Sainsbury's Bank plc
Annual Report and Financial Statements for the year ended 31 December 2013

COMPANY NUMBER: 3279730

Contents

Directors' and Strategic report

The Directors have pleasure in submitting the their annual report and the financial statements of Sainsbury's Bank plc (the Bank) for the year ended 31 December 2013 to the Annual General Meeting to be held on 27 March 2014.

Principal activities

The Bank provides banking services and related financial services wholly within the UK. During the year the Bank continued to develop its customer offer through sales of its core products: personal loans, savings accounts, credit cards and general insurance products. Up until 31 January 2014, the Bank was a joint venture between J Sainsbury plc and Bank of Scotland plc with a contractual arrangement in place to govern the sharing of joint control. Bank of Scotland plc is a subsidiary of Lloyds Banking Group plc. J Sainsbury plc and Bank of Scotland plc are incorporated and domiciled in England and Scotland respectively. Sainsbury's Bank plc is incorporated and domiciled in England. From 1 February 2014, the Bank is a wholly-owned subsidiary of J Sainsbury plc.

Developing the business

Sainsbury's Bank has continued to see growth in a challenging environment against a backdrop of declining net interest margins and a competitive insurance market. The Bank's strategy remains to offer shoppers a compelling reason to bank and shop with us by delivering great products at fair prices and rewarding customers with Double Nectar Points on selected products.

To help its customers manage their budgets, in May 2013, the Bank launched its Switch and Save Loan Calculator, allowing customers to compare their current loan to its Standard product. The very competitive loans marketplace has led to a decline in headline rates offered to customers from 5.5% at the start of 2013 to 5% in December 2013. Our Nectar Reward credit card is targeted at the Sainsbury's shopper but with a broad appeal, with 0% on balance transfers and purchases and a reward element it is among the top 1% of cards in the market in terms of the benefits it offers customers.

The insurance offering of the Bank continues to grow and in September 2013, the Bank in partnership with Allianz relaunched its Pet Insurance, offering customers one of the highest vet fees cover in the market at £13,000. The Home and Car Insurance markets have become increasingly price-driven, which reduces profitability of the products for the Bank.

The Bank has over 1,400 ATMs across Sainsbury's stores, giving customers convenient access to their money with 97 new ATMs opened in 2013. Over the summer, Travel Money saw its best ever performance in June, July and August with sales increasing 23% compared to 2012.

Our commitment to delivering the quality of service customers expect from Sainsbury's is reflected in our low levels of industry complaints, and the awards our products win, including Moneyfacts – Best Card Provider (Standard Rate) and Your Money Direct – Best Online Personal Loan Provider.

As noted above from 1 February 2014 the Bank became wholly-owned by J Sainsbury plc. The Bank has established a comprehensive process to manage and oversee the transition from joint venture to stand alone bank – called the New Bank Programme. Services continue to be provided by Lloyds Banking Group (LBG) under a Transition Services Agreement while the Bank develops and rolls out its new business capabilities and operating model in conjunction with Fidelity Information Services (FIS).

In the next financial year the Directors anticipate a strong focus on delivering the transition to time and cost, with the right capability and minimal customer impact. At the same time the Bank must ensure continued growth and development of the existing suite of products in an increasingly competitive market. The Bank has put in place a prudent delivery plan as it moves to its new operating model over the coming years. The strategy has been articulated as "transition, not transformation," and the focus will be on delivering the new operational capability in a way which protects customers and the Bank's relationship with them. At the same time the Bank will continue to drive growth in the existing product suite by ensuring that the products are relevant and compelling for the Sainsbury's customer. In today's increasingly competitive market this means ongoing product development. As a wholly owned subsidiary of J Sainsbury plc the Bank's focus will be even more sharply trained on the Sainsbury's customer and driving total group benefits by driving customer loyalty and unlocking the demonstratable benefits to the group associated with increased sales of Bank products.

Financial performance and position

The Bank's 2013 performance is presented in the income statement on page 8. The Bank's profit after tax for 2013 was £42m (2012: £40m). Although the increase in profit of £2m is lower than has been achieved in prior years, it has been achieved in a market of declining loan rates and an increasingly price-driven insurance market. It also demonstrates cost control and good bad debt management by the Bank.

The Directors monitor the financial performance of the Bank and track a variety of key performance measures including the following ratios:

	2013	2012
Cost: income ratio	**65.06%**	59.45%
Net interest margin	**2.70%**	2.79%
Bad debt asset ratio	**1.06%**	1.24%
Core Tier 1 capital ratio	**12.3%**	11.0%
Total capital ratio	**15.1%**	14.3%

Net operating income decreased by £4m compared to the prior year from £242m to £238m, which along with the increase in costs has increased the cost:income ratio. The decrease in the net interest margin from 2.79% to 2.70% is driven by continued competitive pressure on rates in the market. Interest income decreased by £11m compared to the prior year as the market continued to push loan headline rates down throughout the year, whilst funding costs decreased by £10m reflecting market-driven declines in savings rates. A decline in fees and commission income of £4m was driven primarily by lower commission and lower renewals on Car Insurance products, offset by increased income on Home Insurance.

Costs (excluding bad debt) have increased by £15m compared to the prior year. New provisions of £8m were recognised in respect of Card Protection Plans and Cash Retract. Further details on the provisions are provided in note 21. Excluding the new provisions, the Cost:Income ratio would have been 61.65%. The remaining cost increase of £7m is in line with the Bank's continuing strategy of building business volumes and developing in-house capability. The costs exclude costs associated with the acquisition of the Bank by J Sainsbury plc.

The Bank expects the costs incurred by J Sainsbury plc prior to its acquisition of the Bank on 31 January 2014 in relation to the development of the Bank after that date will be recharged to the Bank. The costs amount to £36m including capital expenditure of £8m. As explained in note 37 to the financial statements, J Sainsbury plc has agreed to provide further capital to the Bank, the first tranche of which, amounting to £20m was paid on 7 February 2014.

The bad debt asset ratio has fallen to 1.06% from 1.24% in the prior year. Impairments recognised on financial assets have fallen by £5m in comparison to the prior year despite strong personal loan lending growth. The Bank continues to focus on credit risk decisioning criteria and strong back book management. The Bank believes that a rise in interest rates could increase pressure on customers' budgets and will monitor its bad debt performance for the impact of any increases in interest rates in the coming months.

Financial performance and position continued

The Bank's funding model is predominantly retail funded with a high level of liquidity being maintained. Overall, savings balances increased to a level of £3.5bn with the Bank tailoring deposit levels to the funding requirements of the business and requirements driven by the repayment of balances with Lloyds Banking Group plc on 31 January 2014. The Bank has maintained a broadly stable holding of highly liquid Treasury Bills and has holdings in very short term high quality investments. Total gross loans and advances to customers increased by £36m in the year (1.4%).

Both the Bank's Core Tier 1 capital ratio and the total capital ratio have improved during the year, this is driven by a higher proportional increase to the Bank's capital than to its risk-weighted assets.

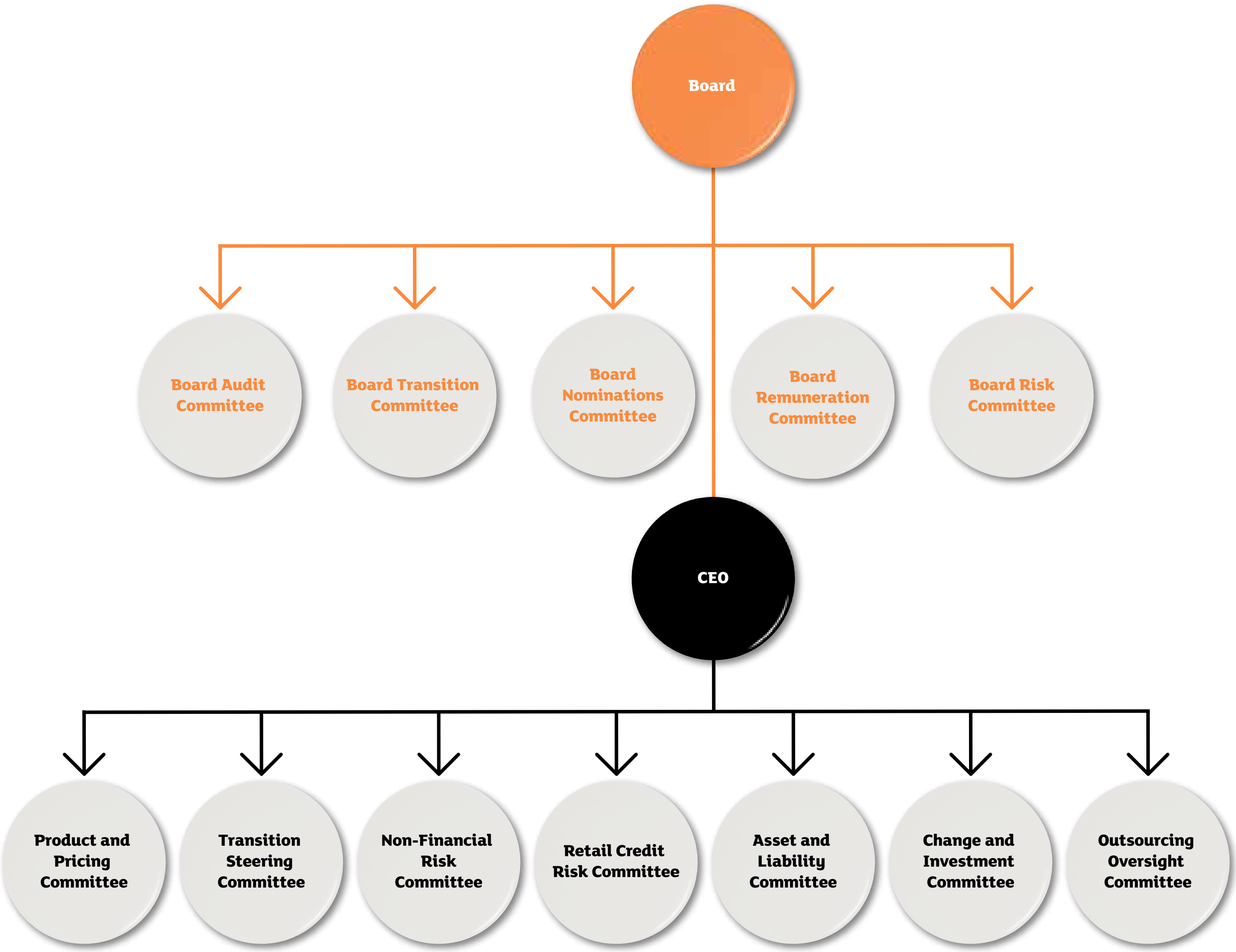
Risk management approach

The Bank aims to appropriately manage all risks that arise from its activities. Through its normal operations the principal risks to the Bank are credit risk, liquidity and funding risk, market risk, operational risk, conduct risk and regulatory risk.

The Bank has established a risk framework and formal structure to monitor and manage risks across its operations. The Board has agreed statements of risk appetite and these are adhered to via detailed risk management policies and through reporting to the various governance structures.

The governance framework in place at the Bank vertically segregates into three levels:

- Board level governance
- Collective management level governance
- Executive level governance



Risk management approach continued

Board level governance

The Board level governance holds overall accountability for the outcomes achieved, decisions made and steering the Bank but this will be in the context of an overall schedule of delegated authority from J Sainsbury plc to the Sainsbury's Bank Board. The Board then subsequently delegates the appropriate responsibility, authority and accountability to the CEO to deliver the Bank's Strategy through the appropriate governance committees and Executive Management Team.

The Board

The Board is the key governance body and is responsible for the overall strategy, performance of the business and management of risk. It has delegated responsibility for the day to day running of the business to the Chief Executive and the Executive Management Team through apportionment of responsibility and delegated authorities.

The Board meets at least nine times a year. It is comprised of key Executive members from the Bank, and Non-Executive Directors from J Sainsbury plc as well as Independent Non-Executive Directors. The chairman is an independent non-executive Director. A number of Board functions are delegated to five key sub-committees – the Board Risk Committee (BRC), Audit Committee, Remuneration Committee (RemCo), Nominations Committee and Transition Committee.

Audit Committee

The Audit Committee's key responsibility is to advise the Board on the Bank's financial statements both interim and final, including systems and controls and related policy issues together with relationships with internal and external auditors.

Transition Committee

The Transition Committee oversees the programme of projects to migrate from Lloyds Banking Group plc systems and processes to the New Bank processes and systems.

Nominations Committee

The Nominations Committee is responsible for reviewing the structure, size and composition of the Board. The Committee is also responsible for succession planning of the Board and the Executive management team and for ensuring a formal, rigorous and transparent process for recommending appointments to the Board to the Bank's shareholders.

Remuneration Committee

The role of the Remuneration Committee (RemCo) is to determine and agree with the Board the broad policy for remuneration and for compliance with the Remuneration Code (the Code) to the extent that the provisions apply to the Bank. RemCo is responsible for recommending, monitoring and noting the level and structure of remuneration for senior management (categorised as Code Staff for the purposes of the Code) and senior risk management and compliance colleagues.

RemCo continually reviews and assesses the impact of remuneration policies on the risk profile of the Bank and employee behaviour. RemCo has oversight over appointment and severance terms for relevant employees (including payments of guaranteed remuneration for appointees and retention terms).

Board Risk Committee

The Board Risk Committee (BRC) is forward looking to anticipate future risks and monitoring and providing oversight over existing risks. It is responsible for reviewing and reporting its conclusions to the Board on the Bank's risk appetite and the Bank's risk management framework.

Collective management level governance

The collective management level governance is established to ensure appropriate checks, balances and transparency on executive decision making. Responsibilities include general operational management delivery of the agreed business plan in line with agreed risk appetite, approval of new business plans or strategic changes prior to submission to the Board and senior management resourcing. The CEO's oversight and governance of the Bank is supported and effected through a number of management committees.

Product and Pricing Committee

The Product and Pricing Committee (PPC) oversees and manages the Bank's product portfolio; including management of tactical decisions regarding pricing and product terms and conditions, and product/channel alignment. It also makes those decisions in relation to products and pricing that are necessary to ensure that the Bank operates within relevant and defined risk appetite.

Transition Steering Committee

The Transition Steering Committee is responsible for ensuring that there is effective governance and oversight of the New Bank Programme, focusing on delivering on time, within budget, and to prescribed quality standards.

Non-Financial Risk Committee

The Non-Financial Risk Committee (NFRC) is in place to ensure effective risk management across operational risk, fraud risk, information risk, regulatory risk and conduct risk and makes those decisions necessary to ensure that the bank operates within its defined risk appetite.

Retail Credit Risk Committee

The Retail Credit Risk Committee (RCRC) is responsible for monitoring the performance of the retail lending book and the credit card portfolio. This Committee receives regular reports about the performance of all retail credit portfolios. This includes the credit cards and loans application process as well as collections and recoveries performance.

Asset and Liability Committee

The Asset and Liability Committee (ALCO) is responsible for ensuring the balance sheet of the Bank is managed effectively with its main areas of responsibility being market risk, wholesale credit risk, liquidity risk, and capital adequacy.

Change and Investment Committee

The Change and Investment Committee (CIC) is responsible for the management and oversight of the Bank's BAU change portfolio ensuring appropriate prioritisation of projects and tracking of progress versus plan.

Outsourcing Oversight Committee

The Outsourcing Oversight Committee (OOC) is responsible for ensuring that outsourcing risk is managed in line with the approved risk appetite and a consistent approach is taken to managing supplier relationships across the Bank.

Executive level governance

This is the executive committee and their mandates in relation to working groups.

Risk management approach continued

Risk appetite

The Bank's Board approves the Bank's strategic risk appetite, which defines the level of risk that the Bank is prepared to accept to achieve its strategic objectives. The Board Risk Committee approves the articulation of these risk appetite statements in relation to retail credit risk, wholesale credit risk, market risk, liquidity risk, operational risk, regulatory risk and conduct risk.

The Bank has a framework of policies in place, which are a manifestation of its risk appetite statements, to manage key risks. Each policy has an Executive owner who is responsible for maintenance of the policy and ensures it is reviewed at least annually and approved by the relevant governance committees.

The Bank has developed and operates an Enterprise Wide Risk Management Framework (EWRMF) which details the process through which risk is managed this is detailed within the Risk model section below.

The Bank operates within appetite tolerances and regularly reports against performance to the Board through its management committees.

Risk model

As part of the EWRMF that the Bank operates, the risk model requires that the roles and responsibilities of risk management, risk oversight and risk assurance are clearly delineated from those of the commercial and operational activities of the Bank, and there is in place effective segregation. This is known as the Three Lines of Defence model and operates as follows:

- The first line of defence is responsible for execution of the Bank's strategy, business performance, setting and implementation of policy and management of risks and internal controls. This primarily lies with the Chief Executive, the Executive Committee (ExCo) and through delegated authority to management committees. On a day-to-day basis, management and control of risk in the business is owned by the individual business units. Escalation procedures exist such that any control failures are reported to the Bank's independent risk team, and to the Executive and relevant governance bodies.
- The second line of defence provides risk oversight, an independent and objective challenge to the first line of defence. The various committees in the risk governance structure challenge the main risk types, ensuring the risks are managed effectively in line with the risk.
- The third line of defence provides independent and objective assurance on the effectiveness of the Bank's risk management, internal control and governance. This is provided by an in-house internal audit team and is supplemented by J Sainsbury plc Internal Audit or external firms. The Board retains ultimate responsibility for risk management in the Bank.

Principal risks and uncertainties

The principal risks to the Bank are retail and wholesale credit risk, liquidity risk, market risk, operational risk, regulatory risk and conduct risk. The principal risks and uncertainties table sets out these risks in more detail and also provides examples of relevant controls and mitigating factors. It should be noted that the risk assessment and mapping employed by the Bank goes beyond this assessment and captures less material risks that may still impact the business and require monitoring for future changes in materiality. In addition, the Bank continues to monitor uncertainties, such as Scottish independence as well as potential new regulations impacting the Bank's credit card interchange fees, to assess whether they give rise to new risks to the business.

The Bank has identified transitional risk as a new and emerging risk to the Bank.

Transitional risk

The change to full ownership of the Bank to J Sainsbury plc introduces change driven operational risk in particular through the transitional period. This transitional risk could have an impact on people, process, regulatory compliance and technical infrastructure.

Principal risks and uncertainties continued

Principal risk	Nature of risk	Key controls and mitigating factors
Economic environment including retail credit risk	The Bank is exposed to UK economic conditions. Adverse changes in unemployment, indebtedness, consumer confidence, and consumer spending would all have the potential to impact the credit quality of the Bank's underlying assets as well as new lending activity.	• Regular reporting framework in place to identify adverse performance versus forecast and risk appetite. Tracking includes reference to external benchmarking. • Dedicated credit risk team who report directly to the Chief Risk Officer (CRO). • Low risk appetite with better than industry average credit quality being maintained. • Impact of severe economic scenarios regularly considered as part of stress testing and capital adequacy assessment process.
Wholesale credit risk	The Bank is exposed to losses where institutional counterparties fail or do not meet their contractual cash flow obligations.	• The Bank's exposure to wholesale credit risk is reported to ALCO, BRC, Audit Committee and the Board, including reference to CDS prices, news and industry consensus. • Daily reporting to ALCO on economic environment and any pertinent industry information. Weekly credit risk meetings and weekly summary documents to Board. • Regular stress testing and daily monitoring of pricing. • Any changes to risk appetite or credit lines approved by ALCO, BRC and Board.
Liquidity and funding risk	The risk of the Bank being unable to meet its obligations as they fall due.	• The Bank has a liquidity crisis management plan in place which is subject to regular review and testing. • Daily liquidity risk early indicators and escalation process in place. • Robust liquidity position with stock of highly marketable liquid assets that can be utilised to meet liquidity requirements stemming from unexpected events. Internal limits in place to ensure liquid assets are held at a level significantly above regulatory requirements. • No reliance on short term wholesale funding and low liquidity risk appetite as evidenced by Individual Liquidity Adequacy Assessment. Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) oversight of management's assessment of liquidity risk. • Diversified customer funding base, reducing impact on liquidity in event of unforeseen events.
Market risk	The risk that net interest income is compressed through changes in the external rate environment or unexpected customer behaviour.	• The Bank has a detailed market risk policy, which sets out its risk appetite statement with reference to defined interest rate shocks. • Regular reporting to ALCO on earnings and market value sensitivity. • Monthly reporting of prepayment behaviour versus forecast and general product re-pricing assumptions. • Rate view committee sets out the Bank's view on forward looking base rate. • All new banking products or amendments to the terms of existing products are reviewed from an interest rate risk perspective to ensure compliance with existing risk appetite.
Operational risk	Represents the risk of loss stemming from failed processes, systems, human error or fraud.	• Operational risk team in place to provide a second line of defence reporting directly to the CRO. • Annual control self assessment exercise undertaken where the adequacy of the control framework is considered and action plans agreed. • Ongoing maintenance of risk registers with appropriate oversight by NFRC, BRC and the Board. Risk registers include quantification of risks following an agreed methodology. • Process in place for capturing operational risk losses and ensuring action is taken to mitigate the possibility of reoccurrence. • Formal engagement with strategic partners to understand the impact of all change. Within Sainsbury's Bank, project lifecycle methodology in place and all projects managed accordingly to the level of assessed risk and appetite.
Regulatory and conduct risk	The risk of the Bank failing to meet the requirements of legislation and regulatory requirements as defined by the PRA, FCA and any other requirements from relevant regulatory bodies.	• Regulatory risk team in place to provide a second line of defence reporting directly to the CRO. • Pro-active monitoring of regulatory change and communication to relevant owners in the business including the tracking of actions required and impact on the business. • Regular reporting of regulatory risks to NFRC, BRC, and Board. • Regular and open communication with the FCA and PRA on all aspects of Bank activity but with particular focus on regulatory risk. • Conduct risk considerations fully embedded into all relevant Bank activities and employee performance management framework.

Capital and liquidity

The PRA sets and monitors capital requirements for the Bank. In implementing current capital requirements the PRA requires the Bank to maintain a prescribed level of capital with reference to risk weighted assets and the perceived risk management framework. Submissions to the PRA (previously the Financial Services Authority) in the year have shown that the Bank has complied with all externally imposed capital requirements.

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. Note 30 provides information on the capital resources of the Bank at the year end. The Bank's regulatory capital position at 31 December 2013 and 31 December 2012 was as follows:

	31 December 2013 (unaudited)	31 December 2012 (unaudited)
Risk weighted assets (£m)	**2,475**	2,401
Core Tier 1 capital ratio	**12.3%**	11.0%
Total capital ratio	**15.1%**	14.3%

The Bank will disclose Pillar 3 information as required by the Capital Requirements Directive and PRA prudential sourcebook on the J Sainsbury plc external website during June 2014.

The funding and liquidity position of the Bank remained robust throughout the year. This is described in more detail in note 29. Customer deposits continued to be well in excess of customer lending and the Bank maintains a diversified funding base. The Bank maintains a significant level of highly liquid assets, with the holding of Treasury Bills increasing to £510m representing 14.5% of deposits (2012: £474m, 14.5% of deposits). Whilst not included within the regulatory liquidity buffer, the Bank holds diversified investments in several sterling money market funds, £307m (2012: £375m), which are highly liquid in nature.

Going concern

The Directors believe that the Bank is in a stable financial position and is well placed to generate profits in the future as demonstrated through the 2009-2013 financial performance which has occurred against a challenging economic backdrop. In assessing whether the going concern basis continues to be appropriate, the Bank has considered the Financial Reporting Council's (FRC) guidance on assessing going concern and liquidity risk.

The risk management framework is considered adequate in managing liquidity and other key risks in the current environment. During the year the Bank continues to maintain its strong capital and liquidity position and has also been subject to review and challenge by the PRA as part of its remit as lead regulator of the Bank. Further information on the key financial risks of the business can be found in note 29.

Whilst the Bank outsources many of its operations to other partner providers, including parties within Lloyds Banking Group plc, the Board does not consider these arrangements to be susceptible to those parties' going concern status. As part of the acquisition of the Bank by J Sainsbury plc, transitional service arrangements have been negotiated with Lloyds Banking Group plc and the Bank believes that there would be an orderly rundown in the event of administration, and the ability of the Bank to migrate operations as outlined in the terms of the agreements to alternative providers.

The Directors are satisfied that the Bank has adequate resources to continue in business for the foreseeable future taking into account a range of possible operational and legal scenarios. Consequently the going concern basis continues to be appropriate in preparing the financial statements.

Issued share capital

The amount of issued share capital was unchanged from the previous year at £170m (note 24). On 31 January 2014, Lloyds Banking Group plc sold its 50% shareholding in the Bank to J Sainsbury plc. On 7 February 2014, the Bank issued £20m of share capital to its parent company, J Sainsbury plc.

Dividends

The profit after tax for the year attributable to the shareholders is £42m (2012: £40m). The Directors do not recommend payment of a dividend (2012: £nil).

Directors

The Directors at 31 December 2013 were:

Mr Roger Davis	(Chairman)	Appointed 7 May 2013
Mr Peter Griffiths	(Chief Executive Officer)	
Mr David Arden		Appointed 6 November 2013
Mr Alan Brindley		
Ms Gwyn Burr		
Ms Marcia Campbell		Appointed 23 September 2013
Mr Alan Cook		
Mr Ian Fox		
Mr Richard Keys		
Mr Mark Mullington		Appointed 20 August 2013
Mr John Rogers		

The Directors who resigned from the Board during the year were:

Mr Darren Shapland	(Chairman)	Resigned 28 February 2013
Mr John Galloway		Resigned 7 August 2013
Ms Hannah Bernard		Resigned 6 November 2013

Directors who were appointed to the Board after 31 December 2013, but prior to the signing of the financial statements were:

Mr Steven Burke	Appointed 31 January 2014
Mr Andrew Simmonds	Appointed 3 February 2014

Directors who resigned from the Board after 31 December 2013, but prior to the signing of the financial statements were:

Mr Ian Fox	Resigned 31 January 2014
Mr Alan Brindley	Resigned 31 January 2014

During 2013, the Board comprised three executive Directors and seven non-executive Directors. During 2013, Mr Ian Fox, Mr John Galloway and Mr Alan Brindley were employed and remunerated by Lloyds Banking Group plc. During 2013, Ms Hannah Bernard, Mr John Rogers, Mr Peter Griffiths, Mr David Arden and Mr Mark Mullington were employed and remunerated by J Sainsbury plc. Mr Darren Shapland, Mr Roger Davis, Mr Richard Keys, Mr Alan Cook, Ms Marcia Campbell, Mr Andrew Simmonds are independent non-executive Directors who are not employed by either parent organisation. Ms Gwyn Burr is a non-executive Director is not employed by either parent company.

From 1 February 2014, the executive Directors, Mr Peter Griffiths, Mr David Arden, Mr Mark Mullington and Mr Steven Burke are employed and remunerated by Sainsbury's Bank plc.

Unless otherwise stated above, all of the Directors in office at the date of this report served throughout the year.

Directors' indemnities

The Bank has provided an indemnity for the benefit of all of its current Directors which is a qualifying third party indemnity provision for the purpose of the Companies Act 2006. This was in force throughout the financial year and at the date of signing of the financial statements. From 1 February 2014, Directors' and Officers' insurance is provided through the J Sainsbury plc group policy. Neither the indemnities nor the insurance provide cover in the event that the Director is proved to have acted fraudulently.

Charitable and other donations

During the year the Bank made charitable donations in the UK of £29,199 (2012: £53,694). No political donations were made during the year (2012: nil).

Employees

The Bank is committed to employment policies, which follow best practice, based on equal opportunities for all colleagues, irrespective of sex, race, colour, disability or marital status. The Bank 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 Bank. If colleagues become disabled the Bank continues employment, either in the same or an alternative position, with appropriate retraining being given if necessary.

The Bank values the contribution of colleagues and recognises that business objectives cannot be achieved without attracting and developing high quality people.

The Bank is committed to being an equal opportunities employer and has in place a number of processes to ensure colleagues are engaged in the business and are able to develop over time. The Bank maintains a colleague forum, which regularly collates feedback from colleagues on matters of interest or concern and engages with management to address issues arising. Colleague views on the Bank's performance and as a place of work are also gathered by internet based surveys and through team meetings. Information is provided to colleagues through regular newsletters and through the Bank's Intranet updates on business performance and the financial and economic factors that affect the performance of the Bank are provided through regular newsletters and briefing sessions. Colleague development is important to the Bank and is monitored through individual development plans with access to a wide range of training resources. Employee performance is monitored and encouraged through continuous assessment against set objectives.

Independent auditors

PricewaterhouseCoopers LLP have indicated their willingness to remain in office as auditors.

Disclosure of information to auditors

At the date of this report, each of the Directors in office has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information. As far as each Director is aware, there is no relevant audit information of which the Bank's auditors are unaware.

By order of the Board

David Arden
Company Secretary
London
14 March 2014

Income statement

For the year to 31 December 2013

	Note	2013 £m	2012 £m
Interest receivable	2	**206**	217
Interest payable	2	**(78)**	(88)
Net interest income		**128**	129
Fees and commissions receivable		**110**	114
Fees and commissions payable		**–**	(1)
Net operating income		**238**	242
Administrative expenses	3	**(150)**	(138)
Depreciation and amortisation			
Property, plant and equipment	14	**(3)**	(4)
Intangible assets	15	**(2)**	(2)
		(155)	(144)
Impairment losses on financial assets	13	**(28)**	(33)
Losses realised on financial instruments	6	**–**	(12)
Profit before taxation	7	**55**	53
Taxation	8	**(13)**	(13)
Profit for the financial year attributable to the owners of the Bank		**42**	40

The accompanying notes on pages 13 to 42 form part of these financial statements.

Statement of comprehensive income
For the year to 31 December 2013

	Note	2013 £m	2012 £m
Profit for the financial year		**42**	40
Other comprehensive income/(expense):			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale financial assets	26	**2**	25
Cash flow hedges	26	**–**	(1)
Tax on items that may be reclassified	8	**–**	(6)
Total other comprehensive income for the year, net of tax		**2**	18
Total comprehensive income		**44**	58

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 13 to 42 form part of these financial statements.

Balance sheet

As at 31 December 2013

	Note	2013 £m	2012 £m
Assets			
Cash and balances with central banks	32b	**444**	474
Financial investments – available for sale			
Treasury bills	9	**510**	474
Investment securities	10	**32**	29
Loans and advances to banks	12	**1,059**	1,377
Loans and advances to customers	13	**2,592**	2,547
Derivative financial instruments	11	**2**	–
Property, plant and equipment	14	**18**	17
Intangible assets	15	**4**	5
Deferred tax asset	16	**–**	1
Other assets	17	**103**	43
Prepayments and accrued income		**37**	22
Total assets		**4,801**	4,989
Liabilities			
Deposits by banks	18	**752**	1,234
Derivative financial instruments	11	**7**	6
Customer accounts	19	**3,524**	3,268
Other liabilities	20	**7**	12
Current tax liabilities		**6**	10
Provisions for liabilities and charges	21	**14**	5
Accruals and deferred income	22	**31**	38
Other borrowed funds			
Dated loan capital	23	**60**	60
Undated loan capital	23	**50**	50
Total liabilities		**4,451**	4,683
Equity			
Called up share capital	24	**170**	170
Retained earnings	25	**181**	139
Other reserves	26	**(1)**	(3)
Total equity		**350**	306
Total equity and liabilities		**4,801**	4,989

The financial statements on pages 8 to 42 were approved by the Board of Directors on 14 March 2014 and signed on its behalf by:

Peter Griffiths
Director and Chief Executive
14 March 2014

David Arden
Director and Company Secretary
14 March 2014

The accompanying notes on pages 13 to 42 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity

For the year to 31 December 2013

	Notes	Called up share capital £m	Retained earnings £m	Other reserves £m	Total £m
At 1 January 2013		**170**	**139**	**(3)**	**306**
Profit for the financial year		**–**	**42**	**–**	**42**
Other comprehensive income:					
Available for sale financial assets fair value movements (net of tax)	26	**–**	**–**	**2**	**2**
Total comprehensive income for the year		**–**	**42**	**2**	**44**
At 31 December 2013		**170**	**181**	**(1)**	**350**
At 1 January 2012		170	99	(21)	248
Profit for the financial year		–	40	–	40
Other comprehensive income/(expense):					
Available for sale financial assets fair value movements (net of tax)	26	–	–	19	19
Cash flow hedges effective portion of fair value movements (net of tax)	26	–	–	(1)	(1)
Total comprehensive income for the year		–	40	18	58
At 31 December 2012		170	139	(3)	306

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 13 to 42 form part of these financial statements.

Cash flow statement

For the year ended 31 December 2013

	Note	2013 £m	2012 £m
Profit before taxation		**55**	53
Non-cash items included in profit before taxation		**34**	40
Change in operating assets and liabilities		**(136)**	84
Income taxes paid		**(16)**	(15)
Cash flows (used in)/generated from operating activities	32a	**(63)**	162
Purchase of equipment		**(4)**	(5)
Purchase of intangibles		**(1)**	(2)
Cash flows used in investing activities		**(5)**	(7)
Interest paid on other borrowed funds		**(1)**	(2)
Cash flows used in financing activities		**(1)**	(2)
Net (decrease)/increase in cash and cash equivalents		**(69)**	153
Opening cash and cash equivalents		**2,077**	1,924
Closing cash and cash equivalents	32b	**2,008**	2,077

The accompanying notes on pages 13 to 42 form part of these financial statements.

Notes to the financial statements

1. Accounting policies

a. Statement of compliance

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB as adopted by the European Union. The financial statements also comply with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

b. Basis of preparation

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available for sale financial assets, and financial assets and liabilities (including derivative instruments) held at fair value through profit and loss. The principal accounting policies have been applied consistently throughout the year.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed at section (c) below.

The financial statements have been prepared on a going concern basis. This is discussed in the Directors' and Strategic report on page 6, under the heading 'Going concern'.

Designation of financial instruments
The Bank has classified its financial instruments in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' as follows:

Non-derivative financial assets where there is no active market and which have fixed or determinable payments are classified as 'loans and receivables'. No assets are held for trading. Derivative instruments are automatically classified as 'at fair value through profit or loss' unless they form part of an effective hedging relationship. No financial assets are designated as 'held to maturity'. All other financial assets are classified as 'available for sale'. All other financial liabilities are classified as 'at amortised cost'.

The resulting treatment of these financial instruments is set out in the accounting policies below.

Loans and advances including impairment
Loans and advances are initially recognised at fair value and subsequently held at amortised cost, using the effective interest method, less provision for impairment and recognised on the balance sheet when cash is advanced.

For the Bank's portfolios of loans, such as credit card lending and personal loans, impairment provisions are calculated for groups of assets, otherwise impairment is identified at a counterparty specific level following objective evidence that a financial asset is impaired. Such evidence may include a missed interest or principal payment or the breach of a banking covenant. Provisioning on unsecured balances identified as being in arrears is calculated based on past experience, with regularly updated assumptions. The present value of estimated cash flows recoverable is determined after taking into account any security held. The amount of impairment is calculated by comparing the present value of the cash flows discounted at the loan's original effective interest rate with the balance sheet carrying value. If impaired, the carrying value is adjusted and the difference charged to the income statement and a provision recognised in the balance sheet.

The written down value of the impaired loan is compounded back to the net realisable balance over time using an effective interest rate. This is reported through interest receivable within the income statement and represents the unwinding of the discount.

A write-off is made when all or part of a loan or advance is deemed uncollectable or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement. Subsequent recoveries of amounts written off decrease the charge for loan impairment in the income statement.

An allowance for impairment losses is also maintained in respect of assets which are impaired at the balance sheet date but which have not been identified as such, based on historical loss experience and other relevant factors. This includes analysis of the likelihood of a particular balance to move into an arrears status within a defined period of time and application of an appropriate loss rate. The emergence period into an arrears state represents the average time elapsed between the loss trigger event and default. The methodology and assumptions used are regularly reviewed to reduce any differences between estimates and actual results.

Investment securities including impairment
These comprise debt securities and other fixed interest securities, including Treasury and other eligible bills and are recognised on the date the contract is entered into. They are classified as 'available for sale' and carried on the balance sheet at fair value with unrealised gains or losses being recognised through reserves.

Income on available for sale debt securities is recognised on an effective interest rate basis and taken to interest receivable through the income statement. On sale, maturity or impairment unrealised gains and losses arising from available for sale securities are recognised in other operating income.

Investment securities classified as available for sale are continually reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired. Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

The disappearance of active markets, declines in market value and ratings downgrades do not in themselves constitute objective evidence of impairment and, unless a default has occurred on a debt security, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement.

Other assets
Other assets are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

Property, plant and equipment
Property, plant and equipment includes fixtures and fittings, and computer hardware costs and is stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. The cost is written off, on a straight-line basis, over the expected lives of the assets, generally between three and ten years.

Property, plant and equipment are assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The depreciation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

1. Accounting policies continued

Intangible assets

Computer software

Computer software is carried at cost less accumulated amortisation and any provision for impairment. Externally acquired computer software and software licences are capitalised and amortised on a straight-line basis over their useful economic lives of three to five years. Costs relating to development of computer software for internal use are capitalised once the recognition criteria of IAS 38 'Intangible Assets' are met. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. When the software is available for its intended use, these costs are amortised on a straight-line basis over their useful economic lives of three to five years.

Capitalised development expenditure and purchased software is stated at cost less accumulated amortisation and impairment losses. Such assets are assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The amortisation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Subsequent expenditure is only capitalised when it increases the future economic benefits embodied in the specific asset to which it relates.

Operating leases

Assets leased under operating leases are not recorded on the balance sheet. Rental payments are charged directly to the income statement on a straight-line basis over the lease term.

Income recognition

Interest income and expense are recognised in the income statement for all financial instruments measured at amortised cost using the effective interest method. This calculation takes into account all amounts that are integral to the yield as well as incremental transaction costs. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument to the net carrying amount of the financial asset or liability at initial recognition.

Fees and commissions, that are not integral to the effective interest rate calculation, are recognised in the income statement as services are provided. Where in the case of insurance commissions the income comprises an initial commission and profit share both are recognised on completion of the service to the extent reliably measurable. Where there is a risk of potential claw back, an appropriate element of the commission receivable is deferred and amortised over the life of the underlying loan or period of claw back. Car insurance initial commission is recognised on completion of the service provided, with an element deferred to reflect cancellation expectation and services yet to be performed in future periods.

Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Taxation is determined using tax rates (and laws) enacted or substantively enacted at the balance sheet date. Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

Nectar points

The costs of Nectar points, awarded as incentives to Sainsbury's Bank customers, are recognised when earned by the customer or, where it is highly likely that the customer will meet associated qualifying criteria, are provided for at the point of sale as required by IAS 37 and IFRIC 13. For certain insurance products double Nectar points are awarded on spend in J Sainsbury plc stores subject to a cap for 2 years provided there are no claims on the policy and that renewal occurs. The estimated annual cost of the points is recognised at the point of sale for the first year of the offer, and on policy renewal for the second year. The cost of points is recognised within administrative expenses or as a deduction from non-interest income depending on whether the Bank is acting as a principal or agent.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits at central banks and money market funds. For the purpose of the Cash Flow Statement cash and cash equivalents omits deposits at central banks and includes Treasury Bills and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Other borrowed funds

Other borrowed funds comprise subordinated liabilities, which consist of dated and undated loan capital. These are initially recognised at fair value and subsequently held at amortised cost and the interest payable is recognised in the income statement through interest payable.

Financial liabilities

Financial liabilities comprise deposits from banks and customer accounts. All financial liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. A financial liability is derecognised from the balance sheet when the Bank has discharged its obligations, the contract is cancelled or expires.

Other liabilities

Other liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

Foreign currencies

The financial statements are presented in sterling which is the Bank's functional and presentation currency.

Foreign currency transactions are translated into sterling at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities are translated at balance sheet date exchange rates. Exchange differences arising are recognised in the income statement.

Derivative instruments

All derivative instruments are initially measured at fair value on the contract date and are also measured at fair value at subsequent reporting dates. Changes in fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement. The Bank designates certain derivatives as either:

- hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges)
- hedges of highly probable future cash flows attributable to recognised assets are liabilities (cash flow hedges).

1. Accounting policies continued

These are accounted for as follows:

Cash flow hedging

During the year the Bank used cash flow hedging as a risk management tool for hedging foreign exchange rate risk on on-balance sheet assets.

Cash flow hedge accounting matches the cash flows of hedged items against the corresponding cash flow of the hedging derivative. The effective part of any gain or loss on a hedging instrument is recognised directly in equity in the cash flow hedge reserve and the hedged item is accounted for in accordance with the policy for that financial instrument. Any ineffective portion of the hedging instrument's fair value is recognised immediately in the income statement through net interest income.

The amount deferred in reserves remains until the designated transaction occurs at which time it is released and accounted for in the income statement in line with the treatment of the hedged item. Should circumstances arise where the hedge relationship subsequently proves ineffective, is early settled or is terminated the associated gains and losses that were recognised directly in reserves are reclassified to the income statement through net interest income.

Portfolio fair value hedging

During the year the Bank used fair value hedging as a risk management tool for hedging interest rate risk on the personal loans portfolio.

Fair value hedging matches the change in value of designated hedged items against the corresponding change in value of the hedging derivative. The designated hedged item can be a recognised asset or liability, a firm commitment or an identified portion of an asset. Portfolio fair value hedging allows the designation of the whole or part of a portfolio of assets or liabilities with similar risk exposures. The hedged item can be designated based on expected maturities to match the hedging derivative maturity. The effective part of any gain or loss on the hedged item adjusts the balance of the item and is recognised through profit or loss offsetting the gain or loss on the hedging derivative.

Should circumstances arise where the hedge relationship subsequently proves ineffective, is early settled or is terminated the adjustment to the balance of the hedged item is reversed and associated gains and losses that were recognised in profit and loss are reversed.

Marketing expenditure

All marketing and expenditure related to the acquisition of customer accounts is written off as incurred.

Provisions

The Bank recognises a provision if there is a present obligation as a consequence of either a legal or a constructive obligation resulting from a past event. To recognise this it should be probable that an outflow of economic resources, that can be reliably measured, will be required to settle the obligation. Provisions are measured as the discounted expected future cash flows taking account of the risks and uncertainties associated with the specific liability where appropriate.

Share capital

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

c. Critical accounting estimates and judgements

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, most critically in respect of impairment losses on loans and advances, effective yield and the valuation of investment securities.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Impairment of investment securities

Investment securities classified as available for sale are continually reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired.

Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

The disappearance of active markets, declines in market value and ratings downgrades do not in themselves constitute objective evidence of impairment and, unless a default has occurred on a debt security, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement.

Impairment losses on loans and advances

Impairment loss calculations involve the estimation of future cash flows of financial assets, based on observable data at the balance sheet date and historical loss experience for assets with similar credit risk characteristics. This will typically take into account the level of arrears, security, past loss experience and default levels. These calculations are undertaken on a portfolio basis using various statistical modelling techniques. Impairment models are continually reviewed to ensure data and assumptions are appropriate with the most material assumption being around expected loss rates. The accuracy of any such impairment calculation will be affected by unexpected changes to the economic situation, and assumptions which differ from actual outcomes. As such, significant judgement is applied when determining the levels of provisioning.

Effective yield

In calculating the effective interest rate of a financial instrument the Bank takes into account all amounts that are integral to the yield of a financial instrument as well as incremental transaction costs. In the case of loans and advances significant judgement is applied in estimating the effect of various factors on future cash flows. In the case of insurance commissions income comprises an initial commission and profit share both of which are recognised on completion of the service to the extent reliably measurable. Where there is a risk of claw back judgement is applied in deferring an appropriate element of the commission receivable and amortising this over an expected average life.

Deferred tax

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing, nature and level of future taxable income. The recognition of deferred tax assets relating to tax losses carried forward relies on profit projections and taxable profit forecasts prepared by management, where a number of assumptions are required based on the levels of growth in profits and the reversal of deferred tax balances.

1. Accounting policies continued

Determining fair values
The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of various valuation techniques some of which require significant degrees of judgement.

The main methodologies and assumptions used in estimating the fair values of financial instruments are as follows:

- **Cash and cash equivalents**
  Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or re-price frequently.
- **Loans and advances to customers**
  The fair value of loans and advances is estimated by discounting anticipated cash flows, including interest, at a current market rate of interest.
- **Loans and advances to banks and deposits by banks**
  The fair value of floating rate placements and overnight deposits is equal to carrying value. The fair value of fixed interest bearing deposits is based on cash flows discounted using current money market interest rates for debts with similar maturity and credit risk characteristics.
- **Customer accounts and other borrowings**
  The fair value of customer deposits with no stated maturity date is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings with no quoted market price is calculated using a cash flow model discounted using interest rates for debts with similar maturity.
- **Investment securities**
  Fair value is based on market prices or broker/dealer valuations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. In 2013 and 2012 all securities were valued from market prices or broker/dealer valuations.
- **Derivatives**
  Fair value is based on valuation techniques including discounted cash flow models using solely observable market data. The most significant inputs into these models are interest rate yield curves which are developed from publicly quoted rates.

Qualifying hedge relationships
In designating financial instruments as qualifying hedge relationships, the Bank has determined that it expects the hedge to be highly effective over the life of the hedging instrument. In accounting for derivatives as cash flow hedges, the Bank has determined that the hedged cash flow exposure relates to highly probable future cash flows.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as net interest income as they arise

Commission claw back
Where the Bank receives commission and there is a risk of potential claw back, an appropriate element of the commission receivable is deferred and amortised over the life of the underlying loan or period of claw back.
The principal assumptions underlying the level of deferred income relate to the volume of cancellation, write off or early settlement activity as well as the timing of this. Actual levels of claw back are regularly reviewed against model assumptions.

Double Nectar points
The Bank offers double Nectar points on customer spend in Sainsbury's stores for up to 2 years on purchase of certain savings, personal loan, credit card and insurance products. Points earned in relation to savings, credit card and personal loan products are recognised as incurred as this is the point the customer is entitled to the points. In the case of points earned by customers with insurance products, the Bank provides for the full cost of anticipated Nectar points for a year (linked to spend) for each insurance sale. Where a customer renews at the end of the first year, a further provision is recognised. Costs are estimated based on a model of forecast volumes, expected customer profiles, instore spending levels, and spending caps on the amount of points per month. This model is re-assessed at regular intervals.

Customer redress provision
The customer redress provision, mainly relating to previous sales of Card Protection Plan insurance, includes estimates in relation to levels of customer response rates, average claim value and administration costs.

Further details of the provision are included in note 21.

Financial Services Compensation Scheme
The ultimate liability for levies payable to the FSCS in respect of those financial institutions which collapsed during the 2008 financial year remains uncertain. The amount provided by the Bank is the latest estimate of the contribution required in respect of interest levied on the renewed loan facility from HM Treasury and further levies representing amounts due from the industry to cover the estimated repayment shortfall due to the non recoverable funds from failed institutions. This contribution is dependent upon the following factors:

- Future interest rates;
- The Bank's share of industry protected deposits; and
- Finalisation of the principal balance of the HM Treasury loans, including the extent to which the FSCS can recover assets to fund their repayment.

Further details of the FSCS and the provision are included in note 21.

d. Accounting developments

The following section addresses new IFRS standards and International Financial Reporting Interpretations Committee (IFRIC) Interpretations.

Standards and interpretations effective for the Company in these financial statements:

- IAS 1 'Presentation of Financial Statements', Presentation of other items of other comprehensive income
- IAS 19 (revised) 'Employee Benefits'
- Amendment to IFRS 1 'First time adoption of IFRS', Government loans
- IFRS 7 'Financial Instruments: Disclosures', Offsetting financial assets and financial liabilities
- IFRS 13 'Fair Value Measurement'
- IFRIC 20 'Stripping Costs in the Production Phase of a Surface Mine'
- Annual improvements 2011

IFRS 7 'Financial Instruments: Disclosures'. Effective from 1 January 2013. The revised standard requires additional disclosures on the effect or potential effect of netting arrangements. The Bank has included the requisite disclosures in note 29.

1. Accounting policies continued

IFRS 13 'Fair Value Measurement'. This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards. This has not had a material effect on the financial statements of the Bank.

The Company has considered the remaining above new standards and amendments to published standards and concluded that they are either not relevant to the Company or that they do not have a significant impact on the Company's financial statements, apart from additional disclosures.

Standards and interpretations effective for the Company for the year beginning 1 January 2014

- IAS 27 (revised) 2011, 'Separate financial statements'*
- IAS 28 (revised) 2011, 'Investments in associates and joint ventures'*
- IAS 32 'Financial Instruments: Presentation', Offsetting financial assets and liabilities*
- IFRS 10 'Consolidated financial statements'*
- IFRS 11 'Joint arrangements'*
- IFRS 12 'Disclosure of interest in other entities'*
- Amendments to IFRS 10, 11 and 12 on transition guidance*
- Amendments to IFRS 10, 12 and IAS 27 on investment entities*
- Amendments to IAS 36 on Recoverable amount disclosures for non-financial assets*
- Amendments to IAS 39 on Novation of derivatives and continuation of hedge accounting*
- IFRIC 21 'Levies'

*These standards and interpretations have been endorsed by the EU.

IFRIC 21 'Levies' is expected to change the recognition pattern of the FCSC levy in that it requires the obligation to recognise the levy to be recognised on 1 April of each levy period. Currently in line with IAS 37 'Provision, contingent liabilities and contingent assets', the Bank recognises the provision at the 31 December preceding the start of the levy period as the charge is based on the value of deposits at that date.

The Company has considered the impact of the remaining above standards and revisions and has concluded that they will not have a significant impact on the Company's financial statements, apart from additional disclosures.

Standards and interpretations effective for the Company in future periods:
IFRS 9 'Financial instruments part 1: Classification and measurement'.

IFRS 9 was first issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets and has been amended by additional publications. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification will depend on the approach taken by the Bank for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the Bank's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Financial liabilities, which have been elected to be measured at fair value will have changes in value due to own credit risk, recorded in the Statement of Other Comprehensive Income.
- In November 2012, the IASB published an exposure draft which included a third classification of Fair Value (FV) through the Other Comprehensive Income (OCI). If adopted in the standard, this would allow for fair value fluctuations to be recorded through the OCI, however only impact the profit and loss when realised.

The Bank has considered the possible impact of the standard (as currently drafted) on those instruments currently classified within the Available for Sale category if the FV through OCI category is not introduced. This will be influenced by the characteristics of financial instruments at the date of adoption and at this stage it is not considered possible to determine the overall impact on the financial statements of this change.

In December 2013, the IASB published IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) amending IFRS 9 to:

- include the new general hedge accounting model;
- allow early adoption of the requirement to present fair value changes due to own credit on liabilities designated as at fair value through profit or loss to be presented in other comprehensive income; and
- remove the 1 January 2015 effective date.

The Bank is currently considering the options on accounting for hedges within IFRS 9.

IFRS 9, as it currently stands, is part of the project to replace IAS 39. Further stages exist to deal with changes to impairment of financial assets measured at amortised cost, macro hedge accounting and limited amendments to classification and measurement. These stages have been released as exposure drafts. The Bank has considered the impact of these new draft standards. As information becomes available the Bank will assess the impact of these changes on the financial statements.

Annual improvements projects 2012 and 2013
There is no significant impact expected by the Annual Improvements projects.

2. Net interest income

	2013 £m	2012 £m
Interest income on loans and receivables	**205**	216
Interest income from available for sale financial instruments	**1**	1
Interest receivable	**206**	217
Interest expense on loans and receivables	**(78)**	(88)
Interest expense on derivative liabilities	**–**	–
Interest payable	**(78)**	(88)
Net interest income	**128**	129

Amounts relating to cash flow hedges transferred to profit or loss during the year are reflected as a component of interest income or expense. Net ineffectiveness recognised on cash flow hedges during 2013 was £nil (2012: £nil). Net ineffectiveness recognised on fair value hedges was £nil (2012: £nil).

3. Administrative expenses

	2013 £m	2012 £m
Staff costs	**22**	18
Marketing costs	**34**	38
Other administrative expenses	**94**	82
	150	138

4. Employees

During the financial years ending 31 December 2013 and 31 December 2012, the nature of the joint venture was such that the Bank did not directly employ individuals. The individuals who worked for the Bank have contracts of employment with either a member of the J Sainsbury plc group of companies or a member of the Lloyds Banking Group plc group of companies. The remuneration cost of these individuals is met by the joint venture.

The average weekly number of colleagues working on the Bank's operations during the year is set out below.

	2013 Number	2012 Number
Full time		
Seconded colleagues	**304**	233
Other colleagues	**361**	392
	665	625
Part time		
Seconded colleagues	**23**	24
Other colleagues	**52**	18
	75	42
	740	667

Secondees were directly seconded from the relevant members of the parent organisations to the Bank. The remaining colleagues were involved in processing activities for the Bank's products but are not classed as secondees, they were employed by related parties. Colleague costs are disclosed in other administrative expenses in note 3.

The Bank incurred certain costs for colleagues who work for various entities within the Lloyds Banking Group plc group of companies in accordance with and subject to certain agreed principles. These entities are participating employers in both a defined contribution pension scheme and a defined benefit pension scheme based upon final pensionable pay, operated by Lloyds Banking Group plc. A total of 74 (2012: 73) employees participate in the defined benefit scheme, the HBOS Final Salary Pension Scheme (HBOS FSPS), which was formed on 3 July 2006 following the merger of various other schemes within the HBOS plc group of companies.

As the Bank was not a participating employer in the HBOS FSPS, it did not have a share in the scheme assets and liabilities and as such the pension recharges were treated as a defined contribution charge. The current defined benefit liability on the HBOS FSPS at 31 December 2013, valued on an IAS 19 basis, was £87m (2012: asset of £681m). The latest full actuarial valuation of the HBOS FSPS was carried out as at 30 June 2011 by a qualified independent actuary.

The Bank also incurred certain costs for colleagues who work for members of the J Sainsbury plc group of companies in accordance with and subject to certain agreed principles. A total of 13 (2012: 15) colleagues were members of the Sainsbury's Pension Scheme, a defined benefit scheme which was closed to future accrual on 28 September 2013. All members were moved to the defined contribution pension arrangements at that time and now have deferred pensions.

As the Bank is not a participating employer in the Sainsbury's Pension Scheme, it does not have a share in the Scheme's assets and liabilities and, as such, the pension recharges are treated as a defined contribution charge. The defined benefit liability on the Sainsbury's Pension Scheme at March 2013, valued on an IAS 19 basis, was £688m (2012: liability of £455m). The Scheme was subject to a triennial actuarial valuation carried out by Towers Watson, the Scheme's independent actuary, as at March 2012 on the projected unit basis. The results of this valuation were finalised in August 2013.

4. Employees continued

Colleagues who work for the J Sainsbury plc group of companies are eligible to join the defined contribution arrangements. These plans are also used where colleagues have been automatically enrolled into a pension. Contributions paid by the Bank are based on grade and the amount that the colleague chooses to pay or whether they have been automatically enrolled.

The pension cost recharge for the year represents contributions payable by the Bank to both types of pension scheme and amounted to £0.9m (2012: £0.6m) for the defined contribution schemes and £0.5m (2012: £0.5m) for the defined benefit schemes.

Details of post balance sheet events are given in note 37 on page 42.

5. Directors' emoluments

	2013 £m	2012 £m
Emoluments	**1.6**	1.0
Aggregate amounts payable under long term incentive schemes	**–**	0.1
Highest paid director:		
Emoluments	**0.6**	0.3
Aggregate amounts payable under long term incentive schemes	**–**	0.1

Retirement benefits have accrued or are accruing to no Directors under the J Sainsbury plc defined benefit schemes (2012: 1). Benefits are also accruing to no Directors under the Lloyds Banking Group plc money purchase scheme (2012: 1). In addition to the above, emoluments representing employer's pension contributions of £0.09m (2012: £0.06m) were made in the year. The employers pension contributions in respect of the highest paid Director were £0.03m (2012: benefits accruing in relation to defined benefit schemes of £0.05m).

The emoluments set out above include those Executive Directors who held office during the year, all of whom were employed by and paid by either J Sainsbury plc or Lloyds Banking Group plc. The Bank was recharged emolument costs in accordance with, and subject to the terms of, arrangements agreed with the relevant employer. No recharge was made by either organisation to the Bank in respect of shares in J Sainsbury plc or Lloyds Banking Group plc granted to colleagues. During the year 4 directors (2012: 2) received awards under these schemes reflective of qualifying services. 2 Directors (2012: none) exercised share options in the year.

Payments were made to independent Non-Executive Directors who served during the year and are included in the above details. There was no recharge to the Bank in respect of emoluments for Non-Executive Directors who were employed by J Sainsbury plc or Lloyds Banking Group plc, as their emoluments are deemed to be wholly attributable to services to the respective shareholder companies. Accordingly, the above details include no emoluments in respect of these Non-Executive Directors.

No payments were made in respect of compensation for loss of office during the year (2012: £nil).

6. Losses realised on financial instruments

During the year ended 31 December 2012, the Bank sold a number of financial instruments in order to reduce the overall wholesale credit risk of the Bank. This realised a loss of £12m previously accumulated in reserves. There were no such disposals during the year ended 31 December 2013.

7. Profit before taxation

Profit before taxation is stated including the following items of income and (expense):

	2013 £m	2012 £m
Interest on impaired loan balances	**2**	2
Operating lease rentals	**(1)**	(1)
Auditors' remuneration:		
Statutory audit of the Bank	**(0.3)**	(0.2)
Non-audit services	**(0.1)**	–

8. Taxation

	2013 £m	2012 £m
UK corporation tax on profit for the year at 23.25% (2012: 24.5%)	**12**	13
Adjustments in respect of prior years	**–**	–
Current tax	**12**	13
Deferred tax charge		
Origination and reversal of temporary differences	**1**	–
Impact of change in UK corporation tax rate	**–**	–
Deferred tax	**1**	–
Total tax charge	**13**	13

8. Taxation continued

The taxation charge of £13m (2012: £13m) represents 23.64% (2012: 24.53%) of pre-tax profits. The tax rate applicable to the Bank during the year reduced from 24% to 23% on 1 April 2013. The taxation charges also incorporate a reduction in the deferred tax asset as a result of further changes to the corporation tax rate applicable to the Bank, which have now been substantively enacted. From 1 April 2014, the applicable tax rate will be 21% and from 1 April 2015, the applicable tax rate will be 20%. Differences to the UK corporation tax rate for the year of 23.25% are explained below:

	2013 £m	2012 £m
Profit before taxation	**55**	53
Tax on ordinary activities at 23.25% (2012: 24.5%)	**13**	13
Effects:		
Change in tax rate	**–**	–
Impact of rate change on equity items	**–**	–
Total income tax expense recognised in the income statement	**13**	13

Tax recognised in equity and other comprehensive income relating to Available for Sale and Cash Flow reserve movements is as follows:

	2013 £m	2012 £m
Available for Sale reserve – current tax	**–**	6
Cash Flow reserve – current tax	**–**	–
Total tax expense recognised in equity or other comprehensive income	**–**	6

9. Treasury bills

	2013 £m	2012 £m
Treasury bills	**510**	474
Of which:		
Maturing in three months or less	**243**	200
Maturing between three months and one year	**267**	274
	510	474

10. Investment securities

	2013 £m	2012 £m
Investment securities		
Unlisted – issued by banks and building societies	**32**	29
Of which:		
Between 1 and 5 years	**32**	29
Investment securities	**32**	29

The fair value movement during the year on investment securities classified as available for sale is a gain of £3m (2012: a gain of £4m).

11. Derivative financial instruments

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to reduce its exposure to market risks. The Bank uses interest rate swaps to hedge interest rate risk in the personal loan book and currency swaps to hedge foreign exchange risk from cash flows arising from certain available for sale securities.

This is achieved by hedging specific forecast transactions against balance sheet exposures. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the fair value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

Cash flow hedges

	Notional amount £m	Assets £m	Liabilities £m
Currency swaps			
At 31 December 2013	**27**	**–**	**7**
At 31 December 2012	27	–	6

11. Derivative financial instruments continued

The Bank is exposed to foreign exchange risks from cash flows arising on its available for sale investment securities. These forecast transactions in foreign currencies are hedged with currency swaps. The cash flows on the currency swaps substantially match the cash flow profile of the hedged investment securities. There were no transactions for which cash flow hedge accounting had to be ceased in 2013 (2012: nil) as a result of the highly probable cash flows no longer being expected to occur. All cash flow hedges are non-current.

Portfolio fair value hedges

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 31 December 2013	**637**	**2**	**–**
At 31 December 2012	9	–	–

The Bank is exposed to interest rate risk on the fixed rate interest income from the retail loan portfolio, which is predominantly funded by variable rate savings liabilities. The interest income on a section of the retail loan portfolio has been hedged with 'pay fixed', 'receive floating' interest rate swaps. The cash flows on the interest rate swaps substantially match the cash flow profile of the hedged retail loans. The changes in fair value of the derivatives are hedged against changes in the fair value of the loans, with ineffective movements going to profit or loss.

Details of post balance sheet events are given in note 37 on page 42.

12. Loans and advances to banks

	2013 £m	2012 £m
Sterling loans and advances to banks	**1,059**	1,377

	2013 £m	2012 £m
Repayable on demand (included in cash equivalents)	**38**	–
Other loans and advances repayable:		
In 3 months or less (included in cash equivalents)	**1,021**	1,132
More than 3 months	**–**	245
Gross advances	**1,059**	1,377

13. Loans and advances to customers

	2013 £m	2012 £m
Gross advances	**2,676**	2,640
Impairment	**(82)**	(93)
Adjustment in relation to fair value hedging	**(2)**	–
Loans and advances to customers	**2,592**	2,547
Repayable on demand	**613**	631
Other loans and advances repayable:		
In 3 months or less	**204**	190
Between 3 months and 1 year	**536**	490
Between 1 and 5 years	**1,272**	1,283
After 5 years	**51**	46
Gross advances	**2,676**	2,640

The Bank's gross lending exposure before deduction of impairment provisions is analysed below:

	2013 £m	2012 £m
Individuals:		
Home Mortgages	**60**	70
Unsecured Personal Lending	**2,616**	2,570
Gross loans and advances to customers	**2,676**	2,640

13. Loans and advances to customers continued

A reconciliation of impairment losses on loans and advances by class is set out as follows:

Year ending 31 December 2013	**Unsecured lending £m**	**Secured lending £m**	**Total £m**
At 1 January 2013	**93**	**–**	**93**
New impairment provisions less releases (net of recoveries)	**28**	**–**	**28**
Amounts written off	**(37)**	**–**	**(37)**
Discount unwind on impaired loans and advances to customers	**(2)**	**–**	**(2)**
At 31 December 2013	**82**	**–**	**82**
New impairment provisions less releases	**35**	**–**	**35**
Recoveries of amounts previously written off	**(7)**	**–**	**(7)**
Net charge to income statement	**28**	**–**	**28**
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	**100**	**1**	**101**

Year ending 31 December 2012	Unsecured lending £m	Secured lending £m	Total £m
At 1 January 2012	113	–	113
New impairment provisions less releases (net of recoveries)	33	–	33
Amounts written off	(51)	–	(51)
Discount unwind on impaired loans and advances to customers	(2)	–	(2)
At 31 December 2012	93	–	93
New impairment provisions less releases	43	–	43
Recoveries of amounts previously written off	(10)	–	(10)
Net charge to income statement	33	–	33
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	113	2	115

Impairment loss calculations involve the estimation of future cash flows of financial assets, based on observable data at the balance sheet date and historical loss experience for assets with similar credit risk characteristics. Impairment models are continually reviewed to ensure data and assumptions are appropriate. However, the accuracy of any such impairment calculation will be affected by unexpected changes to the economic situation, and assumptions which differ from actual outcomes.

14. Property, plant and equipment

	2013 £m	2012 £m
Cost		
At 1 January	**54**	49
Additions	**4**	5
Disposals	**(1)**	–
As at 31 December	**57**	54
Accumulated depreciation		
At 1 January	**(37)**	(33)
Charge for the year	**(3)**	(4)
Disposals	**1**	–
As at 31 December	**(39)**	(37)
Net book value as at 31 December	**18**	17

Property, plant and equipment comprises fixtures and fittings and computer hardware costs.

15. Intangible assets

	2013 £m	2012 £m
Cost		
At 1 January	**20**	18
Additions	**1**	2
Disposals	**–**	–
As at 31 December	**21**	20
Accumulated amortisation		
At 1 January	**(15)**	(13)
Charge for the year	**(2)**	(2)
Disposals	**–**	–
As at 31 December	**(17)**	(15)
Net book value as at 31 December	**4**	5

Intangible assets comprise of acquired computer software.

16. Deferred tax asset

The deferred tax asset, which is not wholly recoverable within one year and which is in respect of timing differences which will reverse and result in a lower tax charge in future years is as follows:

	2013 £m	2012 £m
At 1 January	**1**	1
Movement in deferred tax asset charged to income statement	**(1)**	–
At 31 December	**–**	1
Tax effect of timing differences due to:		
Timing differences on impairment provisions	**–**	1

Of the above, £nil is recoverable after more than 12 months (2012: £1m).

17. Other assets

	2013 £m	2012 £m
Customer funds in the course of settlement	**3**	10
Bank funds in course of settlement	**100**	33
	103	43

Other assets have no fixed maturities but are expected to be realised within 12 months.

18. Deposits by banks

	2013 £m	2012 £m
Repayable:		
On demand	**2**	6
Within 3 months	**98**	136
Between 3 months and 1 year	**227**	341
Between 1 and 5 years	**425**	744
More than five years	**–**	7
	752	1,234

Details of post balance sheet events are given in note 37 on page 42.

19. Customer accounts

Customer accounts comprise sterling interest bearing deposits.

	2013 £m	2012 £m
Repayable:		
On demand	**2,897**	2,674
Within 3 months	**47**	28
Between 3 months and 1 year	**269**	275
Between 1 and 5 years	**311**	291
	3,524	3,268

20. Other liabilities

All other liabilities are expected to be settled within 3 months.

	2013 £m	2012 £m
Customer funds in course of settlement	**4**	11
Bank funds in course of settlement	**2**	1
Other liabilities	**1**	–
	7	12

21. Provisions for liabilities and charges

	Customer redress £m	FSCS £m	Other provisions £m	Total £m
At 1 January 2013	**–**	**4**	**1**	**5**
Charge to administrative expenses	**6**	**3**	**4**	**13**
Utilised in year	**–**	**(2)**	**(2)**	**(4)**
At 31 December 2013	**6**	**5**	**3**	**14**

	Customer redress £m	FSCS £m	Other provisions £m	Total £m
At 1 January 2012	–	3	1	4
Charge to administrative expenses	–	2	2	4
Utilised in year	–	(1)	(2)	(3)
At 31 December 2012	–	4	1	5

Customer redress provisions

Customer redress provisions mainly relate to the expected costs of refunding customers in respect of Card Protection Plan insurance (CPP). The Bank previously sold this and other similar products to 2009. During 2013, an investigation by the Financial Conduct Authority (FCA) concluded that CPP had been widely mis-sold during the period from January 2005 to March 2011 and put in place a redress scheme with the 13 largest intermediaries who previously sold the product (not including Sainsbury's Bank). In measuring the provision, the Bank has provided on a basis of redress in line with the FCA approved scheme and has also considered products sold outwith the specific period investigated by the regulator. The charge to the income statement of £6m represents estimated costs of customer refunds, interest and administration costs.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is funded by levies on authorised financial services firms, based on their level of deposits taken at 31 December each year. The Bank, as a regulated deposit taker, is subject to levies imposed by the FSCS whose costs are made up of management expenses and compensation payments. As the UK's statutory fund of last resort for customers of domestic financial institutions, the FSCS stepped in during 2008 to provide significant funding in relation to the bail out of a number of banks whose depositors are protected by the scheme. In order to meet its obligations, the FSCS borrowed funds from HM Treasury. These borrowings are anticipated to be repaid substantially from the realisation of the assets of the institutions assisted. This has resulted in a levy being set by the FSCS to cover the interest on this loan and any shortfall in the principal repayment will be borne by levy payers in the form of additional levies. The principal repayment is expected to be divided into 3 levies from 2013/14 onwards, with the 2013/14 repayment estimated at £363m and the 2014/15 repayment also estimated at £363m. The Bank's share of the repayments is based on its share of industry protected deposits as at 31 December 2013 and 31 December 2012, and has been provided for in 2013 and 2012.

The impact of this levy in the 2013 financial statements is a net charge of £3m (31 December 2012 charge of £2m). The closing provision represents the estimated share of levies that will be raised by the FSCS including the interest on the loan in respect of the levy years, 2013/2014, 2014/2015 and the principal repayment levy for 2014/2015 and is based on an estimate of the interest that the FSCS will pay on the loan and an estimate of the Bank's market participation in the relevant periods. Hence, the provision is based on the interest estimated on the current borrowings from HM Treasury.

21. Provisions for liabilities and charges continued

Other provisions

Other provisions relate to ATM cash retracts and the cost of double Nectar points.

When a customer makes a withdrawal at an ATM, the cash is presented for only a short period. If the customer fails to remove their cash, the ATM will retract the money to prevent a passer-by from taking it. The generic term for this is a Cash Retract. Until March 2011, the customer of the card issuing financial institution was required to raise a claim for any cash retracts with that financial institution in accordance with LINK scheme rules. The card issuing financial institution would then either raise a claim against the Bank or write off the loss in line with their own practices. The Bank has recognised a provision to refund those financial institutions in respect of cash retracts that were never claimed between 2006 and 2011. The charge to the income statement of £2m represents the difference between ATM cash retracts and claims for cash retracts received from other financial institutions and an estimate of interest expected to apply. In March 2011 the LINK scheme rules changed to require pro-active returning of cash retracts. The Bank is fully compliant with those rules.

A provision is recognised for the cost of double Nectar points on insurance contracts, which reflects the estimated cost to the Bank over the first year of the contract, and the second year where the customer has renewed their policy. This is discussed in critical accounting estimates in note 1c to these financial statements.

22. Accruals and deferred income

Included in accruals and deferred income at 31 December 2013 are amounts payable to J Sainsbury plc of £6m (2012: £6m) and amounts payable to Lloyds Banking Group plc of £10m (2012: £16m) in respect of management services and capital expenditure. Accruals and deferred income has no fixed maturity.

23. Other borrowed funds

	2013 £m	2012 £m
Dated loan capital		
£60 million floating rate subordinated loan 2014		
Repayable in less than 1 year	**60**	–
Repayable between 1 and 5 years	**–**	60
	60	60
Undated loan capital		
£50 million floating rate subordinated loan – undated	**50**	50

Dated loan capital

At 31 December 2013 and 31 December 2012, the dated subordinated loan was split in proportion to shareholder funding. No repayment, for whatever reason, of dated subordinated debt prior to its stated maturity may be made without the consent of the Prudential Regulatory Authority. On a winding up of the Bank, the claims of the holders of dated subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of the Bank other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the dated subordinated debt. Interest on the £60 million Floating Rate subordinated loan dated 2014, is payable three months in arrears at LIBOR plus a margin of 0.60% per annum for the duration of the loan.

Undated loan capital

At 31 December 2013 and 31 December 2012, the undated subordinated loans were split in proportion to shareholder funding. The undated subordinated loan capital shall be repaid on such date as the Prudential Regulatory Authority shall agree in writing for such repayment (following a request by either the Lender or Borrower) and in any event not less than five years and one day from the dates of drawdown. On a winding up of the Bank, the claims of the holders of undated subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of that company other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the undated subordinated debt. Interest on the £50 million Floating Rate undated loan capital is payable three months in arrears at LIBOR plus a margin of 1.0% per annum for the duration of the loan.

Details of post balance sheet events are given in note 37 on page 42.

24. Called up share capital

	2013 £m	2012 £m
Authorised ordinary shares		
At 31 December	**200**	200

	'A' ordinary shares of £1 £m	'B' ordinary shares of £1 £m	Total ordinary shares of £1 £m
Allotted, called up and fully paid:			
At 1 January 2013	**85**	**85**	**170**
Issued ordinary shares	**–**	**–**	**–**
At 31 December 2013	**85**	**85**	**170**
At 1 January 2012	85	85	170
Issued ordinary shares	–	–	–
At 31 December 2012	85	85	170

During 2013 and 2012 the share capital was divided into class 'A' and class 'B' Ordinary shares which rank pari passu in all respects.

Details of post balance sheet events are given in note 37 on page 42.

25. Retained earnings

	2013 £m	2012 £m
At 1 January	**139**	99
Profit for the financial year	**42**	40
At 31 December	**181**	139

The shareholders' agreement prescribes that a distribution of profits may not be made if the distribution would result in the Bank being in regulatory test deficit, the distribution would or would be likely to result in a breach of any covenant to any lender, or if a distribution would not be prudent having regard to the future outlook and performance of the Bank.

26. Other reserves

Other reserves comprise the fair value movements for available for sale securities and the effective portion of changes in the fair value of cash flow hedges. Both the available for sale reserve and cash flow reserve will unwind in line with the maturity profile of the underlying investment securities. The maturity profile of the investment securities is highlighted in note 10.

	Available for sale reserve £m	Cash flow reserve £m	Total £m
At 1 January 2013	**(3)**	**–**	**(3)**
Net unrealised losses	**2**	**–**	**2**
At 31 December 2013	**(1)**	**–**	**(1)**
At 1 January 2012	(22)	1	(21)
Net unrealised losses	16	(4)	12
Realised losses reclassified to the income statement on disposal	9	3	12
Tax effect of net losses	(6)	–	(6)
At 31 December 2012	(3)	–	(3)

These balances include tax of £0.4m in the available for sale reserve (2012: £0.9m) and £nil in the cash flow hedge reserve (2012: £nil).

27. Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The principal accounting policies on pages 13 to 17 describe how financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the balance sheet by the class of financial instrument to which they are assigned, and therefore by the measurement basis:

At 31 December 2013	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
Assets:				
Cash and balances with central banks	**444**	–	–	**444**
Financial investments – Available for sale				
Treasury bills	–	**510**	–	**510**
Investment securities	–	**32**	–	**32**
Loans and advances to banks	**1,059**	–	–	**1,059**
Loans and advances to customers	**2,592**	–	–	**2,592**
Derivative financial instruments	–	–	**2**	**2**
Other assets	**103**	–	–	**103**
Prepayments and accrued income	**18**	–	–	**18**
Total financial assets	**4,216**	**542**	**2**	**4,760**
Non-financial assets:				
Prepayments and accrued income				**19**
Property, plant and equipment				**18**
Intangible and deferred tax assets				**4**
				4,801

	Financial liabilities at amortised cost £m	Derivatives designated as cash flow hedging instruments £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:				
Deposits by banks	**752**	–	–	**752**
Derivatives	–	**7**	–	**7**
Customer accounts	**3,524**	–	–	**3,524**
Other liabilities	**7**	–	–	**7**
Accruals and deferred income	**27**	–	–	**27**
Other borrowed funds				
Dated loan capital	**60**	–	–	**60**
Undated loan capital	**50**	–	–	**50**
Total financial liabilities	**4,420**	**7**	–	**4,427**
Non-financial liabilities:				
Accruals and deferred income				**4**
Provisions				**14**
Current tax				**6**
				4,451

27. Analysis of financial assets and liabilities by measurement basis continued

At 31 December 2012	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
Assets:				
Cash and balances with central banks	474	–	–	474
Financial investments – Available for sale				
Treasury bills	–	474	–	474
Investment securities	–	29	–	29
Loans and advances to banks	1,377	–	–	1,377
Loans and advances to customers	2,547	–	–	2,547
Other assets	43	–	–	43
Prepayments and accrued income	18	–	–	18
Total financial assets	4,459	503	–	4,962
Non-financial assets:				
Prepayments and accrued income				3
Property, plant and equipment				17
Intangible and deferred tax assets				6
				4,988

	Financial liabilities at amortised cost £m	Derivatives designated as cash flow hedging instruments £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:				
Deposits by banks	1,234	–	–	1,234
Derivative financial instruments	–	6	–	6
Customer accounts	3,268	–	–	3,268
Other liabilities	12	–	–	12
Accruals and deferred income	38	–	–	38
Other borrowed funds		–	–	
Dated loan capital	60	–	–	60
Undated loan capital	50	–	–	50
Total financial liabilities	4,662	6	–	4,668
Non-financial liabilities:				
Provisions				5
Current tax				10
				4,683

28. Loan and operating lease commitments

Loan commitments

The contractual amount of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers is as follows:

	2013 £m	2012 £m
Commitments to extend credit	**43**	59

Operating lease commitments

The Bank leases office premises under non-cancellable operating leases. Total aggregate future minimum lease payments under operating leases are as follows:

	2013 £m	2012 £m
Due within one year	**1**	1
Due within 1–5 years	**2**	–
Due in more than 5 years	**8**	–
	11	1

29. Risk management

Through its normal operations, the Bank is exposed to a number of risks, the most significant of which are credit risk, operational risk, liquidity and funding risk and market risk. The overall risk management framework is described in detail on pages 2 to 5.

Credit risk

Credit risk is the risk of financial loss arising from the failure of customers or other counterparties to settle their financial obligations to the Bank as they fall due.

Wholesale and derivative credit risk
The Bank lends surplus funds to the inter-bank market. Limits have been established for all counterparties based on their respective financial strength and credit ratings. The limits and proposed counterparties are reviewed and approved by the Asset and Liability Committee as required. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments.

Retail credit risk
Management of credit risk in respect of retail customers makes use of automated credit decisioning techniques (both scorecards and policy rules) for new applications. In addition, behavioural scoring is used to assess the conduct of customers' accounts on an ongoing basis, for example granting extensions to limits. Underwriting is undertaken by specialist teams in operational areas to complement these processes. The Retail Credit Risk Committee ensures that appropriate policies are established and adhered to and this is subject to further oversight from the Board Risk Committee. Internal Audit teams carry out regular reviews of credit risk processes and policies are reviewed and re-approved on an annual basis.

At 31 December 2013, the maximum credit exposure of the Bank in the event of other parties failing to perform their obligations is equal to the sum of loans and advances to banks, loans and advances to customers and credit lines and other commitments to lend. These are set out in notes 12, 13 and 28, respectively. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instrument's balance sheet carrying amount.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral agreements.

	2013 £m	2012 £m
Credit risk exposures relating to on balance sheet items		
Cash and balances with central banks	**444**	474
Treasury bills	**510**	474
Investment securities	**32**	29
Loans and advances to banks	**1,059**	1,377
Loans and advances to customers		
Unsecured	**2,532**	2,477
Secured	**60**	70
Derivative financial instruments	**2**	–
Other assets	**103**	43
Prepayments and accrued income	**18**	18
Credit risk exposures relating to off balance sheet items		
Loans commitment and other related liabilities	**43**	59
Total credit risk exposures	**4,803**	5,021

Risk concentrations of the maximum exposure to retail and wholesale credit risk
Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed according to client or counterparty (and their respective credit qualities). Consideration is also given to geographical sector and in the case of wholesale credit risk the strength of the relevant sovereign.

Geographical sectors

Maximum exposure	2013 £m	2012 £m
United Kingdom	**4,464**	4,617
Countries in Europe adopting the Euro	**339**	404
	4,803	5,021

Concentration by location for loans and advances is measured based on the location of the Bank's operations, which has a high correlation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security.

29. Risk management continued

Industry sectors

Maximum exposure	2013 £m	2012 £m
Corporate	**307**	375
Sovereign		
UK	**515**	477
Bank	**1,326**	1,535
Retail	**2,655**	2,634
	4,803	5,021

The maximum credit exposure to any client or counterparty as of 31 December 2013 was £963m (2012: £1,273m) before taking into account collateral or other credit enhancements of £211m (2012: £362m). This exposure was to Lloyds Banking Group plc and represents short term interbank deposits and lending under a reverse repo arrangement which is supported by UK gilt collateral. The existence of collateral helps the Bank manage credit risk. Amounts are invested in the repo facility up to a maximum of a year with varying maturities depending on forecast liquidity requirements.

Credit quality per class of financial asset

Loans and advances to customers

Loans and advances are summarised as follows:

	2013 £m	2012 £m
Impaired	**101**	115
Past due but not impaired	**17**	18
Neither past due nor impaired	**2,558**	2,507
Gross	**2,676**	2,640
Less: allowance for impairment	**(82)**	(93)
hedging fair value adjustment	**(2)**	–
	2,592	2,547

29. Risk management continued

Credit quality analysis

At 31 December 2013	Unsecured lending £m	Secured lending £m	Total £m
Impaired			
Less than 3 months, but impaired	**2**	**–**	**2**
Past due 3 to 6 months	**7**	**1**	**8**
Past due 6 to 12 months	**–**	**–**	**–**
Past due over 12 months	**–**	**–**	**–**
Recoveries	**91**	**–**	**91**
Possession	**–**	**–**	**–**
Total gross impaired loans	**100**	**1**	**101**
Past due but not impaired			
Past due up to 3 months but not impaired	**14**	**3**	**17**
Total gross past due but not impaired	**14**	**3**	**17**
Neither past due nor impaired*			
Not impaired	**2,502**	**56**	**2,558**
Total gross neither past due nor impaired	**2,502**	**56**	**2,558**
Total gross amount due	**2,616**	**60**	**2,676**

*Includes £2.2m of loans and advances that would have been past due or impaired had their terms not been renegotiated.

At 31 December 2012	Unsecured lending £m	Secured lending £m	Total £m
Impaired			
Less than 3 months, but impaired	3	–	3
Past due 3 to 6 months	7	1	8
Past due 6 to 12 months	–	–	–
Past due over 12 months	–	1	1
Recoveries	103	–	103
Possession	–	–	–
Total gross impaired loans	113	2	115
Past due but not impaired			
Past due up to 3 months but not impaired	15	3	18
Total gross past due but not impaired	15	3	18
Neither past due nor impaired*			
Not impaired	2,442	65	2,507
Total gross neither past due nor impaired	2,442	65	2,507
Total gross amount due	2,570	70	2,640

*Includes £2.5m of loans and advances that would have been past due or impaired had their terms not been renegotiated.

Mortgages held over residential properties represent the only collateral held by the Bank for retail exposures. The market value of collateral held for impaired loans and loans past due but not impaired was £9m (2012: £9m). The fair value of collateral held against possession cases was £nil (2012: £nil).

If a customer falls into arrears, the customer will be held in 'collections' where the Bank will work with the customer to try and regularise the position over a period of time. Where the arrears status of a customer deteriorates and there is a failure to respond to correspondence or agree an acceptable repayment proposal, including notice of default, the customer balance will fall into 'recoveries'. Recoveries will take steps to recover the debt, using their expertise to determine the optimum recovery strategy. Instigation of legal action will depend upon the anticipated recoveries and costs.

29. Risk management continued

Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 31 December 2013 was £nil (2012: £nil). The fair value of collateral held for loans and advances to banks was £209m (2012: £362m). Collateral takes the form of security over UK government gilt securities. The table below presents an analysis of lending to banks by rating agency designation, based on Moody's ratings:

	2013 £m	2012 £m
Aaa to A3	**1,059**	1,377

Debt securities, cash and balances with central banks, treasury bills and other eligible bills

The total gross amount of individually impaired debt securities, cash and balances with central banks, treasury bills and other eligible bills as at 31 December 2013 was £nil (2012: £nil). No collateral is held regarding these assets. The tables below present an analysis of the credit quality of money market funds included within cash and cash equivalents. The credit quality of treasury bills and investment securities by market value is also included. Analysis is by rating agency designation, based on Moody's ratings:

At 31 December 2013	Cash and balances with central banks £m	Treasury bills £m	Investment securities £m	2013 £m
Aaa to A3	**307**	**510**	**–**	**817**
Baa1 to Baa3	**–**	**–**	**32**	**32**
ATM cash and balances with central banks	**137**	**–**	**–**	**137**
	444	**510**	**32**	**986**

At 31 December 2012	Cash and balances with central banks £m	Treasury bills £m	Investment securities £m	2012 £m
Aaa to A3	375	474	–	849
Baa1 to Baa3	–	–	29	29
ATM cash and balances with central banks	99	–	–	99
	474	474	29	977

Financial assets and liabilities subject to offsetting, master netting agreements and similar agreements

The Bank does not present any items net in the balance sheet. However, it does hold some financial instruments which are subject to master netting agreement and similar agreements as disclosed below.

	Gross and net amounts recognised in the balance sheet	Related amounts not offset in the balance sheet		
At 31 December 2013	£m	Financial instruments £m	Collateral pledged £m	Net amounts £m
Derivative financial instruments	**2**	**–**	**(2)**	**–**
Loans to banks	**926**	**(750)**	**(209)**	**(33)**
	928	**(750)**	**(211)**	**(33)**
At 31 December 2012				
Loans to banks	1,264	(1,234)	(362)	(332)

During 2013 and 2012, the Bank invests with Lloyds Banking Group plc through a reverse repo facility, which is 100% collateralised with gilts. At 31 December 2013, the Bank held £209m of gilts (2012: £362m).

The Bank is also permitted to settle net its fixed-term borrowing facility against loans made to Lloyds Banking Group plc. At 31 December 2013, the Bank had a £750m fixed-term borrowing (2012: £1,234m) and £719m of loans made to Lloyds Banking Group plc (2012: £902m).

The Bank has derivatives which are supported by credit agreements whereby if the fair value exceeds a pre-agreed level, cash collateral is required.
At 31 December 2013, the Bank held £2m of collateral against the derivatives (2012: £nil).

29. Risk management continued

Operational risk

The Bank has adopted the industry standard definition of operational risk from the Basel Committee on Banking Supervision. This is 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'.

The Bank's risks are assessed utilising a risk management framework methodology which is aligned to the three lines of defence model. The key risks assessed were wholesale and retail credit risk, liquidity and funding risk, market risk, regulatory risk, conduct risk and operational risk.

In addition to regular reporting to the Non Financial Risk Committee (NFRC), a risk map is also maintained. This provides details of the current impact and likelihood assessments of the key risks of the Bank, along with a forward looking assessment of risks. Any significant change in assessments being highlighted to the Board Risk Committee.

Internal Audit undertakes reviews across the business throughout the year under a programme agreed with the Bank Audit Committee.

Liquidity and funding risk

Liquidity and funding risk is the risk that the Bank is unable to meet its financial commitments as they fall due without an adverse impact on funding costs or profitability. The Bank's liquidity risk management framework is set to adhere to the standards as set by the PRA in BIPRU regulation. The Bank seeks to maintain a liquidity and funding profile to ensure that it can meet its financial obligations under stressed market conditions.

As required by the regulation the Bank has completed an Individual Liquidity Adequacy Assessment (ILAA). This allows the Bank to demonstrate that it understands the liquidity risks it is running and has appropriate controls in place to mitigate them. The Bank has established a Liquidity Risk appetite as well as a suite of limits stemming from the ILAA process that has led to a minimum level of liquidity held. Limits are informed by a number of stress scenarios that assess the survival period of the Bank.

In meeting internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily sold to meet the Bank's obligations to depositors and other creditors. The portfolio of assets is managed on a daily basis and within the framework as outlined in the ILAA and by the PRA.

In addition to this, the Bank prepares both long term and short term forecasts to assess liquidity requirements. Short term forecasting covers a rolling twelve month period and takes into account factors such as ATM cash management, investment maturities and customer deposit patterns and balances. These reports support daily liquidity management and are reviewed daily by management along with early warning indicators. Early warning indicators include market stress indicators such as the 3m LIBOR and the yield spread on UK bonds and also firm specific indicators such as early signs of withdrawals on the Bank's retail deposits.

The table below shows the undiscounted cash flows on the Bank's financial assets, liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The expected (behavioural) cash flows on these instruments vary significantly from this analysis and as such are regularly modelled to ensure operational net cash flows are managed. The disclosure for derivatives shows a gross inflow and outflow amount. As derivatives have a simultaneous gross settlement it is not considered representative to show only the outflow amount.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

29. Risk management continued

Residual contractual maturity analysis

At 31 December 2013	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
Non-derivative assets						
Cash and balances at central banks	444	–	–	–	–	444
Treasury bills	97	146	267	–	–	510
Investment securities	–	–	–	34	–	34
Loans and advances to banks	971	50	–	–	–	1,021
Loans and advances to customers	812	153	620	1,390	59	3,034
Other assets	103	–	–	–	–	103
Prepayments and accrued income	18	–	–	–	–	18
	2,445	349	887	1,424	59	5,164
Derivative assets						
Fair value hedges						
Outflow	–	(1)	(3)	(6)	–	(10)
Inflow	–	1	3	7	–	11
Net derivative cash flows	–	–	–	1	–	1
	2,445	349	887	1,425	59	5,165
Liabilities						
Non-derivative liabilities						
Deposits by banks	32	69	234	433	–	768
Customer accounts	3,435	35	278	318	–	4,066
Other liabilities	7	–	–	–	–	7
Accruals	31	–	–	–	–	31
Other borrowed funds	–	–	61	6	64	131
	3,505	104	573	757	64	5,003
Derivative liabilities						
Cash flow hedges						
Outflow	–	–	–	34	–	34
Inflow	–	–	–	(28)	–	(28)
Net derivative cash flows	–	–	–	6	–	6
Unrecognised loan commitments	43	–	–	–	–	43
	3,548	104	573	763	64	5,052
Net liquidity	(1,103)	245	314	662	(5)	113

29. Risk management continued

Residual contractual maturity analysis (continued)

At 31 December 2012	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances at central banks	474	–	–	–	–	474
Treasury bills	50	150	275	–	–	475
Investment securities	–	–	–	34	–	34
Loans and advances to banks	504	629	245	–	–	1,378
Loans and advances to customers	833	143	585	1,432	49	3,042
Other assets	43	–	–	–	–	43
Prepayments and accrued income	18	–	–	–	–	18
	1,922	922	1,105	1,466	49	5,464
Liabilities						
Non-derivative liabilities						
Deposits by banks	45	97	355	763	6	1,266
Customer accounts	3,259	19	286	301	–	3,865
Other liabilities	12	–	–	–	–	12
Accruals	38	–	–	–	–	38
Other borrowed funds	–	1	1	64	61	127
	3,354	117	642	1,128	67	5,308
Derivative liabilities						
Cash flow hedges						
Outflow	–	–	–	34	–	34
Inflow	–	–	–	(28)	–	(28)
Fair value hedges						
Outflow	–	–	–	–	–	–
Inflow	–	–	–	–	–	–
Net derivative cash flows	–	–	–	6	–	6
Unrecognised loan commitments	59	–	–	–	–	59
	3,413	117	642	1,134	67	5,373
Net liquidity	(1,491)	805	463	332	(18)	91

Market risk

Market risk is defined as the risk that the value of the Bank's assets, liabilities, income or costs may fluctuate as a result of adverse change to market rates. The Bank's market risks include Interest Rate Risk in the Banking Book (IRRBB) and Foreign Exchange Risk. The Bank does not have a trading book. Non-trading book positions are managed and monitored using risk measures including stress tests and sensitivity analysis to minimise market value sensitivity and earnings volatility, taking into account current and expected future business flows. Foreign exchange rate risk is fully hedged.

Interest rate risk

The Bank offers lending and savings products with varying interest rate features and maturities. Unless managed appropriately, adverse changes to interest rates could negatively impact the Bank's economic value and net interest income and represent the main source of market risk in the Bank.

The main sources of interest rate risk faced by the Bank are:

- Re-pricing risk: the risk arising from timing differences in the repricing and maturity of bank assets and liabilities (e.g. fixed rate personal loans and instant access savings accounts).
- Yield curve risk: the risk arising from changes in the slope and shape of the yield curve.
- Basis risk: risk arising from imperfect correlation between rates earned and paid on instruments with similar repricing characteristics (e.g. administered savings products and treasury assets linked to LIBOR).
- Prepayment risk: the risk arising from the timing of customer prepayments which differ from planning and hedging assumptions.
- Pipeline risk: the risk of a customer drawing down, or not, a product at a rate which is unfavourable for the Bank.
- Behavioural risk: the risk of changes in customer behaviour which are not in line with the Bank's original hedging assumptions.

29. Risk management continued

Interest rate risk limits are set by the Board Risk Committee and are monitored by the Asset and Liability Committee to ensure that risk is maintained within the overall risk appetite of the Bank. Hedging strategies are implemented to ensure the Bank remains within risk limits at all time. Where possible, the Bank matches offsetting interest rate positions on the balance sheet to manage interest rate risk. Where offsetting positions do not exist, the Bank transacts interest rate derivatives, currently cash collateralised interest rate swaps, to manage risk. The Bank uses market recognised software through a third party vendor to assist in the measurement and monitoring of interest rate risk.

Hedges are primarily transacted to manage the interest rate risk of the personal loan portfolio (note 13). The interest rate swaps pay a fixed rate of interest to manage the re-pricing risk of the fixed rate personal loan portfolio. The swaps receive a LIBOR rate which better reflect the interest rate risk profile of the Bank's savings products.

The primary measures used by the Bank to capture interest rate risk include analysis of the impact of small and extreme changes in interest rates on the market value of the Bank's assets and liabilities and on the Bank's earnings. As at 31 December 2013, the market value sensitivity (change in equity) and earnings at risk (change in net interest income) for changes in interest rates of +/-50 basis points and +/-25 basis points movements in rates are as follows:

	2013		2012	
	Change on net interest income £m	**Change in equity £m**	Change on net interest income £m	Change in equity £m
+/- 50 basis points	**(1) / –**	**(4) / 4**	(3) / 2	(6) / 6
+/- 25 basis points	**(1) / –**	**(2) / 2**	(1) / 1	(3) / 3

Foreign exchange risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is primarily exposed to foreign exchange risks from currency cash flows arising from its investment security denominated in Euros. These currency cash flows are fully hedged into sterling with currency swaps. At 31 December 2013, the Euro notional value of the foreign investment securities was €40m (2012: €40m). This was exactly matched by the Euro notional value of the derivative obligations.

30. Capital resources

The following table analyses the regulatory capital resources of the Bank:

	2013 £m	2012 £m
Tier 1 capital:		
Ordinary share capital	**170**	170
Reserves	**139**	99
Deduction for intangible assets	**(4)**	(5)
Total Tier 1	**305**	264
Upper Tier 2 capital:		
Undated loan stock	**50**	50
Allowable element of provisions	**6**	7
Lower Tier 2 capital:		
Dated loan stock	**12**	24
Total Tier 2	**68**	81
Total capital	**373**	345

The Bank's regulatory capital is analysed into two tiers. Tier 1 capital includes ordinary share capital and retained earnings after the deduction of intangible assets. Tier 2 capital includes dated and undated loan capital plus an impairment allowance. Various limits are applied to elements of the capital base. Tier 2 capital cannot exceed Tier 1, and lower Tier 2 capital cannot exceed 50% of Tier 1 capital. The Bank meets both requirements.

Capital management

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. The capital base has not changed materially in the 12 months to 31 December 2013. Capital adequacy is monitored on an ongoing basis by senior management, the Asset and Liability Committee, the Executive Risk Committee and the Board Risk Committee. Our submissions to the PRA in the year have shown that the Bank has complied with all externally imposed capital requirements (until April 2013, submissions were made to the FSA).

Details of post balance sheet events are given in note 37 on page 42.

31. Fair value of financial instruments

The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or re-price frequently, fair value approximates to carrying value. The fair value information presented does not represent the fair value of the Bank as a going concern at 31 December 2013 or 31 December 2012. The classification adopted by the Bank is shown in the following table:

	2013		2012	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Assets:				
Cash and balances at central banks	**444**	**444**	474	474
Treasury bills	**510**	**510**	474	474
Loans and advances to banks	**1,059**	**1,059**	1,377	1,377
Loans and advances to customers	**2,592**	**2,561**	2,547	2,491
Derivative financial instruments	**2**	**2**	–	–
Investment securities	**32**	**32**	29	29
Liabilities:				
Deposits by banks	**752**	**759**	1,234	1,254
Derivative financial instruments	**7**	**7**	6	6
Customer accounts	**3,524**	**3,533**	3,268	3,277
Other borrowed funds	**110**	**88**	110	86

Information on how fair values are calculated for the financial assets and liabilities noted above is explained on page 16 of the critical accounting estimates section.

The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

For fixed interest bearing deposits and other borrowings without quoted market price, valuations are based on discounted cash flows using market interest rates for new lending with similar remaining maturity. The estimated fair value of deposits with no stated maturity is the amount repayable on demand.

Fair value hierarchy

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1
Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and exchanges traded derivatives like futures.

Level 2
Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.

Level 3
Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

The following table provides an analysis of the relevant fair value hierarchy:

At 31 December 2013	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial Investments – Available for Sale				
Treasury bills	**510**	**–**	**–**	**510**
Investment securities	**–**	**32**	**–**	**32**
Derivatives designated as fair value hedging instruments	**–**	**2**	**–**	**2**
Total assets	**510**	**34**	**–**	**544**
Derivatives designated as cash flow hedging instruments	**–**	**(7)**	**–**	**(7)**
Total liabilities	**–**	**(7)**	**–**	**(7)**

31. Fair value of financial instruments continued

At 31 December 2012	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial Investments – Available for Sale				
Treasury bills	474	–	–	474
Investment securities	–	29	–	29
Total assets	474	29	–	503
Derivatives designated as cash flow hedging instruments	–	(6)	–	(6)
Total liabilities	–	(6)	–	(6)

32. Notes to the cash flow statement

a. Reconciliation of profit before taxation to cash flows (used in)/generated from operating activities

	2013 £m	2012 £m
Profit before taxation	**55**	53
Non-cash items included in profit before taxation		
Impairment losses on loans and advances	**28**	33
Depreciation on property, plant and equipment	**3**	4
Amortisation of intangible assets	**2**	2
Interest on borrowed funds	**1**	1
	34	40
Change in operating assets and liabilities		
Net (increase) in loans and advances to customers	**(73)**	(194)
Net decrease/(increase) in loans to banks repayable in greater than 3 months	**245**	(245)
Net (increase)/decrease in investment securities	**–**	84
Net (increase) in derivative assets	**(2)**	–
Net increase/(decrease) in derivative liabilities	**1**	(17)
Net (increase)/decrease in other assets	**(64)**	16
Net (increase)/decrease in prepayments and accrued income	**(15)**	2
Net increase in customer accounts	**256**	380
Net (decrease)/increase in borrowed funds	**(482)**	62
Net increase/(decrease) in other liabilities	**5**	(14)
Net (decrease)/increase in accruals and deferred income	**(7)**	10
	(136)	84
Cash (used in)/generated from operations	**(47)**	177
Income taxes paid	**(16)**	(15)
Cash flows (used in)/generated from operating activities	**(63)**	162
Operational cash flows from interest		
Interest paid	**(66)**	(109)
Interest received	**206**	217

32. Notes to the cash flow statement continued

b. Cash and cash equivalents

For the purposes of the cash flow statements, cash and cash equivalents comprise the following:

	2013 £m	2012 £m
Cash and balances with central banks	**444**	474
Balances at central banks	**(5)**	(3)
	439	471
Loans and advances to other banks:		
Repayable on demand	**38**	–
Repayable in less than three months	**1,021**	1,132
Treasury bills	**510**	474
	2,008	2,077

33. Parent company

During the financial years ending 31 December 2013 and 31 December 2012, J Sainsbury plc and Bank of Scotland plc each held 50% of the issued share capital of the Bank, with a contractual arrangement in place to share joint control. Consequently there was no ultimate parent company.

Details of post balance sheet events are given in note 37 on page 42.

34. Related party transactions

During the financial years ending 31 December 2013 and 31 December 2012, the Bank was a joint venture between the shareholders, J Sainsbury plc and Bank of Scotland plc (part of the Lloyds Banking Group plc group of companies).

Details of post balance sheet events are given in note 37 on page 42.

J Sainsbury plc

The Bank has identified the following transactions with J Sainsbury plc, which fall to be disclosed under the terms of IAS 24:

	2013 £m	2012 £m
Transactions during the year		
Services and loans provided by J Sainsbury plc:		
Management services	**30**	25
Interest expense paid in respect of interest bearing loans	**1**	1
Total loans and advances given during the year	**–**	–
Balances at 31 December		
Payables:		
Management services	**6**	6
Interest payable	**–**	–
Subordinated dated loan capital	**30**	30
Subordinated undated loan capital	**25**	25

Lloyds Banking Group plc

In the same period companies within Lloyds Banking Group plc group provided both management and banking services to the Bank. The Bank also entered into financial transactions with, and earned commission from, companies within the Lloyds Banking Group plc group of companies, all under normal commercial terms.

None of the loans and advances to related parties were impaired at the balance sheet date. Furthermore, no expenses were recognised during the year in respect of impairment losses on loans and advances to related parties.

34. Related party transactions continued

	2013 £m	2012 £m
Transactions during the year		
Services and loans provided by Lloyds Banking Group plc group of companies:		
Management and banking services	**35**	32
Interest expense paid in respect of subordinated loan capital	**1**	1
Deposits by banks:		
Fixed term	**–**	386
Deposits repaid during the year	**(482)**	(324)
Net interest paid in respect of interest rate swaps, loans and advances	**19**	27
Loans given to and commission received from Lloyds Banking Group plc group of companies:		
Total loans and advances made during the year	**5,534**	7,480
Loans and advances repaid during the year	**(5,844)**	(7,333)
Net interest received in respect of interest rate swaps, loans and advances	**4**	7
Commission income earned	**8**	6
Balances at 31 December		
Receivables:		
Loans and advances	**957**	1,267
Derivative assets	**2**	–
Prepayments and accrued income	**2**	4
Interest receivable	**1**	1
Commission receivable	**1**	1
Payables:		
Management and banking services	**10**	16
Interest payable	**1**	1
Deposits by banks	**752**	1,234
Derivative liabilities	**7**	6
Subordinated dated loan capital	**30**	30
Subordinated undated loan capital	**25**	25

The Loans and advances figures above include balances collateralised under a reverse repo arrangement which is supported by 100% UK gilt collateral.

Transactions with key management personnel

For the purposes of IAS 24 'Related party disclosures', key management personnel comprise members of the Sainsbury's Bank Board and the Executive Committee of the Bank, who held office during the year.

Remuneration and other compensation

	2013 £m	2012 £m
Short term employee benefits	**2.3**	2.0
Post-employment benefits	**0.1**	0.1
Other long term benefits	**–**	0.5
Share-based payments	**0.4**	0.3
	2.8	2.9

Short term employee benefits represent salary, bonus and benefits in kind. Post-employment benefits relate to employer's contributions to defined benefit and money purchase pension schemes operated by J Sainsbury plc and Lloyds Banking Group plc.

Share based payments relates to share schemes operated by the Lloyds Banking Group plc and J Sainsbury plc. No recharge is made by either organisation to the Bank in respect of shares granted to colleagues. Both schemes are equity-settled in respect of the joint venture parents.

The Sainsbury's 'Future Builder' and 'Value Builder' long term incentive plans conditionally award J Sainsbury plc shares to senior management. The core award is calculated as a percentage of the employee's salary, scaled according to grade. Awards will vest if the threshold levels of 2 performance related conditions (J Sainsbury plc return on capital employed and growth in cash flow per share) are met over a three year performance period. The core award can grow by up to 4 times depending on performance. If performance conditions are met, 50% of the award will be released after 3 years and a further 50% after a further year. Dividends will accrue on awards that vest in the form of additional shares.

The Lloyds Banking Group Long term Incentive Plan (LTIP) is a share-based award available to senior Lloyds Banking Group plc employees. Shares will vest after a 3 year period if performance conditions are met. Performance conditions are based on earnings per share growth and profit growth over the 3 year period.

No termination payments were made during the year (2012: £nil).

34. Related party transactions continued

Product transactions

Details of transactions, under terms and conditions available to all colleagues, between the Bank and key management personnel are provided below. For this purpose, key management personnel include Sainsbury's Bank key management personnel and members of their close families. This note does not include key management personnel of J Sainsbury plc or Lloyds Banking Group plc as they are not considered to be key management personnel of Sainsbury's Bank.

	Number of key management personnel	Directors £'000	Other £'000 £'000
Mortgages, credit cards and term loans			
At 1 January 2012	3	9	–
Resignations during 2012	–	–	–
Appointments/New accounts during 2012	2	–	–
Amounts advanced during the year	–	93	2
Amounts repaid during the year	–	(91)	–
At 31 December 2012	**5**	**11**	**2**
Resignations during 2013	**(4)**	**(10)**	**(2)**
Appointments/New accounts during 2013	**3**	**–**	**–**
Amounts advanced during the year	**–**	**46**	**–**
Amounts repaid during the year	**–**	**(46)**	**–**
At 31 December 2013	**4**	**1**	**–**

	Number of key management personnel	Directors £'000	Other £'000
Savings and deposit accounts			
At 1 January 2012	5	275	–
Resignations during 2012	(1)	(105)	–
Appointments/ New accounts during 2012	2	–	1
Amounts deposited during the year	–	266	–
Interest paid	–	3	–
Amounts withdrawn during the year	–	(10)	–
At 31 December 2012	**6**	**429**	**1**
Resignations during 2013	**(3)**	**(104)**	**(1)**
Appointments/ New accounts during 2013	**–**	**–**	**–**
Amounts deposited during the year	**–**	**122**	**–**
Interest paid	**–**	**7**	**–**
Amounts withdrawn during the year	**–**	**(59)**	**–**
At 31 December 2013	**3**	**395**	**–**

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 31 December 2013 was £nil (2012: £nil).

35. Capital commitments

There are commitments in respect of capital expenditure which has been authorised, but not provided for in the financial statements, for which contracts have been entered into, on:

	2013 £m	2012 £m
Property, plant and equipment	**1**	1
Software development	**2**	–
	3	1

36. Contingent liabilities

In 2013, the EU announced its intention to regulate the interchange fees paid by merchants to card providers on payments made by debit and credit cards. The current proposals may result in a reduction of the interchange fee income earned by the Bank. It is not yet clear when the regulations will be enforced and whether they will be applied retrospectively and hence the Bank has not recognised a provision.

37. Events after the balance sheet date

On 24 January 2014, the Bank received £150m of Treasury Bills from the Bank of England as part of an arrangement to become part of the Funding for Lending Scheme. The Bank was required to post £152m of Treasury Bills as security for the arrangement.

As referenced in the Directors' and Strategic report on page 1, and notes 4,11,18,23,24,30,33 and 34 on 31 January 2014, J Sainsbury plc purchased the 50% holding in the Bank from Lloyds Banking Group plc. As a result, the Bank from this date is a wholly-owned subsidiary of J Sainsbury plc, which is also its ultimate controlling parent company. The following events were a consequence of the transaction:

On 31 January 2014, the Bank repaid the fixed-term borrowing with Lloyds Banking Group plc of £720m incurring a break cost of £8.4m to repay the borrowings. In order to mitigate the increased interest rate risk due to the repayment of the fixed-term borrowings, the Bank entered into interest rate swaps with a nominal value of £541m.

From 1 February 2014, all employees seconded to the Bank by J Sainsbury plc group or Lloyds Banking Group plc became employees of Sainsbury's Bank plc.

From 1 February 2014, the Bank altered its Articles of Association to change the status of its share capital to one class of ordinary shares. At the same time, the authorised share capital limit of the Bank was removed in line with the provisions of the Companies Act 2006.

The Bank expects the costs incurred by J Sainsbury plc prior its acquisition of the Bank on 31 January 2014 in relation to the development of the Bank after that date will be recharged to the Bank. The costs amount to £36m including capital expenditure of £8m.

On 7 February 2014, the Bank issued £20m of share capital for cash to J Sainsbury plc.

On 28 February 2014, the Bank repaid the £50m of undated loan notes with J Sainsbury plc through the issue of £50m of share capital.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic report, Directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) 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 Company and of the profit or loss of the Company 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 International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company 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. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board and signed on its behalf by

David Arden
Company Secretary
London
14 March 2014

Independent auditors' report to the members of Sainsbury's Bank plc

Report on the financial statements

Our opinion
In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2013 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.

This opinion is to be read in the context of what we say below.

What we have audited

The financial statements for the year ended 31 December 2013, which are prepared by Sainsbury's Bank plc, comprise:

- the Income Statement;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity;
- the Cash flow statement; and
- the related notes.

The financial reporting framework that has been applied in their preparation comprises applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

What an audit of financial statements involves

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

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

Opinion on matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' and Strategic report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

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, 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 if, in our opinion, certain disclosures of Directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors
As explained more fully in the Directors' Responsibilities Statement set out on page 43, 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.

Lindsay Gardiner (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
14 March 2014