet. In the absence of counterparty default, the Group has no right to sell or re-pledge the securities collateral received and therefore in accordance with the provisions of IAS 39 such securities are not recognised on the Balance Sheet.

## 35. Financial risk management

A description of the principal risks to which the Group is exposed is provided on pages 71 to 74 which form an integral part of the audited Financial Statements.

**(a) Credit risk**

Credit risk is the potential for financial loss caused by a party failing to meet an obligation as it becomes due. The Group considers its most significant credit risk to be the exposure to retail, commercial and wholesale counterparties failing to meet their obligations. As credit risk is the main risk to the Group, a credit risk framework has been established as part of the overall governance framework to measure, mitigate and manage credit risk within risk appetite. The Group closely monitors its credit risk against the Board's credit policies.

The maximum credit risk exposure at the Balance Sheet date before taking account of any collateral netting and other credit enhancements was as follows:

| | At 31 Mar 2015 £m | At 31 Mar 2014 £m |
|---|---|---|
| **On Balance Sheet:** | | |
| Balances with the Bank of England | **6,916.7** | 5,020.3 |
| Cash at bank and in hand | **2,266.4** | 2,503.2 |
| Investment securities | **522.7** | 1,074.7 |
| Loans to customers | **52,682.5** | 61,249.5 |
| Derivative financial instruments | **2,962.7** | 4,616.2 |
| Other financial assets | **19.4** | 29.9 |
| **Total on Balance Sheet** | **65,370.4** | 74,493.8 |
| **Off Balance Sheet:** | | |
| Loan commitments (see note 30) | **1,430.4** | 1,757.3 |

Loans to customers include loans which are secured on property. Additional information in respect of credit risk is provided in note 11 (for wholesale assets) and note 14 (for loans to customers).

The Board has approved a framework for maximum wholesale credit counterparty limits against which total wholesale credit exposures are continually monitored and controlled. The credit limit structure adopts a risk based matrix whereby lower rated counterparties are afforded lower overall levels of limit. Although publicly available ratings produced by rating agencies provide a useful guide to the creditworthiness of counterparties, an internal evaluation is also used in the limit assignment process. Counterparties are assigned maximum limits in accordance with the ratings matrix, based on the lowest rating afforded to any part of the counterparty group.

**Concentration risk**

The Group has investments in a range of investment securities issued by government bodies and banks and in asset-backed securities, in both the UK and overseas. UK government securities, bank and supranational bonds comprise 6% (2014: 10%) of investment securities held. 42% (2014: 39%) of the asset-backed securities are backed by UK assets. Further details in respect of concentrations in the wholesale assets portfolio are given in note 11.

## 35. Financial risk management (continued)

### (a) Credit risk (continued)

**Concentration risk** (continued)
The Group operates primarily in the UK and adverse changes to the UK economy could impact all areas of the Group's business. Residential loans to customers are all secured on property in the UK. 42% (2014: 39%) of residential loans to customers are concentrated in the buy-to-let market; most of the remaining balances are secured on residential owner-occupied properties.

The residential loan book of £51.1bn (2014: £59.3bn) is geographically spread across the UK broadly in line with the country's housing stock. Consequently, there is a geographic concentration of mortgages secured on properties in London and the South-East representing 41% (2014: 42%) of the book.

Within the commercial mortgage portfolio and housing association loans there are 89 loans (2014: 115) totalling £0.5bn (2014: £0.6bn), with the largest 10 loans accounting for 73% (2014: 65%) of the portfolio. All of these loans are secured on commercial properties.

For derivative financial instruments the Group uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers. Derivative transactions with wholesale counterparties are typically collateralised, in the form of cash or highly liquid securities, under a Credit Support Annex in conjunction with the ISDA Master Agreement. All outstanding positions are held with wholesale counterparties with a minimum of a BBB+ credit rating.

### (b) Liquidity risk
The Group closely monitors its liquidity position against the Board's liquidity policy. Minimum and target liquidity levels are established through stress testing and cash flow forecasting, taking into consideration an assessment of any emerging and potentially extreme funding conditions.

The table below analyses the Group's financial assets and liabilities into relevant maturity groupings:

| At 31 March 2015 | On demand £m | Within three months £m | After three months but within six months £m | After six months but within one year £m | After one year but within five years £m | After five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Financial assets:** | | | | | | | |
| Balances with the Bank of England | 6,914.3 | 2.4 | - | - | - | - | 6,916.7 |
| Cash at bank and in hand | 1,754.7 | 511.7 | - | - | - | - | 2,266.4 |
| Investment securities | - | 32.1 | 18.0 | 26.5 | 28.2 | 417.9 | 522.7 |
| Loans to customers | 322.3 | 119.6 | 135.6 | 412.2 | 3,371.8 | 48,321.0 | 52,682.5 |
| Fair value adjustments on portfolio hedging | - | 2.5 | 3.0 | 5.9 | 30.3 | 426.0 | 467.7 |
| Derivative financial instruments | - | 114.8 | 46.6 | 191.7 | 877.5 | 1,732.1 | 2,962.7 |
| Other financial assets | - | 19.4 | - | - | - | - | 19.4 |
| **Total financial assets** | **8,991.3** | **802.5** | **203.2** | **636.3** | **4,307.8** | **50,897.0** | **65,838.1** |
| | | | | | | | |
| **Financial liabilities:** | | | | | | | |
| Amounts due to banks | 2,185.8 | - | - | - | - | - | 2,185.8 |
| Statutory Debt and HM Treasury loans | 34,590.0 | 29.4 | - | - | - | - | 34,619.4 |
| Derivative financial instruments | - | 6.6 | 6.5 | 19.7 | 45.1 | 492.1 | 570.0 |
| Debt securities in issue | 2.5 | 1,906.3 | 820.6 | 1,346.6 | 12,836.5 | 4,034.2 | 20,946.7 |
| Capital instruments | - | 0.2 | - | 4.5 | 4.6 | 7.8 | 17.1 |
| Other financial liabilities | - | 107.2 | - | - | - | - | 107.2 |
| **Total financial liabilities** | **36,778.3** | **2,049.7** | **827.1** | **1,370.8** | **12,886.2** | **4,534.1** | **58,446.2** |

## 35. Financial risk management (continued)

**(b) Liquidity risk** (continued)

| At 31 March 2014 | On demand £m | Within three months £m | After three months but within six months £m | After six months but within one year £m | After one year but within five years £m | After five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| Financial assets: | | | | | | | |
| Balances with the Bank of England | 5,019.8 | 0.5 | - | - | - | - | 5,020.3 |
| Cash at bank and in hand | 2,503.1 | 0.1 | - | - | - | - | 2,503.2 |
| Investment securities | - | 38.9 | 40.3 | 32.2 | 98.8 | 864.5 | 1,074.7 |
| Loans to customers | 321.3 | 131.2 | 130.8 | 258.6 | 3,892.6 | 56,515.0 | 61,249.5 |
| Fair value adjustments on portfolio hedging | - | 2.5 | 3.0 | 6.5 | 38.7 | 258.1 | 308.8 |
| Derivative financial instruments | - | 13.4 | 3.0 | 6.9 | 1,968.2 | 2,624.7 | 4,616.2 |
| Other financial assets | - | 29.9 | - | - | - | - | 29.9 |
| Total financial assets | 7,844.2 | 216.5 | 177.1 | 304.2 | 5,998.3 | 60,262.3 | 74,802.6 |
| | | | | | | | |
| Financial liabilities: | | | | | | | |
| Amounts due to banks | 3,119.2 | - | - | - | - | - | 3,119.2 |
| Statutory Debt and HM Treasury loans | 38,326.4 | 24.1 | - | - | - | - | 38,350.5 |
| Derivative financial instruments | - | 11.0 | 6.7 | 10.8 | 104.9 | 312.6 | 446.0 |
| Debt securities in issue | 3.0 | 945.6 | 857.4 | 1,615.7 | 16,101.6 | 6,362.7 | 25,886.0 |
| Capital instruments | - | - | - | 4.7 | 9.5 | 201.1 | 215.3 |
| Other financial liabilities | - | 126.1 | - | - | - | - | 126.1 |
| Total financial liabilities | 41,448.6 | 1,106.8 | 864.1 | 1,631.2 | 16,216.0 | 6,876.4 | 68,143.1 |

HM Treasury has indicated that it expects the loans and the WCF provided to the Group by HM Treasury and the Statutory Debt due to the FSCS to be repaid out of the cash flows generated by the Group during its wind-down. It is not possible to specify the contractual maturity dates of the loans to the Group from HM Treasury and from the FSCS and therefore they have been included in the table above as though repayable on demand.

Debt securities in issue include notes which securitise loans to customers through SPVs. These notes are repaid on a pass-through basis. In the above table, maturities of such notes are based on the expected repayment of notes which, in turn, are derived from the expected redemption profiles of securitised loans.

In the above table, where derivatives have been taken out to hedge mortgage backed securitised notes, the timings of derivative payments are based on the expected repayment dates of the hedged notes.

Following the repurchase and cancellation during the year of the majority of the Group's capital instruments, the remaining notes in issue are £8.0m principal of NRAM notes which are payable in 2015-2016 and £5.0m principal of B&B notes which are not callable but are assumed in the above table to be redeemed on 31 December 2055; further details are provided in note 25.

Other assets and liabilities are included in the above table according to the earliest date that payment can be contractually demanded. It should be noted that many financial instruments are settled earlier than their contractual maturity date; in particular, many mortgage loans are repaid early, in full or in part.

Assets and liabilities with a remaining period to contractual maturity of within one year are classed as current and those with a remaining period of more than one year are classed as non-current. Non-financial assets and liabilities amount to £304.2m and £643.0m respectively (2014: £137.4m and £455.9m) of which £8.6m and £113.5m respectively are classed as current (2014: £7.5m and £183.4m) and £295.6m and £529.5m respectively are classed as non-current (2014: £129.9m and £272.5m).

## 35. Financial risk management (continued)

### (b) Liquidity risk (continued)

**Non-derivative cash flows**

The table below analyses the Group's non-derivative cash flows payable into relevant periods. The assumptions used in the preparation of this table are consistent with those used in the maturity table on pages 139 to 140. The amounts disclosed are the contractual undiscounted cash outflows. 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.

| At 31 March 2015 | On demand £m | Within three months £m | After three months but within six months £m | After six months but within one year £m | After one year but within five years £m | After five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Financial liabilities:** | | | | | | | |
| Amounts due to banks | **2,185.8** | **-** | **-** | **-** | **-** | **-** | **2,185.8** |
| Statutory Debt and HM Treasury loans | **34,590.0** | **29.4** | **-** | **-** | **-** | **-** | **34,619.4** |
| Debt securities in issue | **2.5** | **1,873.2** | **843.0** | **1,519.1** | **13,287.3** | **5,355.2** | **22,880.3** |
| Capital instruments | **-** | **0.2** | **0.2** | **4.3** | **4.3** | **18.0** | **27.0** |
| Other financial liabilities | **-** | **107.2** | **-** | **-** | **-** | **-** | **107.2** |
| Loan commitments | **1,423.8** | **0.2** | **0.2** | **0.3** | **2.3** | **3.6** | **1,430.4** |
| **Total** | **38,202.1** | **2,010.2** | **843.4** | **1,523.7** | **13,293.9** | **5,376.8** | **61,250.1** |

| At 31 March 2014 | On demand £m | Within three months £m | After three months but within six months £m | After six months but within one year £m | After one year but within five years £m | After five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| Financial liabilities: | | | | | | | |
| Amounts due to banks | 3,119.2 | - | - | - | - | - | 3,119.2 |
| Statutory Debt and HM Treasury loans | 38,326.4 | 24.1 | - | - | - | - | 38,350.5 |
| Debt securities in issue | 3.0 | 1,012.6 | 882.4 | 1,857.7 | 16,855.9 | 6,979.8 | 27,591.4 |
| Capital instruments | - | 1.1 | 3.3 | 4.5 | 17.7 | 629.4 | 656.0 |
| Other financial liabilities | - | 126.1 | - | - | - | - | 126.1 |
| Loan commitments | 1,749.2 | 0.2 | 0.2 | 0.4 | 2.8 | 4.5 | 1,757.3 |
| Total | 43,197.8 | 1,164.1 | 885.9 | 1,862.6 | 16,876.4 | 7,613.7 | 71,600.5 |

**Derivative cash flows**

The following table analyses cash outflows for the Group's derivative financial liabilities. The amounts are allocated into relevant periods using assumptions consistent with those used in the preparation of the maturity table on pages 139 to 140.

| At 31 March 2015 | On demand £m | Within three months £m | After three months but within six months £m | After six months but within one year £m | After one year but within five years £m | After five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| Derivative financial liabilities to be settled on a net basis | **-** | **16.0** | **15.8** | **31.3** | **203.8** | **811.7** | **1,078.6** |
| Derivative financial liabilities to be settled on a gross basis: | | | | | | | |
| - outflows | **-** | **-** | **-** | **-** | **0.1** | **24.5** | **24.6** |
| - inflows | **-** | **-** | **-** | **(0.1)** | **(0.5)** | **(26.9)** | **(27.5)** |
| **Total** | **-** | **16.0** | **15.8** | **31.2** | **203.4** | **809.3** | **1,075.7** |

| At 31 March 2014 | On demand £m | Within three months £m | After three months but within six months £m | After six months but within one year £m | After one year but within five years £m | After five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| Derivative financial liabilities to be settled on a net basis | - | 38.7 | 29.6 | 56.1 | 266.5 | 891.9 | 1,282.8 |
| Derivative financial liabilities to be settled on a gross basis: | | | | | | | |
| - outflows | - | 151.0 | 144.5 | 351.3 | 1,257.1 | 615.8 | 2,519.7 |
| - inflows | - | (146.4) | (140.2) | (342.8) | (1,224.8) | (602.5) | (2,456.7) |
| Total | - | 43.3 | 33.9 | 64.6 | 298.8 | 905.2 | 1,345.8 |

## 35. Financial risk management (continued)

**(c) Market risk**
The following table describes the significant activities that were undertaken by the Group prior to nationalisation and which currently give rise to financial or market risk, the potential consequences associated with such activities and the derivative instruments used by the Group to mitigate the risks arising.

| Activity | Risk | Type of derivative instrument used |
|---|---|---|
| Legacy funding in sterling involving either fixed rate instruments or instruments with embedded options | Sensitivity to changes in interest rates | Interest rate swaps |
| Fixed and capped rate mortgages and legacy investments involving either fixed rate instruments or instruments with embedded options | Sensitivity to changes in interest rates | Interest rate swaps and options |
| Variable rate mortgage balances | Sensitivity to changes in interest rates | Interest rate swaps |
| Legacy investments and funding in foreign currencies | Sensitivity to changes in foreign currency exchange rates | Cross-currency interest rate swaps and foreign exchange contracts |

**Interest rate swaps**:
The notional principal amounts of the outstanding interest rate swap contracts in Cash Flow Hedge Relationships ('CFHR') as at 31 March 2015 were £11.3bn (31 March 2014: £19.8bn).

Gains and losses recognised in the cash flow hedge reserve on interest rate swap contracts as at 31 March 2015 will be continually released to the Income Statement up until the maturity of the hedging instruments in 2022.

**Cross currency swaps:**
The notional principal amounts of the outstanding cross currency swaps in an eligible CFHR as at 31 March 2015 were £15.2bn (31 March 2014: £17.4bn).

The hedged transactions denominated in foreign currency are expected to mature at various intervals over the next 40 years. Gains and losses recognised in the cash flow hedge reserve on cross currency swap contracts as at 31 March 2015 will be released to the Income Statement during the periods in which the hedged transactions affect the Income Statement, the latest maturity of these transactions being in 2055.

The accounting policy for derivatives and hedge accounting is described in note 1 (i), and further details of hedge accounting are provided in note 33(d).

**Interest rate risk**
Interest rate risk typically arises from mismatches between the repricing dates of interest-bearing assets and liabilities on the Group's Balance Sheet, and from the investment profile of the Group's capital and reserves. The Finance & Investment Director is responsible for managing this exposure within the risk exposure limits set out in the Market Risk policy, as approved by the Board. This policy sets out the nature of the market risks that may be taken along with aggregate risk limits, and stipulates the procedures, instruments and controls to be used in managing market risk.

Market risk is the potential adverse change in income or net worth arising from movements in interest rates, exchange rates or other market prices. Effective identification and management of market risk is essential for maintaining stable net interest income.

The Group measures, monitors and controls the following interest rate risks and sensitivities:

- Mismatch risk
- Curve
- Prepayment risk
- Basis risk
- Reset risk

Exposures are reviewed as appropriate by senior management and the Board with a frequency between daily and monthly, related to the granularity of the position.

Interest rate risk exposure is predominantly managed through the use of interest rate derivatives, principally interest rate swaps. The Group also uses asset and liability positions to offset exposures naturally wherever possible to minimise the costs and risks of arranging transactions external to the Group.

## 35. Financial risk management (continued)

**(c) Market risk** (continued)

**Interest rate risk** (continued)

Interest rate sensitivities are reported to ALCO monthly and are calculated using a range of interest rate scenarios, including non-parallel shifts in the yield curve. The main metrics used by management are:

(i) the change in value of the Group's net worth due to a notional 2% parallel move in market and base rates.

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| 2% increase | **18.3** | (0.6) |
| 2% decrease | **(13.0)** | 1.4 |

(ii) the sensitivity of the Group's interest margin over 12 months to a notional 2% parallel move in market and base rates.

| | **At 31 Mar 2015 £m** | At 31 Mar 2014 £m |
|---|---|---|
| 2% increase | **518.1** | 485.2 |
| 2% decrease | **(125.5)** | (126.0) |

**Foreign currency risk**

The Group's policy is to hedge all material foreign currency exposures by use of naturally offsetting foreign currency assets and liabilities or by the use of derivatives. Consequently, at 31 March 2015 and 31 March 2014 the Group had no net material exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates. The impact on the Group's profit and equity of reasonably possible changes in exchange rates compared to actual rates would not have been material at 31 March 2015 or 31 March 2014.

The table below summarises the Group's exposure to foreign currency exchange rate risk at the Balance Sheet date. Included in the table are the Group's financial instruments, including those classified as equity, under the relevant currency headings. The amounts disclosed are the sterling equivalents of the notional amounts due on maturity, including interest accrued at the Balance Sheet date, less any impairment provisions.

| **At 31 March 2015** | **€ £m** | **$ £m** | **Other £m** | **Total £m** |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Cash at bank and in hand | **772.0** | **236.6** | **-** | **1,008.6** |
| Investment securities | **333.3** | **54.2** | **-** | **387.5** |
| Derivative financial instruments | **10,676.2** | **5,325.8** | **487.6** | **16,489.6** |
| **Total financial assets** | **11,781.5** | **5,616.6** | **487.6** | **17,885.7** |
| **Financial liabilities:** | | | | |
| Amounts due to banks | **1,040.6** | **203.4** | **-** | **1,244.0** |
| Derivative financial instruments | **(313.1)** | **122.8** | **-** | **(190.3)** |
| Debt securities in issue | **11,055.0** | **5,289.2** | **487.6** | **16,831.8** |
| **Total financial liabilities** | **11,782.5** | **5,615.4** | **487.6** | **17,885.5** |
| **Net currency gap** | **(1.0)** | **1.2** | **-** | **(0.2)** |

| At 31 March 2014 | € £m | $ £m | Other £m | Total £m |
|---|---|---|---|---|
| Financial assets: | | | | |
| Cash at bank and in hand | 1,202.6 | 209.1 | - | 1,411.7 |
| Investment securities | 741.3 | 95.4 | - | 836.7 |
| Derivative financial instruments | 14,026.3 | 5,497.3 | 732.9 | 20,256.5 |
| Total financial assets | 15,970.2 | 5,801.8 | 732.9 | 22,504.9 |
| Financial liabilities: | | | | |
| Amounts due to banks | 1,642.9 | 161.4 | - | 1,804.3 |
| Derivative financial instruments | 194.1 | (89.4) | - | 104.7 |
| Debt securities in issue | 14,148.3 | 5,707.4 | 732.9 | 20,588.6 |
| Total financial liabilities | 15,985.3 | 5,779.4 | 732.9 | 22,497.6 |
| Non-controlling interests | - | 10.4 | - | 10.4 |
| Total | 15,985.3 | 5,789.8 | 732.9 | 22,508.0 |
| Net currency gap | (15.1) | 12.0 | - | (3.1) |

## 36. Contingent liabilities

(a) On 20 January 2009 a solicitor's letter was received notifying B&B and certain present and former B&B directors of a potential claim by former individual shareholders who subscribed for additional shares in the £401m rights issue approved on 17 July 2008. These former shareholders claim to have suffered loss through having been induced to subscribe for shares in the rights issue by allegedly materially misleading and/or incomplete statements made in the associated prospectus dated 24 June 2008 as revised and supplemented by the supplementary prospectus dated 11 July 2008. Should such a claim result in proceedings which are pursued through the courts and which succeed, the defendant directors and/or B&B could be liable in damages to certain former shareholders in B&B who subscribed for shares in the rights issue. In May 2009 B&B together with its legal advisors responded to the allegations raised. Nothing further was heard until 23 January 2012 when correspondence was received from the solicitors representing the former shareholders, to which B&B together with its legal advisors responded. This correspondence contained no further allegations or details of the former shareholders' potential claim. It is not possible at this stage to determine the outcome or timing of any conclusion to this matter. No provision has been made in respect of these allegations.

(b) In October 2014 the Group sold a portfolio of standard mortgages for £2,478.7m. B&B will continue to service these loans for a period. Under the terms of the sale, the Group provided certain warranties. Any claim under these warranties must be made by 15 months from the date on which B&B ceases to service the loans. The Group's maximum liability under these warranties is limited to £122.1m.

## 37. Events after the reporting period

On 30 March 2015 NRAM announced a tender offer in relation to the outstanding Euro2bn 3.875% Covered Bonds due 2020 and proposed an amendment to the terms and conditions that would enable NRAM to insert a call option to repurchase the bonds under offer in their entirety. On 7 May 2015 NRAM announced the results of the tender offer. Sufficient Covered Bonds were validly tendered to pass the proposal and enable NRAM to repurchase this tranche of Covered Bonds in full. The Euro2bn were redeemed, at prices ranging from 119.494% to 121.494% of the nominal amount on 8 May 2015.

# Independent Auditors' report to the Members of UK Asset Resolution Limited

## Report on the Financial Statements

### Our opinion

In our opinion, UK Asset Resolution Limited's financial statements (the "Financial Statements"):

- give a true and fair view of the state of the company's affairs as at 31 March 2015;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### What we have audited

UK Asset Resolution Limited's Financial Statements comprise:

- the Balance Sheet as at 31 March 2015;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the Financial Statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report & Accounts (the "Annual Report"), rather than in the notes to the Financial Statements. These are cross-referenced from the Financial Statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the Financial Statements is applicable law and IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

## Other required reporting

### Consistency of other information

*Companies Act 2006 opinion*

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

*ISAs (UK & Ireland) reporting*

Under International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)") we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited Financial Statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or
- otherwise misleading.

We have no exceptions to report arising from this responsibility.

### Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Financial Statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

### Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

## Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

### Other voluntary reporting

#### Opinion on additional disclosures

*Directors' Remuneration Report*
The parent company voluntarily prepares a Directors' Remuneration Report in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the parent company were a quoted company.

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

#### Matter on which we have agreed to report by exception

*Directors' remuneration*
The parent company voluntarily provides the disclosures relating to directors' remuneration required by the Listing Rules of the Financial Conduct Authority as if it were a premium listed company and the directors have requested that we review the elements of the report to shareholders by the Board on directors' remuneration specified for auditor review by the Listing Rules. We have nothing to report having performed our review.

### Responsibilities for Financial Statements and the audit

#### Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 79, 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 ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

#### What an audit of Financial Statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the Financial Statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the Financial Statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Independent Auditors' report to the Members of UK Asset Resolution Limited (continued)

### Other matter

We have reported separately on the Group financial statements of UK Asset Resolution Limited for the year ended 31 March 2015.

**Craig Gentle** (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

15 June 2015

## COMPANY BALANCE SHEET

| | Note | 31 March 2015 £m | 31 March 2014 £m |
|---|---|---|---|
| **Assets** | | | |
| Investments in Group undertakings | E | **2,634.1** | 2,634.1 |
| Other assets | | **0.1** | - |
| **Total assets** | | **2,634.2** | 2,634.1 |
| **Equity** | | | |
| Issued capital and reserves attributable to owners of the parent: | | | |
| - share capital | 26 | **1.2** | 1.2 |
| - merger reserve | F | **2,632.8** | 2,632.8 |
| - retained earnings | | **0.2** | 0.1 |
| **Total equity** | | **2,634.2** | 2,634.1 |

The notes on pages 150 to 154 and note 26 on page 127 form an integral part of these Financial Statements.

The Financial Statements on pages 148 to 154 were approved by the Board of Directors on 15 June 2015 and signed on its behalf by:

**Richard Banks**
Chief Executive Officer

**Ian Hares**
Finance & Investment Director

UK Asset Resolution Limited is registered in England and Wales under company number 07301961.

## COMPANY STATEMENT OF CHANGES IN EQUITY

| | Share capital £m | Merger reserve £m | Retained earnings £m | Total share capital and reserves £m |
|---|---|---|---|---|
| At 1 January 2013 and 31 March 2014 | 1.2 | 2,632.8 | 0.1 | 2,634.1 |
| Profit for the financial year ended 31 March 2015 | - | - | 0.1 | 0.1 |
| **At 31 March 2015** | **1.2** | **2,632.8** | **0.2** | **2,634.2** |

## COMPANY CASH FLOW STATEMENT

During the 12 month period ended 31 March 2015 and the comparative 15 month period ended 31 March 2014 the Company had no material cash flows or balances. Consequently no Cash Flow Statement has been presented.

The Company had no significant non-cash transactions during the year or comparative period.

## A. Principal accounting policies

The Company is a private limited company incorporated on 1 July 2010 and domiciled in the United Kingdom. The principal activity of the Company is to provide management services to its subsidiary undertakings. The Company applies the accounting policies of the UKAR Group, set out on pages 93 to 101, with the following additional item.

**Investments in Group undertakings**

In the Financial Statements of the UKAR Company, investments in Group undertakings are carried at cost less any impairment. UKAR's acquisition of the entire issued share capital of B&B and NRAM in a share-for-share exchange has been accounted for under 'predecessor accounting' and the cost of each of these investments has been deemed to be the net assets of the B&B company and the NRAM company at 30 June 2010. Investments are reviewed at each published Balance Sheet date for any indication of impairment. If there is indication of impairment of any investment, the carrying value of the investment is reviewed, and any impairment identified is charged immediately to the Company's Income Statement.

## B. Critical judgements and accounting estimates

In preparing the Financial Statements, management have made the following critical judgement.

**Investments in Group undertakings**

The Directors consider the value of the Company's investments in subsidiary undertakings to be supported by their underlying assets.

## C. Profit

The Company's profit after tax for the period was £19,000 (31 March 2014: £21,000). As permitted by s408 of the Companies Act 2006 the Company's individual Income Statement, Statement of Comprehensive Income and related notes have not been presented. The Company's retained earnings at 31 March 2015 were £155,000 (2014: £136,000).

## D. Taxation

The Company bears tax at the standard weighted average rate of UK corporation tax of 21.0% (2014: 23.2%) and has no deferred tax provided or unprovided.

## E. Investments in Group undertakings

The investments in Group undertakings represent the Company's holdings of the entire issued share capital of B&B and NRAM, which were acquired in a share-for-share exchange on 1 October 2010 and also of UKARcs which was incorporated on 20 June 2013.

The Company's principal subsidiary undertakings at 31 March 2015 held directly or indirectly, all of which are wholly owned and are fully consolidated into the Group Financial Statements, are listed below. All operate in their country of incorporation.

| | Nature of business | Country of incorporation | Class of shares held |
|---|---|---|---|
| **Direct** | | | |
| Bradford & Bingley plc ('B&B') | Mortgage administration | UK | Ordinary |
| Northern Rock (Asset Management) Limited | Non-trading | UK | Ordinary |
| NRAM plc ('NRAM') | Mortgage administration | UK | Ordinary and preference |
| UKAR Corporate Services Limited ('UKARcs') | Administration | UK | Ordinary |
| **Indirect** | | | |
| Mortgage Express | Mortgage administration | UK | Ordinary |

## E. Investments in Group undertakings (continued)

The following companies are also fully consolidated into the Group Financial Statements; all operate in their country of incorporation. All are indirectly wholly-owned except where indicated.

| | Nature of business | Country of incorporation | Class of shares held |
|---|---|---|---|
| Bradford & Bingley Homeloans Limited | Non-trading | UK | Ordinary |
| Bradford & Bingley Investments | Non-trading | UK | Ordinary |
| Bradford & Bingley Mortgage Management Limited | Non-trading | UK | Ordinary |
| Community Housing Initiatives Limited | Non-trading | UK | Ordinary* |
| F&NE (1990) Limited | Non-trading | UK | Ordinary* |
| F&NE Limited | Non-trading | UK | Ordinary* |
| FFM Limited | Non-trading | UK | Ordinary |
| Finance for Mortgages Limited | Non-trading | UK | Ordinary |
| Heron’s Reach Developments Limited | Non-trading | UK | Ordinary |
| HSMS | Non-trading | UK | Ordinary |
| Leamington Mortgage Corporation Limited | Non-trading | UK | Ordinary |
| Mortgage Express (No. 2) | Non-trading | UK | Ordinary |
| Mortgage Express Holdings | Non-trading | UK | Ordinary |
| NRAM (No. 2) Limited | Non-trading | UK | Ordinary |
| NRAM Homes Limited | Non-trading | UK | Ordinary |
| Scotlife Homeloans (No. 2) Limited | Non-trading | UK | Ordinary |
| Silhouette Mortgages Limited | Non-trading | UK | Ordinary |

** The Group owns 50% of the shares of these companies.*

The Directors consider the value of investments in Group undertakings to be supported by their underlying assets.

## E. Investments in Group undertakings (continued)

### SPVs

The following entities are SPVs established in connection with the Group's securitisation and secured funding programmes (see note 22). UKAR, B&B and NRAM have no contractual arrangement or intention to provide additional financial or other support to these SPVs. Although the Company has no direct or indirect ownership interest in these entities and no rights to vote or to receive dividends they are regarded as subsidiaries. This is because they are principally engaged in providing a source of long-term funding to the Group, which in substance has the rights to all benefits from the activities of the SPVs. They are, therefore, effectively controlled by the Group. B&B is a member of Bradford & Bingley Covered Bonds LLP and NRAM is a member of NRAM Covered Bond LLP.

| | Nature of business | Country of incorporation and operation |
|---|---|---|
| Aire Valley Funding 1 Limited | Holder of interest in loans | UK |
| Aire Valley Funding 2 Limited | Non-trading | UK |
| Aire Valley Funding 3 plc | Non-trading | UK |
| Aire Valley Holdings Limited | Holding company | UK |
| Aire Valley Mortgages 2004-1 plc | Issue of securitised notes | UK |
| Aire Valley Mortgages 2005-1 plc | Issue of securitised notes | UK |
| Aire Valley Mortgages 2006-1 plc | Issue of securitised notes | UK |
| Aire Valley Mortgages 2007-1 plc | Issue of securitised notes | UK |
| Aire Valley Mortgages 2007-2 plc | Issue of securitised notes | UK |
| Aire Valley Mortgages 2008-1 plc | Issue of securitised notes | UK |
| Aire Valley PECOH Limited | Post-enforcement call option holder | UK |
| Aire Valley Trustee Limited | Mortgage trustee | Jersey |
| Aire Valley Warehousing 1 Limited | Non-trading | UK |
| Aire Valley Warehousing 2 Limited | Non-trading | UK |
| Aire Valley Warehousing 3 Limited | Non-trading | UK |
| Bradford & Bingley Covered Bonds LLP | Mortgage funding | UK |
| Designated Member No.1 Limited | Member of Bradford & Bingley Covered Bonds LLP | Jersey |
| Designated Member No.2 Limited | Member of Bradford & Bingley Covered Bonds LLP | UK |
| GPCH Limited | Post-enforcement call option holder | UK |
| Granite Finance Funding Limited | Holding company | Jersey |
| Granite Finance Funding 2 Limited | Holding company | UK |
| Granite Finance Holdings Limited | Holding company | UK |
| Granite Finance Trustees Limited | Mortgage trustee | Jersey |
| Granite Master Issuer plc | Issue of securitised notes | UK |
| Granite Mortgages 03-2 plc | Issue of securitised notes | UK |
| Granite Mortgages 03-3 plc | Issue of securitised notes | UK |
| Granite Mortgages 04-1 plc | Issue of securitised notes | UK |
| Granite Mortgages 04-2 plc | Issue of securitised notes | UK |
| Granite Mortgages 04-3 plc | Issue of securitised notes | UK |
| Ivybond Holdings Limited | Holding company | Jersey |
| Moore Investments Limited | Member of NRAM Covered Bond LLP | Jersey |
| NRAM Covered Bond LLP | Mortgage funding | UK |
| Whinstone Capital Management Limited | Issue of credit linked notes | Jersey |
| Whinstone 2 Capital Management Limited | Issue of credit linked notes | Jersey |

## E. Investments in Group undertakings (continued)

**Summarised financial information for material SPVs**

Set out below is summarised financial information for each material SPV:

| | Net assets | | Profit after tax | |
|---|---|---|---|---|
| | **At 31 March 2015 £m** | At 31 March 2014 £m | **12 months to 31 March 2015 £m** | 15 months to 31 March 2014 £m |
| Aire Valley Mortgages 2004-1 plc | **3.2** | 2.9 | **0.3** | (1.2) |
| Aire Valley Mortgages 2005-1 plc | **1.3** | 0.8 | **0.5** | (0.4) |
| Aire Valley Mortgages 2006-1 plc | **13.8** | 13.9 | **(0.1)** | 1.9 |
| Aire Valley Mortgages 2007-1 plc | **2.8** | 3.0 | **(0.2)** | 0.4 |
| Granite Mortgages 03-2 plc | **0.4** | 1.3 | **(0.9)** | (0.2) |
| Granite Mortgages 03-3 plc | **0.2** | 0.3 | **(0.1)** | 0.4 |
| Granite Mortgages 04-1 plc | **0.4** | 1.1 | **(0.7)** | (0.2) |
| Granite Mortgages 04-2 plc | **(0.1)** | 0.2 | **(0.3)** | (0.2) |
| Granite Mortgages 04-3 plc | **0.2** | 0.5 | **(0.3)** | (0.1) |
| Granite Master Issuer plc | **(3.6)** | (18.0) | **14.5** | (11.7) |
| Granite Finance Funding Limited | **0.3** | 0.3 | **-** | - |
| Granite Finance Funding 2 Limited | **0.1** | 0.1 | **-** | - |
| Whinstone Capital Management Limited | **48.4** | 49.7 | **(1.3)** | (18.9) |
| Whinstone 2 Capital Management Limited | **49.0** | 45.7 | **3.3** | (15.6) |

## F. Merger reserve

| | **£m** |
|---|---|
| **At 1 January 2013, 31 March 2014 and 31 March 2015** | **2,632.8** |

The merger reserve was generated on 1 October 2010 when the Company acquired all the issued shares of B&B and NRAM from the Treasury Solicitor via a share-for-share exchange. The merger reserve represents the difference between the value attributed to the Company's investment in each company and the nominal value of the share capital issued by the Company in exchange.

## G. Related party disclosures

**(a) Subsidiary companies**

At 31 March 2015 the Company was owed £0.1m by B&B (2014: £nil).

The Company had transactions with its subsidiaries as follows:

| | **12 months to 31 March 2015 £000** | 15 months to 31 March 2014 £000 |
|---|---|---|
| Management charges to subsidiary undertakings | **537** | 827 |
| Costs recharged by subsidiary undertakings | **514** | 791 |

**(b) Key management personnel**

The Group considers the Boards of Directors and the members of the Executive Committees of UKAR, B&B and NRAM to be the key management personnel. The Company had no transactions or balances directly with any key management personnel during the period. The Company's non-executive Directors have service contracts with the Company. Their fees are paid by B&B and recharged at cost to the Company, along with other related costs.

**(c) Directors' emoluments**

The aggregate UKAR Group emoluments of the Directors of the UKAR Company for the 12 months ended 31 March 2015 were £1,459,251 and of the highest paid Director £653,227 (15 months ended 31 March 2014: £1,952,323 and £980,771 respectively).

## H. Financial risk management

The Company has no significant financial risks.

## I. Ultimate controlling party

All shares in the Company are owned by the Treasury Solicitor as nominee for HM Treasury, and the Company considers the UK government to be its ultimate controlling party. The results of the UKAR Group are consolidated into those of HM Treasury as presented in HM Treasury's Annual Report and Accounts.

## UNAUDITED CONSOLIDATED INCOME STATEMENT

| | **12 months to 31 March 2015 £m** | Unaudited 12 months to 31 March 2014 £m |
|---|---|---|
| Interest receivable and similar income | **2,010.8** | 2,291.5 |
| Interest expense and similar charges | **(641.8)** | (822.3) |
| **Net interest income** | **1,369.0** | 1,469.2 |
| Fee and commission income | **22.6** | 26.9 |
| Fee and commission expense | **(12.1)** | (12.1) |
| **Net fee and commission income** | **10.5** | 14.8 |
| Net realised gains less losses on investment securities | **12.8** | (8.3) |
| Unrealised fair value movements on financial instruments | **(8.1)** | (33.3) |
| Hedge ineffectiveness | **(74.9)** | (18.2) |
| Provision for customer redress | **(295.0)** | (115.8) |
| Other operating income | **16.0** | 10.6 |
| **Non-interest income** | **(338.7)** | (150.2) |
| **Net operating income** | **1,030.3** | 1,319.0 |
| Administrative expenses | **(177.2)** | (189.8) |
| Impairment on loans to customers credit/(charge) | **150.6** | (46.6) |
| Net impairment release on investment securities | **16.4** | 9.2 |
| Profit on sale of loans | **22.3** | 21.2 |
| Loss on repurchase of own liabilities | **(70.1)** | - |
| **Profit before taxation** | **972.3** | 1,113.0 |
| Taxation | **(200.7)** | (243.3) |
| **Profit for the period** | **771.6** | 869.7 |

The unaudited 2014 information above has been prepared using accounting bases and policies which are consistent with those used in the audited Financial Statements set out on pages 88 to 144.

**Reconciliation of underlying profit before taxation to statutory profit before taxation**

| | **12 months to 31 March 2015 £m** | 12 months to 31 March 2014 £m |
|---|---|---|
| Net interest income | **1,369.0** | 1,469.2 |
| Underlying net non-interest income | **39.3** | 17.1 |
| **Underlying net operating income** | **1,408.3** | 1,486.3 |
| Administrative expenses | **(177.2)** | (189.8) |
| Impairment on loans to customers credit/(charge) | **150.6** | (46.6) |
| Net impairment release on investment securities | **16.4** | 9.2 |
| **Underlying profit before taxation** | **1,398.1** | 1,259.1 |
| Unrealised fair value movements on financial instruments | **(8.1)** | (33.3) |
| Hedge ineffectiveness | **(74.9)** | (18.2) |
| Provision for customer redress | **(295.0)** | (115.8) |
| Profit on sale of loans | **22.3** | 21.2 |
| Loss on repurchase of own liabilities | **(70.1)** | - |
| **Statutory profit before taxation** | **972.3** | 1,113.0 |

UK Asset Resolution Limited

Registered Office:
Croft Road
Crossflatts
Bingley
West Yorkshire
BD16 2UA

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www.ukar.co.uk

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