Sainsbury's Bank plc

Annual Report and Financial Statements for the year ended 28 February 2018

COMPANY NUMBER: 3279730

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Financial headlines

£25m

Statutory profit before tax
(2017: £0m)

£62m

Underlying profit before tax
(2017: £60m)

3.6%

Net interest margin
(2017: 3.9%)

0.9%

Bad debt asset ratio
(2017: 0.6%)

68%

Cost : income ratio (underlying)
(2017: 72%)

14.1%

CET1 capital ratio
(2017: 13.3%)

120%

Net stable funding ratio
(2017: 113%)

Performance, including reference to the above headlines, is explained in the business review and financial review sections on pages 3 and 13.

Strategic Report

The Directors present their Strategic Report of Sainsbury's Bank plc ('the Bank') for the year ended 28 February 2018.

The Bank is a company limited by shares, registered in England and domiciled in the United Kingdom. Its registered office is 33 Holborn, London, EC1N 2HT.

Business model

We provide a range of retail banking services and related financial services wholly within the UK.

Sainsbury's Bank

Product Offering	Nature of Income	Distribution Channels
Banking Products	**Banking Products**	**Banking Products**
— Loans — Credit Cards — Residential Mortgages — Savings — ATMs	— Funds raised through savings deposits and wholesale sources — Funds lent to customers or held as liquid assets — Resultant margin is income to the Bank	— Telephone — Online — Broker distribution of Mortgages — ATMs in Sainsbury's stores
Insurance	**Insurance**	**Insurance**
— Car — Home — Pet — Travel — Life	— Products offered via introducer contracts with third party insurance partners — Income received through commission and profit share arrangements	— Telephone — Online
Travel Money	**Travel Money**	**Travel Money**
— Foreign Exchange — Prepaid Cards — Money Transfer	— Foreign currency acquired wholesale — Sold to customers at retail rate with a resulting margin — Fees earned on prepaid cards and money transfer services	— Bureaux in Sainsbury's stores — Telephone — Online

As a bank authorised by the Prudential Regulation Authority (PRA), together with the Financial Conduct Authority (FCA), we are required to raise and hold specified minimum levels of our funding in the form of capital (see note 34), and hold specified levels of liquid assets in order to meet our financial commitments as they are expected to fall due (see note 33).

Our underlying profitability reflects the difference between incomes generated from our products compared to costs arising from marketing and operating those products, supplier and head office related costs, charges arising from impairment of customer balances and other realised gains and losses.

We are a wholly owned subsidiary of J Sainsbury plc, governed by our own Board and Executive Management Team, independent from J Sainsbury plc (see Risk overview and Governance sections on pages 4 and 9). We are nearing completion of a programme, known as the New Bank Programme (NBP), to transition banking product services previously performed by Lloyds Banking Group (LBG) to our own infrastructure. Savings and loans customers are now being handled through our own infrastructure with remaining elements due to be transitioned during 2018.

The programme represents a significant investment in the future potential of the Bank which requires increased costs in the short term as the new platforms are built and operations transitioned to the new operating model. The investment is being supported by additional equity share capital invested by J Sainsbury plc (see note 28).

The current financial statements continue to report the performance and position of the Bank as a standalone entity. Further disclosure on the combined Financial Services segment of the Sainsbury's Group ('the Group') is provided in the J Sainsbury plc Group financial statements.

Market context

Economy
UK economic growth held up and performed relatively well, demonstrating resilience amid ongoing Brexit uncertainty. Rising inflation, driven in part by the depreciation of Sterling, squeezed household incomes and depressed consumer spending; consequently average annual pay growth slowed but the unemployment rate fell to a 40-year low at 4.3%.

In November 2017, the Bank of England (BoE) reversed the emergency interest rate cut in the aftermath of the vote to leave the EU by raising the interest rate for the first time since 2007, on the back of the resilient performance of the UK economy. The BoE also ended its Term Funding Scheme in February 2018 as planned, and signalled that further tightening of monetary policy may be required should domestic inflation pressures increase further.

Financial markets performed strongly in 2017, and many economists expect central banks to tighten monetary policy as the global economy is expected to carry on the 2017 growth momentum well into 2018. However, UK economic activity may slow as businesses delay investment plans due to the continued Brexit related uncertainty and the ongoing squeeze of household incomes.

The Bank's liquidity portfolio performed well in 2017 on the back of strong financial markets performance and better than expected economic backdrop. The Bank also successfully engaged with the financial markets in a debut capital raising exercise and raised £175 million of Tier 2 capital, which demonstrates its ability to access the financial markets, if and when required.

The Bank will continue to monitor the UK economy's performance and manage potential risks in the financial markets as well as the development of the Brexit process.

Loans
The markets for unsecured personal lending in which the Bank operates remained highly competitive throughout the year.

The Personal Loans market saw the addition of new market participants as well as pricing activity undertaken by high street banks. For loans between £7,500 and £15,000 the headline rate dropped to 2.8% for the first time and there continues to be a large number of providers within 0.2% of the lowest rate. The differentiation in rate for loans between £7,500 and £15,000 and those greater than £15,000 but less than £25,000 has reduced against a background of strong competition across both these lending segments. Demand for personal loans remains strong. Loans less than £7,500 have continued the downward trend from the previous year.

The Bank seeks to provide loans for the Sainsbury's shopper and as such the majority of our lending is to Nectar card holders who benefit from a lower rate.

Credit Cards
The Credit Card market continued to see intense competition; however, balance transfer promotional periods have started to reduce towards the end of the year, with the longest promotions now shorter when compared to the same period last year. The Bank has achieved sustained growth in new business sales and outstanding balances, contributing to the continued growth of the Bank's total active customer base. Sainsbury's Bank remains committed to delivering compelling credit card products to its shoppers, underpinned by a strong Nectar reward proposition that continues to attract Sainsbury's shoppers to the Bank's product suite.

Savings
Market rates have been slowly increasing throughout 2017 with the increase in the Bank of England Base Rate helping maintain this gradual upward trend. However, the significant drawdown across the market from the Funding for Lending scheme (FLS) and more recently the Term Funding Scheme (TFS) has meant rates have remained relatively low. The withdrawal of TFS at the end of February 2018 may result in a more meaningful increase in deposit rates in the near future.

Easy access products grew consistently throughout 2017 with fixed term products continuing to contract. Pricing within key markets remains led by smaller providers with established high street banks typically offering considerably lower rates.

Insurances
The Insurance market remains competitive and price continues to be the dominant decision maker for consumers. Preference for digital channels, especially price comparison sites, is now almost universal. Loyalty schemes and brand continue to have an influence on buying decisions, however price is the key driver. There has been a noted increase in customers' propensity to switch since the implementation of the FCA renewal transparency rules in April 2017. This year there were a number of regulatory changes driving up premiums. This has all added to the competitive nature of the insurance market and consumers' behaviour on shopping around based on price.

Travel Money
The Travel Money market saw increased and continued growth in 2017 of 7.4% (this compares to 4.8% in 2016) with airline passenger numbers similarly growing by 7.6%. As a result of the increased demand, the competitive landscape continued to present a challenging market with many players heavily reliant on discounted pricing and sales.

The currency markets saw fluctuations with the maximum and minimum Euro exchange rates moving by up to 10% against Sterling through the year, heavily impacted by European elections. The US Dollar similarly moved by up to 18% impacted by Federal Reserve rate increases. As the media agenda gained momentum, so customers became increasingly rate savvy with competitors reacting to this by tightening the margin in a race for top spot.

Strategy

Aligned to the Sainsbury's Group strategy to be the most trusted retailer, where people love to work and shop, our principal strategic purpose and objective is to provide banking products for Sainsbury's customers in the distinctive Sainsbury's way to create Group shareholder value. One of Sainsbury's Group four strategic priorities is to diversify and grow Sainsbury's Bank. We know that when customers take out a Bank product they become more loyal and go on to spend more in Sainsbury's stores.

Strategic outcomes have been defined in order to measure the successful and balanced delivery of the overall strategy.

Our customers will trust us, supporting them as their needs change over time	**Our shareholders** see that we drive value to the Group
Our colleagues know that Sainsbury's Bank is a great place to work where they are rewarded fairly and get great development	**Our regulators** know that we challenge the market through healthy innovation, fair outcomes for customers and strong prudential regulation

Aligned to the strategic outcomes, we have developed five key priorities for the Bank:

1. Customer Numbers: Look to increase the number of Sainsbury's shoppers that are also our customers
2. Volatility: Target low earnings volatility under stressed conditions to safeguard capital
3. Asset Mix: In time, target 60% of lending to be secured, lowering overall risk levels
4. Efficiency: Reduce our cost/income ratio by leveraging the new banking platforms to build scale
5. Fee Income: To maintain this income source as it diversifies the income mix in a capital efficient way

Performance in the year is covered in the business review on page 3 and the financial review on page 13.

We have access to Sainsbury's customers through a large number of outlets, including Sainsbury's supermarkets and convenience stores, Argos stores and Habitat stores. This is in addition to the strong online presence, with an average weekly number of customer orders of 320,000 being made through the Sainsbury's groceries online platform.

Our short-term focus is to conclude the NBP transition whilst looking to utilise the platforms that have been completed to grow and diversify our balance sheet further. The new IT platforms will enable us to offer greater flexibility and simplicity to customers aligned with the principal of customer-focused values which will be critical in delivering the future strategy.

Business review

This year we've delivered what we promised, a New Bank Programme which sees Loans customers now on our own banking platform along with our Savings customers. We successfully launched and delivered a new Mortgage offering and delivered strong growth from our new Car and Home Insurance broker panel. We enhanced and continue to build our data and digital capabilities in order to deliver unique offers and excellent service to our customers.

The Bank achieved £62 million underlying profit, up 3% compared to 2017, with good trading across all products offset by planned strategic costs for the New Bank Programme as well as the launch of Mortgages. Financial performance is covered in more detail in the financial review on page 13.

We grew active customer numbers by 8% year-on-year in Bank, now exceeding 1.9 million. Over 81% of Insurance customers and 74% of banking customers have a Nectar card, in line with our strategy of being the bank for Sainsbury's customers.

Credit Cards performed strongly with a 40% year-on-year growth in new Credit Card sales. The Bank as a responsible lender and in line with the market and FCA guidance reviewed our lending criteria and rates available across Loans and Credit Cards to ensure we have appropriate and compelling offers. The launch of the New Bank Personal Loan platform enabled us to enhance the online customer journey including offering e-signatures and the adoption of faster payments. Around 70% of all new personal lending goes to Nectar card holders.

We've reduced the length of time available on our Balance Transfer Credit Cards in order to focus on the Purchase Credit Cards which drive greater value to the Group.

Our first full year on the New Bank platform for Savings saw strong growth in new accounts and deposit growth. New Savings account growth was up 41% year-on-year with growth in deposits up 21%; this includes a 32% growth in ISA and Fixed Term deposits.

Sainsbury's Bank Mortgages, which come with special rewards for Sainsbury's shoppers, were launched in April 2017 to help customers purchase a new home or re-mortgage. We've delivered a strong first year welcoming on board eight new broker partners, receiving over 3,000 applications and lending in excess of £275 million. The Bank continues to add new intermediary broker partners to build scale. In March 2018 the Bank launched Mortgages with a 95% loan to value helping First Time Buyers, and is set to launch Buy to Let Mortgages in the coming year. Our products continue to regularly feature in Best Buy tables.

Since launching our new Insurance broker panel model in February 2017, Car and Home Insurance have delivered strong sales. Car Insurance saw growth in new policy sales of 43% year-on-year and Home Insurance saw growth of 39%. By working with a broader base of underwriting partners and leveraging our data advantage we've been able to offer more quotes to more Sainsbury's customers, and give better discounts to Nectar customers underpinned by a more rewarding proposition.

In Travel Insurance, we launched an exciting new proposition with our new partner, Hood Group, and we are now able to offer Sainsbury's customers a more rewarding proposition with better choice, a better digital experience and also offer 'kids go free' cover. Sainsbury's Bank Pet Insurance was launched on Money Supermarket, a key aggregator sales channel, opening up another route for customers to access our products. We've also leveraged our unique supermarket position to collaborate and promote Life Insurance and offer unique incentives to our customers. Maintaining a strong commission based income business will enable us to diversify income and reduce volatility.

Travel Money continued to demonstrate significant double digit growth at 26% year-on-year, taking market share from both banks and high street competitors. This was against a highly competitive market where customers are increasingly rate savvy. We have seen 12 record breaking months in succession and have served over three million customers. We opened a further nine Travel Money bureaux, taking our estate to 241 bureaux. As well as an in-store service in convenient locations across the UK we offer an online, home delivery service. This year we launched a new money transfer service, provided by MoneyCorp, allowing customers to transfer up to £100,000 overseas.

Our free to use ATM estate grew by over 5% year-on-year to 1,825. ATM transactions stayed flat year-on-year and £1 of every £11 dispensed from a LINK ATM transaction is from Sainsbury's Bank. We continue to grow our ATM estate into Argos stores and we are also seeking further opportunities outside the Group to install ATMs into areas of deprivation, providing free access to cash in 'under banked' areas. Friday 22 December 2017 was the highest day on record with over one million transactions. The Bank is now successfully through the first year of utilising the enhanced capability of the new platform, with over 150 client advertising campaigns running on the ATM estate in the year, providing additional revenue. The Bank was recognised by the Bank of England as a leader in our deployment of the new polymer £10 notes.

Sainsbury's Bank is committed to delivering customer service that is convenient, reliable and helpful. Our website receives over 2 million visits every month, up 7% year-on-year. We have invested in the new capabilities needed to help respond to the increasingly digital world our customers live in. This is helping us bring together the range of complex technologies and partnerships that support the safe and reliable running of the Bank into re-usable services that allow us to construct the online and app experiences our customers are asking for. We've spent time this year increasing the speed and agility of how we deliver this sort of change as well as building New Bank teams, partnerships and technologies for the digital age. Our focus on service ensures that we continue to report industry low levels of customer complaints, consistently recording fewer than 1.3 complaints per 1,000 customer accounts over the last two years.

We've won industry awards for customer service and the quality of our products including Moneyfacts, Best Card Provider (Introductory Rate), What Mortgage, Best Home Insurance Provider and Your Money Best Online Loans Provider, five years in a row, and Best New Mortgage Provider, 2017 Moneynet.

The Bank successfully issued Tier 2 capital in November 2017 (which was significantly oversubscribed) providing access to market capital in addition to continued support from our parent. Our Tier 1 capital ratio increased to 14.1% in the year.

Risk overview

Introduction

Effective risk management is a core component of our strategy and operations. Our objective is to support the growth of the Bank by thinking broadly about risks and managing them in a proportionate manner. In order to achieve this we focus on:

- **Our risk principles:** we have set six key risk principles (see below) that provide a compass to guide the future direction of the Bank and promote an effective risk-aware culture throughout the Bank.
- **Our risk appetite:** we have set clear boundaries aligned to our risk principles that determine the level of risk which we are comfortable to operate with, in order to achieve our strategic objectives.
- **Our risk exposure:** we think about all risk types, their interactions and our mitigating actions. We look at both internal and external risk sources and the direct and indirect knock-on effects of each risk.

Our risk principles

Our six risk principles help us to build sustainable foundations that support our strategic plans and competitive advantage. They encapsulate a wide scope of strategic objectives and activities, from our target market to our target balance sheet shape to our focus on achieving fair outcomes for our customers. Our principles are:

Principle:	Good Customer Outcomes at the Heart of What We Do	Control Before We Grow	Our Customers are Sainsbury's and/or Argos Customers
Aim:	We are open, feel able to raise issues, use the right incentives and treat our customers fairly	We care about how our activities are done and focus our controls on the things that matter	We are disciplined in matching what we do to our competencies and serving our target market
Expressed through:	— Fair customer outcomes — Conduct risk appetite — Operational capability metrics	— Risk awareness ratings — Control effectiveness ratings — Minimise operational risk losses	— Customers with Nectar cards — Activity rates — Retention rates

Principle:	Identify and Manage Risk Concentrations	Fund Before We Lend	Anticipate Market Trends, Don't Follow Them
Aim:	We target an appropriate level of diversification across our asset portfolio, systems and supply chain	We have sufficient access to resources to support our plans and to manage exposure to stress	We provide insight on emerging threats and opportunities and manage volatility in our earnings
Expressed through:	— Diversification targets — Portfolio limits — Supplier risk management	— Capital adequacy targets — Liquidity targets — Funding targets	— Earnings stability targets — Use of data-driven insights — Market risk limits

Our risk appetite

We have set a risk appetite that is consistent with our risk principles. It provides a clear articulation of the level and types of risk that we are prepared to accept in order to achieve our strategic objectives and is expressed and embedded through:

- A 'high-level' Risk Appetite Statement – set and reviewed on an annual basis by the Board – that provides a concise set of key Bank-wide targets and limits, aligned to our risk principles and business strategy. It contains a balance between current, forward-looking and stress-based metrics.
- 'Directional' risk appetite limits that are set for each of the Bank's key risk types (e.g. retail credit risk, operational risk). Directional limits provide early indications of changes in the operating environment and whether we remain on-track to meet our 'high-level' risk appetite targets.

Our risk appetite enables us to make clear and transparent decisions on potential trade-offs between different aspects of our risk profile. In this way strategic decisions are made in the full context of those factors likely to be of interest to a range of stakeholders, enabling us to understand the Bank's current and future risk profile and how it supports our strategic objectives.

Our risk exposure

We have identified a set of primary risk types (see page 6) to which we are exposed through our activities. In line with our three lines of defence model, risks are owned and managed by our business functions with independent oversight provided by our dedicated risk management function and independent assurance provided by our internal audit function.

Each risk type is actively managed through primary risk policies and supporting policy standards that clearly articulate the rules, boundaries and measures by which the risks are controlled and help everyone to understand their individual responsibilities. This provides a consistent approach to risk awareness, risk behaviours and decision making. Our risk reporting processes are critical to understanding the aggregate level of risk to which we are exposed and the effectiveness of our controls to manage these risks. We promote insightful reporting at all levels to encourage debate on what matters most, and to ensure effective action is being taken to address any current or emerging areas of concern.

We also identify and manage specific material key risks that cut across our business areas and primary risk types (for example, cyber risks and IT failure). Each material risk is assessed on the basis of its inherent exposure, its residual exposure in the prevailing control environment and its target exposure where enhanced controls or mitigating actions are planned.

Key uncertainties

In line with our risk principle of "anticipate market trends, don't follow them", we regularly monitor changes in the risk environment to detect early signs of material threats and opportunities that could impact on our activities and risk profile, such as:

- Strategic threats and opportunities (e.g. changes in the competitive environment).
- Operational threats and opportunities (e.g. technological developments).
- Financial & economic threats and opportunities (e.g. the Bank of England's moves towards a normalisation of monetary policy and uncertainty arising from the Brexit process).
- Regulatory threats and opportunities (e.g. new regulations that the Bank is required to comply with).

As more information is known about an emerging risk, it will be subject to a full residual risk assessment and action plan, be risk accepted or be deemed to be not relevant or not material to the Bank.

Argos Financial Services (AFS)

These financial statements present the standalone financial performance and position of the Bank and do not consolidate the Argos Financial Services (AFS) subsidiaries. However, the risks associated with AFS business are managed in line with the Group wide risk framework, with a suite of risk appetite measures in place for AFS and tracked within the wider Group governance structure.

Principal risks

The Board of Directors retains overall responsibility for setting the Bank's strategy and principal risks (primary risk types detailed on page 6). These are actively managed by the Board Risk Committee (BRC) and Executive Risk Committee (ERC) in line with the guiding risk principles and overall risk appetite approved by the Board.

Primary risk types

Retail credit risk

Losses arising from a retail customer failing to meet their agreed repayment terms as they fall due.

How it may arise

Changes in the economic conditions in the UK may impact on the ability of our customers to repay their loans leading to an increase in levels of bad debt.

What has changed?

- Launch of mortgage products in 2017.
- Consumer credit lending criteria have been tightened in anticipation of a more challenging outlook.
- Development of our modelling capabilities in line with the implementation of IFRS 9 in March 2018.

How do we manage the risk?

- We lend responsibly, considering the suitability of the product to meet our customers' needs and their ability to repay any debt.
- We have policies in place to support vulnerable customers and those in financial difficulties.
- Credit decisioning based on information from a number of credit related sources.
- Regular stress testing is undertaken using a variety of plausible stress scenarios.

Operational risk

Losses resulting from inadequate or failed internal processes, people and systems or from external events.

How it may arise

Inadequate processes or internal controls may result in poor customer outcomes, service disruption, reputational damage and/or financial losses.

What has changed?

- New business models for Mortgages and Insurance.
- Transition to stand-alone platform for Loans.

How do we manage the risk?

- A process-centric approach.
- Investment in people, processes and technology to further improve our operational risk management.
- A supply chain management framework to manage operational risk across outsourced service providers.

Operational capability risk

Disruption to systems or processes which impact on web channels, telephony or the ATM network and ensuring adequate business continuity arrangements are in place.

How it may arise

Failure to protect systems and processes or have adequate recovery processes in place may impact on availability of services and lead to reputational damage.

What has changed?

- New business models for Mortgages and Insurance.
- Transition to stand-alone platform for Loans.
- Expansion of customer contact centre in Rosyth.
- Operational capability assessment for key suppliers.

How do we manage the risk?

- Performance is monitored on a regular basis with triggers in place for timely escalation.
- Incident Management Plan is in place and tested.
- A combined crisis management capability has been created across the Bank and AFS.
- Outsourced services managed via key Service Agreements with a range of SLAs.

Conduct and compliance risk

Failing to meet the letter and spirit of all relevant legislative regulatory and customer conduct requirements.

How it may arise

Failure to understand the needs of our customers or to provide them with the level of service required at all stages of the customer journey.

What has changed?

- Responsibility Map updated to reflect changes in the Bank's structure in line with SMCR requirements.
- Programme underway to align approach to conduct and compliance risk across AFS and the Bank.

How do we manage the risk?

- Control procedures and processes in place, with clear reporting and escalation procedures.
- Central team provide advice and support on conduct and compliance issues, with a monitoring and assurance plan for processes and controls.
- Horizon scanning of emerging threats or changes in the regulatory environment.
- Regular and open engagement with PRA and FCA.

Capital adequacy risk

Holding insufficient capital to absorb losses in normal and stressed conditions or the ineffective deployment of capital.

How it may arise

Changes in economic conditions or regulatory requirements may impact on the level of capital resources required.

What has changed?

- Phasing-in of CRD IV regulatory requirements.
- Issuance of Tier 2 capital in November 2017.

How do we manage the risk?

- Daily monitoring and reporting of capital position, with triggers in place for escalation.
- Capital adequacy built in to our strategic planning and capital plans.
- The annual ICAAP review determines the adequacy of the level and type of capital resources held.

Liquidity and funding risk

The risk that the Bank is unable to meet its obligations as they fall due or can only do so at excessive cost.

How it may arise

Loss of confidence in the Bank leading to a material and rapid outflow of savings deposits and/or difficulties in accessing wholesale funding markets.

What has changed?

- Launch of mortgages and implications for our liquidity and funding profile.
- Further utilisation of the Term Funding Scheme with appropriate consideration of re-financing risk.

How do we manage the risk?

- Daily monitoring and reporting of key Liquidity and Funding EWIs, with triggers in place for escalation.
- Liquidity and funding targets built in to our strategic planning and capital plans.
- The annual ILAAP review determines the adequacy of liquidity and funding plans.
- Liquidity Contingency Plan in place with identified management actions under stress conditions.

Market risk

The risk of loss as a result of the value of financial assets or liabilities (including off balance sheet instruments) being adversely affected by movements in market rates or prices.

How it may arise

The Bank does not have a trading book, but is exposed to the impact of sudden changes in interest rates on its lending book as well as market risk in the assets held for liquidity purposes.

What has changed?

- Mortgages included within the Bank's market risk monitoring process and strategy.

How do we manage the risk?

- A range of market risk limits are in place. Exposures are modelled and reported on a regular basis.
- Hedging risk management strategies used to reduce exposures to earnings volatility.
- Behavioural assumptions are applied to the treatment of non-interest bearing balances and expectations within the Bank's balance sheet.

Wholesale credit risk

Losses arising from institutional counterparties failing to meet their contractual cash flow obligations.

How it may arise

Default or downgrades in the credit rating of counterparties.

What has changed?

- Composition of Liquid Asset Buffer regularly reviewed and tested.

How do we manage the risk?

- Counterparty limits and credit assessment process are in place to control exposure levels.
- Key ratios are monitored and reported on a daily basis with triggers in place for escalation.
- Investment activity for liquid assets focused on a small set of asset classes with proven credit performance.

Non-financial reporting

The Bank has complied with the new EU non-financial reporting directive requirements contained in sections 414CA and 414CB of the Companies Act 2006. The below disclosures are intended to help stakeholders understand the Bank's position on key non-financial matters.

Business model

The Bank seeks to provide quality financial services to Sainsbury's Argos customers at an affordable price. The business model is outlined on page 1 of the Strategic Report.

Environmental

We are always looking for ways to manage the impact our operations have on our environment. As part of Sainsbury's, our facilities management approach actively manages, and looks to continuously improve, our waste management and recycling, including food waste. We use video and telephone conferencing facilities rather than travel to meetings, where possible. Colleagues are encouraged to use public transport and cycle to work, with shower facilities provided on site. We take time to identify practical ways to reduce the environmental impact of our leaflets and Point of Sale materials in stores.

Additionally, we have invested in the new capabilities needed to help respond to the increasingly digital world our customers live in. This investment will help to drive more sustainable banking. For example, the new Loans platform affords the Bank the ability to offer an e-signature facility thus removing the requirement to both generate and send physical Personal Loan documentation.

Social

The Sainsbury's Group Values and Sustainability Plan underpin our approach to what we do, and how. By acting in the best interests of all our stakeholders, we can make a sustainable and positive contribution to our community. We also know that playing an active and supportive role in our community is really important to our colleagues. It makes us all feel good to know we're doing something for someone else.

Our customers

Here at Sainsbury's Bank we recognise that money influences all areas of our customers' lives. Whether it's during their daily commute to work or in planning a holiday with their family, we know how important saving money and savvy spending is to today's families. We want to help families get the most out of their life, today, tomorrow and in the future.

Our publication 'Money Matters', both in print and as a blog, offers readers practical ideas about how to get the most out of their busy lives. From money-saving ideas to family travel tips, Sainsbury's Bank customers are the driving force behind every Money Matters article and blog post. It's a resource just for them – a place to discover valuable information and share ideas on how to live life to the fullest.

Charity

In 2017/18, our colleagues raised over £33,000 for our charity partner, Bobath. Our support has ensured that nine families living with the daily challenges that cerebral palsy brings have been able to access help when they've most needed it.

We also support the fantastic fund-raising activity that Sainsbury's does each year including Comic and Sport Relief.

Employees

We aim to make our Bank a great place to work for all colleagues. We want our people to develop their skills and knowledge to be the best they can be, learning from each other, their managers and through structured learning activity that develops behavioural and technical capability. How it feels to work at our Bank makes us different because our Values guide everything we do. Cornerstones of our approach include investing time in two-way communication between leaders and other colleagues – informing and listening – and building trust through clear accountabilities and leadership. We check in with our colleagues regularly to gather their feedback on what we do well and how we can improve how it feels to work for the Bank.

We are committed to an equal opportunities policy for recruitment and selection, through training and development and to performance reviews and promotion. The Bank has well developed policies for the fair and equal treatment of all colleagues and the employment of disadvantaged persons.

During the year, a number of training courses have been held to ensure that our policies are understood throughout the organisation. We have a workplace adjustments process in place for our colleagues who are living with a disability or long-term health condition which operates through the Government's Access to Work scheme. Workplace adjustments can be made at any point during a colleague's employment with us.

In support of the wider objectives of the J Sainsbury plc Group, our colleagues are encouraged to participate in two all employee share plans for colleagues, namely the Savings-Related Share Option Plan ('Sharesave') and the All-Employee Share Ownership Plan, of which the Sainsbury's Share Purchase Plan ('SSPP') is a part.

As part of the Sainsbury's Group, the Bank supports the Group's vision to become the 'most inclusive' retailer by embracing our differences across the Bank. The activities we're undertaking to be a more diverse and inclusive organisation are fundamentally about fairness, equality and inclusion for men and women. A balanced workforce at all levels improves culture, behaviours, outcomes, profitability and productivity. With this diversity comes a diversity of ideas and views that inform decision-making and enable us to understand our customers better.

In response to colleague feedback, the Bank and Group have worked together to put an affordable colleague loan scheme in place with third party Salary Finance. Salary Finance take loan repayments directly from colleagues' pay via payroll. This means loan interest rates are often lower and a wider range of criteria can be used than most lenders when reviewing and approving loan applications. Colleagues' applications are assessed to make sure the loan is appropriate and affordable for them.

Gender pay gap

Details of the Bank's gender pay gap can be found within the Sainsbury's Group disclosures at https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/sainsbury-group-gender-pay-report-2017.pdf.

The mean gender pay gap of 39.45 (as at April 2017) is reflective of the structure of our business. Nearly half of Bank colleagues work in our Travel Money bureaux and are employed directly – not via a third party. Nearly three quarters of these hourly paid roles are held by women.

In addition, more men than women hold senior positions, with larger salaries and bonus potential. 20.7% of our senior managers and directors are women.

The Bank has signed the HM Treasury Women in Finance Charter, pledging to set targets and improve the gender balance and diversity of our senior team. Progress against these targets will be published on an annual basis and the variable pay of the senior executive team is linked to the delivery of our gender diversity targets.

Human rights and modern slavery

Sainsbury's Bank has a zero tolerance towards modern slavery and human trafficking. We are committed to acting ethically and with integrity in all of our business relationships. We will work closely with our business partners, suppliers and supply chains to ensure there is no place for modern slavery and human trafficking in any area of our business. We will regularly review our processes and controls to prevent modern slavery and human trafficking.

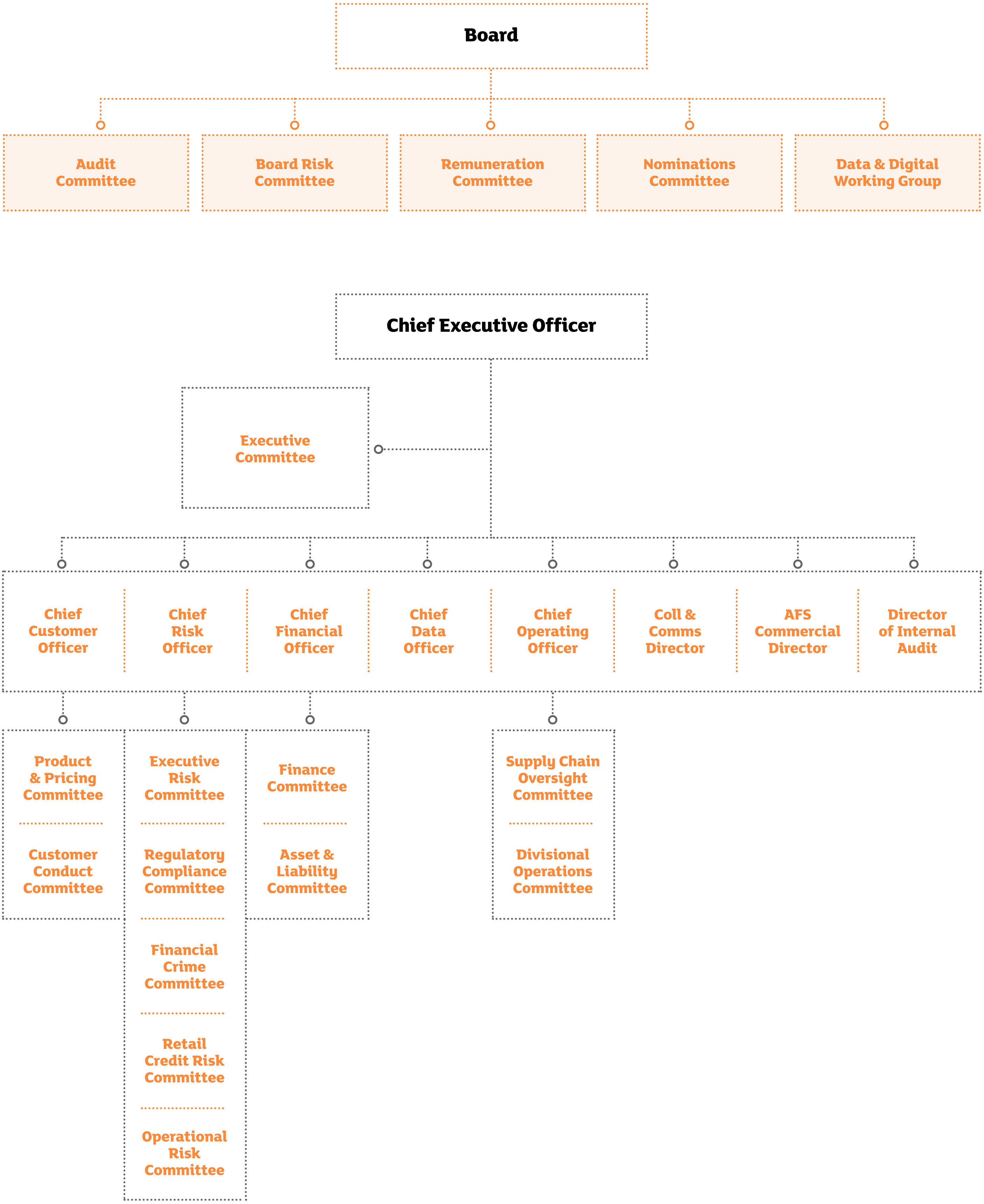
Our policies and procedures support and encourage colleagues to raise concerns relating to modern slavery or the presence of it in our supply chain at the earliest opportunity. Our full Modern Slavery statement is published on the Bank's website (https://www.sainsburysbank.co.uk/~/media/files/pdf/modern-slavery-statement.pdf).

Anti-Corruption/Anti-Bribery

As a financial services provider, the Bank is exposed to the risk of facilitating bribery or aiding corruption through the provision of financial services. This risk is managed through a clear set of policies, procedures and controls which are communicated to colleagues through regular mandatory training modules including Anti-Bribery and Corruption, Anti-Money Laundering, Conduct Rules, Conflicts of Interest and Whistleblowing. The training material is reviewed and updated to reflect changes in legislation (e.g. Criminal Finances Act 2017) or best practice (e.g. tailored senior management training). The Supply Chain Management team regularly monitors suppliers to ensure that processes and controls are in line with the Bank's required standards.

Governance

The diagram below shows the Governance structure in place for Sainsbury's Bank as at 28 February 2018.



Key changes in the accounting period

Additions:

Financial Crime Committee

In 2017 a Financial Crime Committee was established, chaired by the Money Laundering Reporting Officer (MLRO) and reporting to the Chief Risk Officer, to provide additional specialised oversight and reflect changes in UK legislation.

Removals:

Transition Committee

The Transition Committee reported to the Board and oversaw delivery of the New Bank Programme and the transition to new banking platforms, systems and processes following the transfer of full ownership to J Sainsbury plc in 2014. Following the successful launch of the Insurance, Savings and Loans platforms in 2017 a decision was made to disband this Board Committee from January 2018, with responsibility for any outstanding activity being monitored by the Board Risk Committee.

Transition Steering Committee (TSC)

The Executive-level TSC was also disbanded in January 2018. The remaining New Banking Programme migrations fall within the remit of the Chief Operating Officer with oversight undertaken through the relevant risk and operational committees.

Investment and Strategy Committee (ISC)

The ISC advised and assisted the Chief Financial Officer (CFO) in making significant decisions relating to the Bank's strategy, strategic investments in line with the Bank's agreed strategic priorities and agreed risk appetite. This Committee was disbanded with effect from July 2017 with responsibility for any outstanding activity remaining with the accountable individual.

Board-level governance

The Board is the key governance body, holding overall accountability for the decisions made and outcomes achieved by the Bank, subject to specific reserved matters that require the consent of J Sainsbury Plc. The Board meets at least seven times a year and is comprised of an independent Non-Executive Chairman, other Independent Non-Executive Directors, Non-Executive Directors from J Sainsbury plc and key Executive members from the Bank. Further details on the Board composition may be found on page 16.

A number of Board functions are delegated to four key sub-committees. The role and scope of authority for each sub-committee is fully outlined in a documented Terms of Reference:

- Audit Committee. The Audit Committee's key responsibility is to advise the Board on the Sainsbury's Bank Group financial statements, including systems and controls and related policy issues together with relationships with external auditors. The Audit Committee also reviews and challenges where necessary management's response to any major external or internal audit recommendations. The Committee is also responsible for reviewing and approving the internal audit plan and budget, and for ensuring that the function is adequately resourced. The Audit Committee meets at least four times a year. At least once a year the Audit Committee will meet without executive management being present. Additionally, the Audit Committee will meet with the external auditors and Sainsbury's Bank Director of Internal Audit.
- Nominations Committee. The Nominations Committee is responsible for reviewing the structure, size and composition of the Board. The Committee is also responsible for the 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. The Bank recognises the benefits of achieving a diverse Board and Executive Management Team to reflect the environment in which it operates. The Nominations Committee will meet at least once per year, with additional meetings convened as required.
- 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 and it continually reviews and assesses the impact of remuneration policies on the risk profile of the Bank and employee behaviour. RemCo also has oversight over appointment and severance terms for relevant employees. The Remuneration Committee meets at least three times per year.
- Board Risk Committee. The Board Risk Committee (BRC) provides the Board with a forward-looking view to anticipate future risks together with the monitoring and oversight over existing risks within the risk appetite set by the Board. 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. The Board Risk Committee meets at least on a quarterly basis.

Executive-level governance

The Board delegates the appropriate responsibility, authority and accountability to the Chief Executive Officer (CEO) to deliver the Bank's strategy through the appropriate governance committees and Executive Management Team. The CEO chairs the Executive Committee (ExCo) and is supported by a number of other executive-level committees to provide the appropriate checks, balances and transparency on decision making.

Each committee has a documented Terms of Reference, with delegated authority to the Chair who is the appropriate identified accountable individual in line with their Statement of Responsibilities under FCA and PRA rules (Senior Manager Regime).

CEO Executive Committee:

Executive Committee (ExCo)

The role of the Committee is to advise and assist the CEO in overseeing the Bank's activities, performance and making significant decisions relating to the executive management of the Bank. ExCo meets on a monthly basis.

CRO Executive Committees:

Executive Risk Committee (ERC)

The ERC is responsible for ensuring that the Enterprise Wide Risk Management Framework (EWRMF) is effective in ensuring that risks are adequately and consistently managed within risk appetite. In doing so the ERC ensures that appropriate policies and methodologies are in place to manage the Bank's primary risk types. The ERC meets on a monthly basis.

Retail Credit Risk Committee (RCRC)

The RCRC is responsible for monitoring the performance of the retail lending book, ensuring there is an effective credit risk management framework and that the Bank is operating within its credit risk appetite. The RCRC meets on a monthly basis.

Operational Risk Committee (ORC)

The ORC assesses the adequacy and effectiveness of the overall risk framework and control environment of the Bank. It forms a view on the aggregate operational risk position relevant for both a control awareness (CA) and control environment (CE) assessment and meets six times a year.

Regulatory Compliance Committee (RCC)
The role of the committee is to oversee delivery of an effective Bank-wide compliance risk management framework that ensures all compliance (including Anti Money Laundering (AML) and Sanctions) and conduct risks are managed within the Bank's approved risk appetite. The RCC meets six times a year.

Financial Crime Committee (FCC)
The role of the committee is to provide oversight of the firm's end to end Financial Crime (FC) control and governance framework to ensure that it is: fully implemented, compliant and effectively managing the Bank's FC risk within agreed risk appetite. The committee is chaired by the Money Laundering Reporting Officer (MLRO) and reports direct to the CRO. The FCC meets on a monthly basis.

CFO Executive Committees:
Asset and Liability Committee (ALCo)
The ALCo is responsible for ensuring the balance sheet of the Bank is managed effectively and within risk appetite with its main areas of responsibility being market risk, wholesale credit risk, interest rate risk, liquidity & funding risk and capital adequacy. The ALCo meets monthly.

Finance Committee
The role of the committee is to ensure there are effective levels of governance in place across the Bank's finance function so that significant decisions are fully informed, transparent, recorded and reported and in line with risk appetite and relevant governance structures. The Finance Committee meets monthly.

Chief Customer Officer (CCO) Executive Committees:
Product Governance and Pricing Committee
The role of the committee is to oversee and maintain a product portfolio and pricing structure which enables the Bank to meet its commercial and strategic objectives within risk appetite parameters and to manage tactical decisions regarding pricing, product terms and conditions, and product/channel alignment.

Customer Conduct Committee
The role of the committee is to ensure that the Bank provides customers with fair outcomes in line with the FCA's requirements around Treating Customers Fairly and Conduct Risk, and the Bank's own Conduct Risk Policy framework and risk appetite. The Customer Conduct Committee meets monthly.

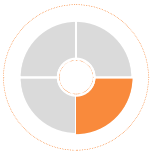
Divisional Risk Committees
Each division across the Bank has its own Divisional Risk Committee (DRC) chaired by the relevant ExCo member. The role of the DRC is to ensure the effectiveness of the EWRMF within the division, so that risks are effectively and consistently managed within the overall approved risk appetite. Each DRC provides input on material risks which may affect the Group to the Executive Risk Committee.

Pillar 3 report
Further information on the risks and controls can be found in the Bank's Pillar 3 Disclosure Report for the year ended 28 February 2018. This report is published in the investor relations section of the J Sainsbury plc corporate website: www.about.sainsburys.co.uk/investors/results-reports-and-presentations#2018.

Key performance indicators

Maintain strength and sustainability

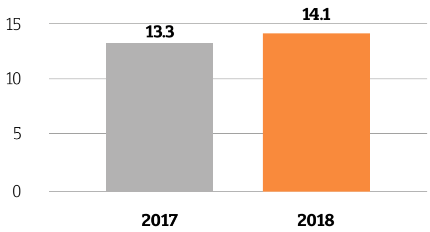
Our regulators know that we challenge the market through healthy innovation, fair outcomes for customers and strong prudential regulation



Common equity tier 1 capital ratio

Definition: Tier 1 capital as a percentage of risk-weighed assets.

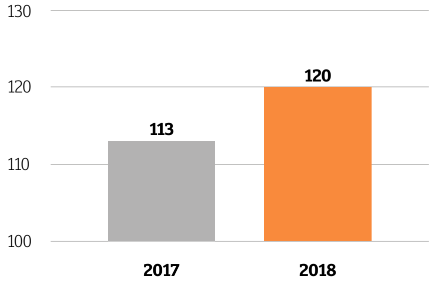
Common equity tier 1 capital ratio (%)



Net stable funding ratio

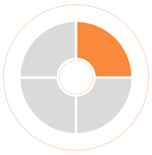
Definition: Amount of available stable funding (ASF) relative to the amount of required stable funding (RSF) over a one-year time horizon, assuming a stressed scenario.

Net stable funding ratio (%)



Financial performance

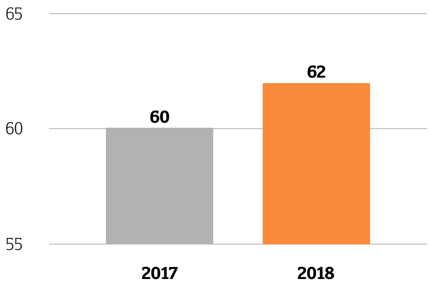
Our shareholders see that we drive value to the Group



Underlying profit before tax

Definition: Profit before tax before any one-off items that are material and infrequent in nature.

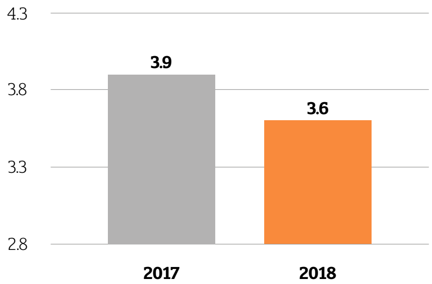
Underlying profit before tax (£'m)



Net interest margin

Definition: Net interest income as a percentage of average interest earning assets.

Net interest margin (%)

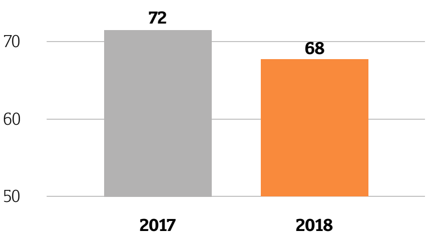


Efficiency

Cost : Income ratio (underlying)

Definition: Underlying operating expenses as a percentage of total income.

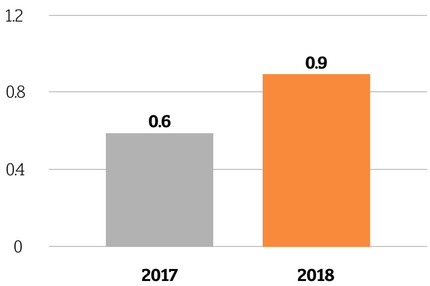
Cost : income ratio (%)



Bad debt asset ratio

Definition: Impairment losses as a percentage of the average balance of loans and advances to customers.

Bad debt asset ratio (%)

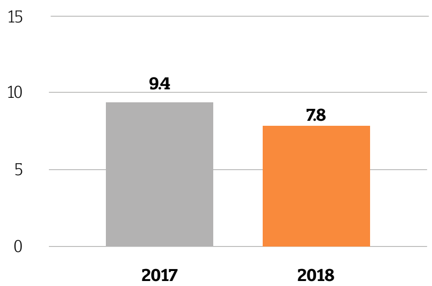


Value

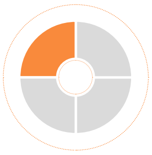
Return on tangible equity

Definition: Underlying profit after tax divided by average tangible equity (equity excluding intangible assets).

Return on tangible equity (%)

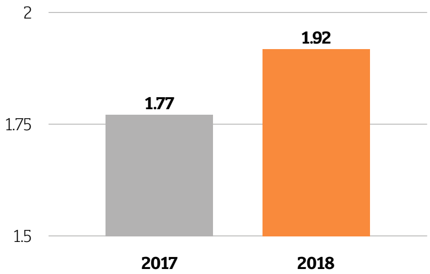


Our customers will trust us, supporting them as their needs change over time

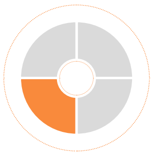


Number of active customers
Definition: The number of customers who hold an active account (savings/loans/credit card/insurance policy).

Active customers (million)

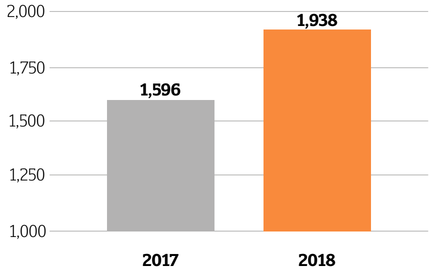


Our colleagues know that Sainsbury's Bank is a great place to work where they are fairly rewarded and get great development



Number of colleagues
Definition: The average number of full time and part time colleagues throughout the financial year.

Number of colleagues



Our performance, including reference to the above KPIs, is further outlined in the business review on page 3 and the financial review below.

Financial review

The Bank's performance for the year ended 28 February 2018 and financial position at the end of that period are presented in the income statement and balance sheet. A summarised income statement and balance sheet are presented below:

Summary income statement	2018 £m	2017 £m	Change %
Total income	**326**	285	14.4
Operating expenses	**(260)**	(265)	(1.9)
Add: items excluded from underlying results[1]	**38**	60	(36.7)
Underlying operating expenses	**(222)**	(205)	8.3
Impairment losses on financial assets	**(42)**	(22)	90.9
Realised gains on financial instruments	**–**	2	(100.0)
Underlying profit before taxation	**62**	60	3.3
Statutory profit before taxation	**25**	–	100.0

1 Expenditure excluded from the underlying performance relates to transitional costs connected to the migration of data and other services to the Bank's new infrastructure and operating model. Any increased operational costs arising as a result of the new operating model that will form part of the Bank's cost base going forward have been included in underlying operating costs.

Statutory profit before tax for the year ended 28 February 2018 was £25 million compared to a profit of £nil in the prior year. This was driven by a 3.3% increase in underlying profits and a 36.7% reduction in the non-underlying items relating to the transition to the Bank's own core banking platforms.

Income growth driven by higher customer lending and Travel Money sales was partially offset by a marginal reduction in Insurance income.

Underlying costs increased by 8.3% reflective of strategic product development in Mortgages and Insurance and a full year of the costs associated with the new Savings platform which launched in the prior year. Impairment losses increased as a result of lending growth and loss rates experienced at the upper end of the Bank's risk appetite; however, the bad debt asset ratio remains low and is reflective of the Bank's low risk appetite to credit losses.

Summary balance sheet	2018 £m	2017 £m	Change %
Loans and advances to customers	**4,972**	3,962	25.5
Cash and cash equivalents	**988**	461	114.3
Other	**1,805**	1,371	31.7
Total assets	**7,765**	5,794	34.0
Customer deposits	**4,980**	4,101	21.4
Wholesale funds	**1,543**	820	88.2
Other	**174**	–	100.0
Total liabilities	**125**	142	(12.0)
	6,822	5,063	34.7
Net assets			
	943	731	29.0

Customer lending grew by 25.5% during the year. The Bank has consistently remained near the top of price comparison tables during the year in relation to Personal Loans and Credit Cards and the new Mortgage offering was launched in the year which resulted in growth in active customers and overall increased lending. Liquid assets have increased to reflect increased liquidity requirements given the growth in customer lending.

The increase in retail and wholesale funding reflects the additional funding required due to the growth in lending and to support liquidity requirements. The Bank also received significant funding from the issue of Tier 2 loan notes in November 2017 and utilised the Bank of England Term Funding Scheme prior to its closure in February 2018.

J Sainsbury plc continues to support the Bank's investment in systems and provided additional share capital of £190 million during the year.

Net interest income

Net interest income summary	2018 £m	2017 £m	Change %
Interest receivable	**261**	224	16.5
Interest payable	**(65)**	(61)	6.6
Net interest income	**196**	163	20.2
Net interest margin	**3.6%**	3.9%	(30) bps

Summary of funds lent to customers and held as liquid assets	2018 £m	2017 £m	Change %
Loans and advances to customers	**4,972**	3,962	25.5
Cash, balances with central banks and other demand deposits	**876**	403	117.4
Financial investments – available for sale	**648**	398	62.8
	6,496	4,763	36.4

Summary of funds raised	2018 £m	2017 £m	Change %
Customer deposits	**4,980**	4,101	21.4
Other deposits	**1,231**	509	141.8
Other borrowed funds	**312**	311	0.3
Subordinated debt	**174**	–	100.0
	6,697	4,921	36.1

Interest income grew to £261 million as the Bank's increased lending on Personal Loans, Credit Cards and Mortgages resulted in top line growth. Market rates on Personal Loans fell during the year and the Bank remained competitive, consistently positioning near the top of price comparison tables. Interest rates on customer deposits broadly fell in line with lending rates. Margin pressure on unsecured lending, the impact of secured lending growth and the additional Tier 2 funding raised in the year contributed to an overall 30 basis points reduction in net interest margin.

Fee, commission and other operating income

Fee, commission and other operating income summary	2018 £m	2017 £m	Change %
Banking income	**72**	72	–
Insurance income	**23**	24	(4.2)
Other income	**2**	1	100.0
Total fees and commissions receivable	**97**	97	–
Other operating income	**33**	25	32.0
Total fee, commission and other operating income	**130**	122	6.6

Growth in the Bank's Travel Money business, which continued to see new bureaux open in the Sainsbury's store network during the year, contributed to growth in total fee, commission and other operating income. Travel Money transactions grew by 26% which is reflected in the 32% growth in other operating income. Insurance income was slightly reduced following the launch of the new insurances operation in the year which saw the Bank strategically price more competitively in order to grow volumes.

Operating expenses and investment

Operating expenses summary	2018 £m	2017 £m	Change %
Underlying staff costs	**64**	59	8.5
Marketing costs	**20**	24	(16.7)
Other underlying operating costs (including depreciation and amortisation)	**138**	122	13.1
Underlying operating expenses	**222**	205	8.3
Non-underlying items	**38**	60	(36.7)
Total operating expenses	**260**	265	(1.9)

Underlying operating expenses of £222 million increased by £17 million year-on-year. Staff costs increased by 8.5% driven by growth in colleague numbers resulting from operations going live on the Bank's own infrastructure, and also continued growth in the Travel Money estate. Other operating costs increased by 13.1% and included higher ATM maintenance driven by growth in the estate and higher costs related to strategic product development such as Mortgages and Insurance. Following the successful migration of Savings customers in September 2016, this year also includes operational costs of the new platform including a £6 million amortisation charge from the related intangible asset. These increases were offset by a 16.7% reduction in marketing costs.

Non-underlying costs associated with the transition of Sainsbury's Bank from Lloyds Banking Group to its own banking platforms totalled £38 million in the year. The reduction from 2016/17 was reflective of the Savings migration that took place in the previous financial year.

Summary of fixed assets	2018 £m	2017 £m	Change %
Intangible assets	**204**	146	39.7
Property, plant and equipment	**44**	44	–
	248	190	30.5

Intangible assets were £204 million, an increase of £58 million since prior year. This was mainly due to the additions of £69 million reflecting capitalisation of software development in relation to the loans and cards platforms, and development of systems to support the launch of mortgages. There were no write offs or impairments arising.

Impairment losses on financial assets

Impairment losses summary	2018 £m	2017 £m	Change %
Impairment losses on financial assets	**42**	22	90.9
Bad debt asset ratio	**0.9%**	0.6%	30 bps

Impairment losses on lending increased by £20 million year-on-year. This was partly driven by the 25% year-on-year lending growth. The increase in the bad debt asset ratio was driven by higher loss rates experienced on unsecured personal lending following a strategic decision to test lending to customers with a higher credit risk profile. Higher risk lending has now stopped at approximately £150 million and our arrears performance remains considerably better than industry benchmarks. The non-performing asset coverage ratio remained flat at around 70% year-on-year.

By order of the Board

Peter Griffiths
Chief Executive Officer
4 May 2018

Directors' Report

The Directors have the pleasure in submitting their Annual Report and the financial statements of Sainsbury's Bank plc ('the Bank') for the year ended 28 February 2018.

Board of Directors

The Board comprises four Executive Directors and eight Non-Executive Directors. The position and remuneration of members who served during the year is described in the following table:

Name	Position	Remunerating entity	Appointment/ resignation date
Mr Roger Davis	Chairman (Independent Non-Executive)	Sainsbury's Bank plc	
Mr Peter Griffiths	Chief Executive Officer	Sainsbury's Bank plc	
Mr David Arden	Executive	Sainsbury's Bank plc	Resigned 18 March 2018
Ms Gwyn Burr	Non-Executive	Sainsbury's Bank plc	
Ms Marcia Campbell	Independent Non-Executive	Sainsbury's Bank plc	
Mr Peter Clarke	Senior Independent Non-Executive	Sainsbury's Bank plc	Appointed 22 February 2018
Mr Graeme Forrester	Executive	Sainsbury's Bank plc	
Mr David Jones	Executive	Sainsbury's Bank plc	
Mr Richard Keys	Independent Non-Executive	Sainsbury's Bank plc	Resigned 30 June 2017
Ms Angie Risley	Non-Executive	J Sainsbury plc	
Mr John Rogers	Non-Executive	J Sainsbury plc	
Mr Michael Ross	Independent Non-Executive	Sainsbury's Bank plc	
Mr Andrew Simmonds	Independent Non-Executive	Sainsbury's Bank plc	
Mr Guy Thomas	Independent Non-Executive	Sainsbury's Bank plc	Appointed 31 July 2017

Unless otherwise stated above, all of the Directors in office at the date of this report served throughout the period, and up to the date of approval of these financial statements.

Board selection criteria

We regard succession at Board and senior management level as a key priority. Recruitment into the Board combines an assessment of both technical, leadership capability and competency skills to ensure the optimum blend of individual and aggregate capability having regard to our long-term strategic plan. Board recruitment is subject to the approval of the Nominations Committee, the Board and the relevant regulatory bodies (PRA/FCA).

Board diversity

We are committed to promoting a diverse and inclusive workplace at all levels, reflective of the communities in which it does business, and our diversity and inclusion vision aligns with that of our parent J Sainsbury plc whose aim is to be 'the most inclusive retailer'. We will achieve this aspiration by recruiting, retaining and developing diverse and talented people and creating an inclusive environment where everyone can be the best they can be and where diverse views are listened to. The Nominations Committee is responsible for ensuring there is an appropriate balance of skills and experience across the Board.

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. 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.

Colleagues

Refer to the Non-financial reporting section on page 8 for the Bank's policies on colleagues and the employment of disabled persons.

Charitable and other donations

During the year the Bank made charitable donations in the UK of £41,661 (2017: £43,823). No political donations were made during the year (2017: £nil).

Independent auditors

Ernst & Young LLP were appointed as auditors of the Bank during the year and have expressed their willingness to continue in office.

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.

Financial risk management

Details of the use of financial instruments, together with risk management disclosures, can be found in note 33 and the risk management section in the Strategic Report on pages 4 to 7.

Future developments

The development of the Bank is set out in the Strategic Report on pages 3 to 4.

Post balance sheet events

There are no significant events affecting the Bank that have arisen between 28 February 2018 and the date of this report that require disclosure.

Going concern

The Directors have considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance.

The risk management framework as described in the Strategic Report on page 4 is considered adequate in managing liquidity and other key risks in the current environment. 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 33.

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, economic and legal scenarios. Consequently the going concern basis continues to be appropriate in preparing the financial statements.

Dividends

The profit after tax for the year attributable to the shareholders is £19 million (2017: loss after tax of £4 million). The Directors do not recommend payment of a dividend (2017: £nil).

By order of the Board and signed on its behalf by

Peter Griffiths
Chief Executive Officer
4 May 2018

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 Sainsbury's Bank plc ('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 in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs as adopted by the EU is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Bank has complied with IFRSs as adopted by the EU, subject to any material departures and explained in the financial statements.

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 Annual Report and Financial Statements and Pillar 3 disclosures included on the J Sainsbury plc 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

Peter Griffiths
Chief Executive Officer
4 May 2018

Independent Auditors' Report

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

Opinion

We have audited the financial statements of Sainsbury's Bank plc for the year ended 28 February 2018 which 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 1 to 40, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the financial statements:

- give a true and fair view of the Bank's affairs as at 28 February 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditors' responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Bank's ability to continue to adopt the going concern basis of accounting for a period of at least 12 months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	— Measurement of the provision for impairment relating to loans and advances to customers on unsecured loans and credit cards; — Appropriateness of the recognition of intangible assets capitalised in the year and the assessment of whether intangible assets are impaired (including the risk of management override of internal control); — Measurement of the effective interest rate adjustment (including the risk of management override of internal control); and — Deficiencies in IT general controls at an outsourced service provider.
Materiality	— Overall materiality was £3.1 million which represents 5% of underlying profit before tax. (As shown on the face of the Income Statement.)

First year audit

As part of our first year as auditors, to establish an audit base, we reviewed the predecessor auditors' working papers to understand the nature and extent of procedures performed as well as the identification and assessment of risks, judgements and potential audit and accounting issues to enable us to conclude that the comparative balances and opening position were appropriate.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Measurement of the provision for impairment relating to loans and advances to customers on unsecured loans and credit cards		
Provision for impairment (2018: £95 million, 2017: £78 million) Refer to note 13 of the financial statements. Customer receivables comprise unsecured personal loans; credit cards; and mortgages. Credit provisions represent management's best estimate of impairment under accounting standards and judgements are made in determining that estimate. The risks, as we see them, are that: (a) the data used in making the estimate is not complete and accurate; (b) the judgements made are not appropriate (especially the liquidation outcome period, emergence period and provision rates); and, (c) the calculation methodology is not applied correctly.	(a) We performed testing over data integrity and clerical accuracy of the model inputs on a sample basis. We did this by independently tracing a sample of customer data relating to up to date arrears and recoveries categories feeding the model. We obtained the Statistical Analysis System (SAS) codes used to extract the data from the source systems and assessed the reasonableness of the codes being in line with the requirements of the methodology. (b) We assessed the appropriateness and challenged management's detailed review of all provision assumptions (including liquidation outcome period, emergence period and provision rates) used in the methodology and the impairment model with reference to historical data. We challenged model overlays for appropriateness using our knowledge and experience across the industry. (c) We tested that the calculation methodology was appropriate and had been correctly applied by recalculating the provision.	We gained reasonable assurance over the completeness of data including the SAS codes used by management in their model and identified no overall material differences in our recalculation of collective and individual provision amounts. We consider the assumptions and model overlays used by management to be appropriate, and consistent with our knowledge and current economic and market data. We found the application of the calculation to be appropriate in all material respects. In addition, we performed procedures over the implementation of IFRS 9 models supporting the impact disclosure in note 1 of the accounts and concluded the disclosure was reasonable.
Appropriateness of the recognition of intangible assets capitalised in the year and the assessment of whether intangible assets are impaired (including the risk of management override of internal control)		
Intangible asset – net book value (2018: £204 million, 2017: £146 million) Refer to note 18 of the financial statements In accordance with accounting standards, the Bank is able to capitalise some of its development costs in relation to the New Bank Programme if it is probable that future economic benefits will flow to the entity and the cost of the asset can be measured reliably. The risks, as we see them, are that amounts capitalised: (a) do not meet the criteria to be recognised; and, (b) are greater than the probable future economic benefit to the entity. Additionally, there is a risk that management might override internal control to achieve an accounting result.	(a) We tested a sample of additions in the year to ensure that their capitalisation was appropriate in accordance with IAS 38. (b) We reviewed the assessment of the impairment of the intangibles and reviewed the key judgements and assumptions. Additionally, on a sample basis, we performed journal testing to ensure that the amounts capitalised were appropriate and for indications of management override of internal control.	We found the capitalisation of assets to be reasonable. We stressed the balance sheet growth and cost of capital assumptions to determine the relative sensitivity of inputs. We noted that even using combinations of stress factors, headroom remained. We gained assurance that there was no evidence of management override of internal controls.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Measurement of the 'effective interest rate' ("EIR") adjustment (including the risk of management override of internal controls)		
EIR asset (2018: £39 million, 2017: £14 million) Refer to note 13 of the financial statements Accounting standards require that interest income on personal loans, credit cards and mortgages is recognised at the effective interest rate (EIR). For products with introductory rates, such as credit cards and mortgages, where the reversionary interest rate in future years is expected to be greater, but receipt of such interest income depends on the customer remaining with the Bank, there is significant judgement involved in forecasting customer behaviour and estimating the future expected cash flows. The risks, as we see them, are that: (a) the data used in making the estimate is not complete and accurate; (b) the judgements made are not appropriate (especially the customer prepayment rate); and, (c) the calculation methodology is not applied correctly.	a) We tested the completeness and accuracy of data by: (i) Testing a sample of credit cards, loans and mortgage data from the data warehouse to contract to verify accuracy. (ii) Performing analytical procedures to ensure that movements in the Income Statement appear reasonable in relation to movements in the balance sheet. (iii) Inspecting reconciliations from the general ledger to the source systems; and subsequently from the general ledger to the data warehouse; to the model; and, to the financial statements to verify completeness. (b) We tested the appropriateness of management's assumptions by: (i) Reviewing management's methodology paper, assisted by our valuation specialists, to assess the completeness of variables considered and whether they accorded with the applicable accounting standards. (ii) Comparing judgements to: observable recent customer behaviour; and product pricing models; and consideration of future expected changes; (iii) Checking for indications of management bias by: comparing judgements to observable customer behaviour; and assessing whether judgements made by management were consistent with prior periods where they should be; (iv) Engaging our modelling experts to assess that management's assumed customer behavioural profiles were appropriate when benchmarked against other comparable financial institutions. (c) We performed sample testing on the year-end calculation of EIR, including the underlying data integrity, the clerical accuracy of the calculation, and the application of relevant assumptions. Our valuation specialists: (i) tested that all variables and assumptions in management's methodology papers were included in the models; (ii) reviewed the macros that are used to load the data into the model.	We gained assurance over the completeness and accuracy of data used within EIR models through reconciliation to source systems and sample testing of data attributes. The EIR model assumptions were reasonable in the context of current market data and observable customer behaviours. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger.
Deficiencies in IT general controls at outsourced service providers		
Some of the Bank's IT systems are hosted by third parties. The Bank receives reports, prepared by independent audit firms, on the effectiveness of the third parties' control environment. For one service provider, deficiencies in the control environment are identified. The risk, as we see it, is that control deficiencies are: (a) not mitigated by the Bank's third-party oversight controls, or, (b) are not mitigated by the Bank's operational controls.	We gained an understanding of the processes which are outsourced to third parties and their impact on the financial statements. We made enquiries of management to understand the process through which the Bank: a) Monitors control effectiveness at third parties. (b) Performs control activities over the completeness and accuracy of data received from third parties. Where available, we inspected controls reports from the third parties to understand whether there were mitigating controls that were effective. We also tested management's compensating controls in response to the exceptions identified for one service provider. Where required, we performed a suite of additional procedures to address the risk of material misstatement associated with those exceptions.	We have gained reasonable assurance over the Bank's processes and control activities over the completeness and accuracy of data received from third parties.

Tailoring the scope
Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Bank. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Bank and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Our application of materiality
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality
The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined audit materiality for the Bank to be £3.1 million, which is 5% of underlying profit before tax (statutory profit before tax, with non-underlying items added back). We believe adjusted profit before tax is the most important financial metric on which users of the financial statements would judge the performance of the Company, and accordingly, consider this to be an appropriate metric to determine materiality. This is consistent with the approach taken in the prior period by PwC.

Performance materiality
The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that performance materiality was 50% of our planning materiality, namely £1.6 million. We have set performance materiality at this percentage because this is an initial audit and we have assessed the risk of material misstatement to be higher. In the prior period, PwC based performance materiality on 75% of planning materiality.

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.15 million, which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. This is consistent with the approach taken in the prior period by PwC.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information
The other information comprises the information included in the Annual Report set out on pages 1-18, other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception
In the light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

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

Responsibilities of Directors
As explained more fully in the Directors' responsibilities statement set out on page 18, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are: to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').We understood how Sainsbury's Bank plc is complying with those frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Board Risk Committee meetings held; and gained an understanding of the Bank's approach to governance demonstrated by the Board's enterprise risk management framework ('ERMF') and internal control processes.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur by considering the entity level controls that the Bank has established to address risks identified by the Bank, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiries of legal counsel, executive management, internal audit, and focused testing, as referred to in the Key audit matters section of this report.
- The Bank operates in the financial services industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Other matters we are required to address

- We were appointed by the Bank at its annual general meeting on 30 June 2017 to audit the financial statements of the Bank for the year ended 28 February 2018 and subsequent financial periods. Our total period of uninterrupted engagement is one year, covering the year ending 28 February 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank and we remain independent of the Bank in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Peter Wallace
Senior Statutory Auditor
for and on behalf of Ernst & Young LLP

Statutory Auditor
Edinburgh

4 May 2018

Notes:

1. The maintenance and integrity of the Sainsbury's Bank plc website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Financial Statements

Income statement

For the year ended 28 February 2018

	Notes	2018 £m	2017 £m
Interest receivable	3	**261**	224
Interest payable	3	**(65)**	(61)
Net interest income		**196**	163
Fees and commissions receivable	4	**97**	97
Other operating income	5	**33**	25
Total income		**326**	285
Administrative expenses	6	**(243)**	(254)
Depreciation and amortisation			
Property, plant and equipment	19	**(8)**	(7)
Intangible assets	18	**(9)**	(4)
Operating expenses		**(260)**	(265)
Impairment losses on financial assets	13	**(42)**	(22)
Gains on financial assets and liabilities	7	**1**	2
Profit before taxation	11	**25**	–
Analysed as:			
Underlying profit before tax		**62**	60
Non-underlying items	8	**(37)**	(60)
		25	–
Taxation	12	**(6)**	(4)
Profit/(loss) for the financial year attributable to the owners of the Bank		**19**	(4)

The accompanying notes on pages 29 to 64 form part of these financial statements.

Statement of comprehensive income

For the year ended 28 February 2018

	Notes	2018 £m	2017 £m
Profit/(loss) for the financial year		**19**	(4)
Other comprehensive income/(expense):			
Items that may be reclassified subsequently to profit or loss:			
Available for sale financial assets fair value movements	30	**–**	2
Realised gains reclassified to the income statement on disposal	30	**–**	(2)
Tax effect of net losses	30	**–**	–
Total other comprehensive income, net of tax		**–**	–
Total comprehensive income/(expense)		**19**	(4)

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 29 to 64 form part of these financial statements.

Balance sheet
As at 28 February 2018

	Notes	2018 £m	2017 £m
Assets			
Loans and advances to customers	13	**4,972**	3,962
Cash, balances with central banks and other demand deposits	15	**876**	403
Derivative financial instruments	16	**15**	1
Financial investments – available for sale			
Investment securities	17	**648**	398
Intangible assets	18	**204**	146
Property, plant and equipment	19	**44**	44
Other assets	21	**1,006**	840
Total assets		**7,765**	5,794
Liabilities			
Customer accounts	22	**4,980**	4,101
Other deposits	23	**1,231**	509
Other borrowed funds	24	**312**	311
Subordinated liabilities	25	**174**	–
Derivative financial instruments	16	**5**	21
Other liabilities	26	**117**	106
Provisions for liabilities and charges	27	**3**	15
Total liabilities		**6,822**	5,063
Equity			
Equity	28	**756**	566
Called up share capital	29	**186**	164
Retained earnings	30	**1**	1
Total equity		**943**	731
Total equity and liabilities		**7,765**	5,794

The financial statements on pages 24 to 64 were approved by the Board of Directors on 4 May 2018 and signed on its behalf by

Peter Griffiths
Director and Chief Executive Officer

The accompanying notes on pages 29 to 64 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity

For the year ended 28 February 2018

	Note	Called up share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
At 1 March 2017		**566**	**164**	**1**	**731**
Profit for the financial year		–	**19**	–	**19**
Other comprehensive income/(expense):					
Available-for-sale financial assets fair value movements	30	–	–	–	–
Realised gains reclassified to the income statement on disposal	30	–	–	–	–
Total comprehensive expense		–	**19**	–	**19**
Transactions with owners:					
Shares issued in the year	28	**190**	–	–	**190**
Share-based payment (net of tax)		–	**3**	–	**3**
At 28 February 2018		**756**	**186**	**1**	**943**

	Note	Called up share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
At 1 March 2016		436	166	1	603
Loss for the financial year		–	(4)	–	(4)
Other comprehensive income:					
Available-for-sale financial assets fair value movements	30	–	–	2	2
Realised gains reclassified to the income statement on disposal	30	–	–	(2)	(2)
Total comprehensive expense		–	(4)	–	(4)
Transactions with owners:					
Shares issued in the year	28	130	–	–	130
Share-based payment (net of tax)		–	2	–	2
At 28 February 2017		566	164	1	731

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 29 to 64 form part of these financial statements.

Cash flow statement

For the year ended 28 February 2018

	Notes	2018 £m	2017 £m
Profit before taxation		**25**	–
Non-cash items included in profit before taxation		**64**	49
Change in operating assets and liabilities		**151**	(228)
Income taxes received		**–**	13
Cash flows generated from/(used in) operating activities	14	**240**	(166)
Purchase of equipment		**(8)**	(12)
Purchase of intangibles		**(69)**	(46)
Cash flows used in investing activities		**(77)**	(58)
Proceeds from issue of share capital	28	**190**	130
Proceeds from issue of subordinated liabilities	25	**174**	–
Cash flows generated from financing activities		**364**	130
Change in cash and cash equivalents		**527**	(94)
Opening cash and cash equivalents		**461**	555
Closing cash and cash equivalents		**988**	461

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

	2018 £m	2017 £m
Cash, balances with central banks and other demand deposits	**876**	403
Less: mandatory reserve deposit held at central banks	**(8)**	(6)
	868	397
Investment securities	**120**	64
	988	461

The accompanying notes on pages 29 to 64 form part of these financial statements.

Notes to the financial statements

1. Basis of preparation

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 IFRS 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.

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 as adopted by the European Union 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 in note 2.

The financial statements have been prepared on a going concern basis. This is discussed in the Directors' Report, under the heading 'Going concern'.

The Bank is a wholly-owned subsidiary of J Sainsbury plc and is included in the consolidated financial statements of J Sainsbury plc which are publicly available. Consequently, the Bank has taken advantage of the exemption from preparing consolidated financial statements under the terms of section 400 of the Companies Act 2006 and IFRS 10 4(a).

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.

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

The Bank has considered a number of minor amendments to published International Financial Reporting Standards and interpretations effective for the year ended 28 February 2018 and concluded that they are either not relevant to the Bank or that they do not have a significant impact on the Bank's financial statements. Amendments to IAS 7 'Statement of Cash Flows' has resulted in minor disclosure updates to note 14 to include additional information on movement in liabilities relating to financing activities and details of restricted cash balances.

Standards and interpretations effective for the Company in future periods:

The following standards, issued by the IASB but not yet effective, are expected to impact the Bank's financial statements in future periods:

- IFRS 9 'Financial Instruments'.
- IFRS 15 'Revenue from Contracts with Customers'.
- IFRS 16 'Leases'.

IFRS 17 'Insurance Contracts' and the Amendments to IFRS 2 'Classification and Measurement of Share-based Payment Transactions' are not expected to have any material impact on the Bank.

IFRS 9 'Financial Instruments'

In July 2014, the IASB issued the complete version of IFRS 9, which replaces IAS 39 Financial Instruments: Recognition and Measurement. The new classification and measurement and impairment requirements will be applied by adjusting our balance sheet on 1 March 2018, the date of initial application, with no restatement of comparative period financial information. Based on current estimates, the adoption of IFRS 9 is expected to result in a decrease in the Bank's total assets of approximately £80 million, with a related deferred tax asset of £14 million. The overall impact on retained earnings is therefore expected to be a reduction of approximately £66 million. The impact is primarily attributable to increases in the allowance for credit losses under the new impairment requirements as outlined in the relevant section below.

The adoption of IFRS 9 is also expected to impact the Bank's regulatory capital. The fully loaded Day 1 reduction in the consolidated retained earnings for the regulatory group would reduce the CET1 capital ratio by 119 basis points. However the Bank will follow the transitional regulatory capital arrangements adopted by the EU which enable the expected increase in impairment provisions to be spread over a five-year period commencing 1 March 2018 for capital purposes. Adopting the transitional capital treatment, the Bank's CET1 capital ratio is expected to reduce by approximately 18 basis points as at 1 March 2018.

As described in note 34, from a prudential perspective the Bank is monitored and supervised on a consolidated basis with its subsidiary, Home Retail Group Card Services Limited and the above capital impact also includes the IFRS 9 transitional impact of that subsidiary entity.

Implementation approach

To manage our transition to IFRS 9, the Bank's implementation project was initiated in early 2015 and was expanded to incorporate subsidiaries acquired in 2016 as part of J Sainsbury's acquisition of Argos. The project is jointly led by Finance and Credit Risk with support from external professional advisors. Dependent on the product type, the expected credit loss (ECL) models are being built in-house by the Bank's Credit Risk function with support from external advisors, or are being built by outsourced service providers with oversight from the Bank. All models were subject to second line review and user acceptance testing before the models went live on 1 March 2018.

The Bank continues to refine and validate the impairment models and related process.

Classification and measurement

IFRS 9 introduces a principles-based approach to the classification of financial assets. Financial assets are measured at fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) or amortised cost. Classification is determined by the nature of the cash flows of the assets and the business model in which they are held. These categories replace the existing IAS 39 classifications. For financial liabilities, most of the pre-existing requirements for classification and measurement previously included in IAS 39 were carried forward unchanged into IFRS 9.

The application of IFRS 9 classification criteria is not expected to result in significant recognition differences when compared to our classification under IAS 39. The most significant changes in classification relate to the cash and cash in transit balances of the Bank's ATM and Travel Money operations. As these financial assets generate fee income and are not held solely to collect payments of principal and interest they are classified as FVTPL as opposed to amortised cost. However, due to the short-term nature of the cash in transit cycle there will be no recognition differences arising.

Impairment

IFRS 9 introduces an ECL impairment model that differs significantly from the incurred loss model under IAS 39 and is expected to result in earlier recognition of credit losses. Additional details on the key elements of the new expected credit loss model are described below. The most significant impact will be on the Bank's personal loans, credit cards and mortgages portfolios.

1. Basis of preparation continued

ECL impairment model

Under IFRS 9, credit loss allowances will be measured on each reporting date according to a three-stage expected credit loss impairment model. As soon as a financial instrument is originated or purchased, 12-month expected credit losses must be recognised in profit and loss and an impairment allowance will be established (Stage 1). If the credit risk increases significantly (and the resulting credit quality is not considered to be low credit risk) full lifetime expected credit losses will be provided for (Stage 2). Under both Stage 1 and Stage 2, interest income is recognised on the gross carrying value of the financial asset. Financial assets will move into Stage 3 when they are considered to be credit impaired, i.e. when one or more events have occurred that have a detrimental impact on the estimated future cash flows of the asset. Stage 3 assets will continue to recognise lifetime expected impairment losses and interest income will be recognised on the net carrying amount (i.e. gross amount less impairment allowance) – as under IAS 39.

The expected Day 1 increase in provisions, as quantified above, is driven by:

- For Stage 1 assets, the 12-month ECL provisions under IFRS 9 are generally higher than collective allowances under IAS 39 where the emergence period is less than 12 months.
- Recognition of lifetime ECL on assets which have experienced a significant increase in credit risk since origination (but are not yet credit impaired). This represents the ECL that will result from all possible default events over the expected life of an instrument.
- IFRS 9 provisions include ECL in respect of undrawn (i.e. off-balance sheet) loan commitments and guarantees. For certain revolving facilities, like credit cards, ECLs will reflect drawdowns over the expected life of the facility.

Post-Day 1 movements in the ECL provisions reported through the income statement are likely to be more volatile than under IAS 39 due to the forward-looking nature of the new approach and the need to take account of future macroeconomic conditions in the ECL modelling, which will be sensitive to management judgement and estimates.

Inputs into measurement of ECL

For the purposes of impairment provisioning, ECL is a function of the Probability of Default (PD), the Exposure at Default (EAD) and Loss given Default (LGD) discounted to the reporting date, using the effective interest rate, or an approximation thereof. An expected credit loss estimate will be produced for individual exposures, including undrawn commitments on credit cards and pipeline lending. The impairment requirements of IFRS 9 are complex and require management judgements, estimates and assumptions, particularly in the following areas which are discussed below:

Significant increase in credit risk

We have established thresholds for significant increases in credit risk based on a percentage change in lifetime PD relative to initial recognition. The exact thresholds applied will differ by product and/or business. Additional qualitative reviews will be performed to assess the staging results and make adjustments, as necessary, to better reflect the positions which have significantly increased in risk.

Additionally, we do not intend to rebut the presumption within IFRS 9 that instruments which are 30 days past due have experienced a significant increase in credit risk.

Definition of default

The definition of default under IFRS 9 will be broader than the individual assessment of financial assets for objective evidence of impairment under IAS 39.

The definition of default used in the measurement of expected credit losses and the assessment to determine movement between stages will be consistent with the definition of default used for internal credit risk management purposes. IFRS 9 does not define default, but contains a rebuttable presumption that default has occurred when an exposure is greater than 90 days past due which we do not intend to rebut.

The Bank will consider a financial instrument in default if either one, or both, of the following conditions is met:

1. If the exposure is 90 days or more past due date, or
2. If the borrower exhibits unlikeliness to pay characteristics (which vary from product to product).

Forward-looking information, macroeconomic factors and multiple scenarios

IFRS 9 requires that the measurement of expected credit losses for each stage and the assessment of significant increases in credit risk must consider information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information will require significant judgement.

Credit loss allowances are modelled based on the macroeconomic variables (or changes in macroeconomic variables) that are most closely correlated with credit losses in the relevant portfolio. The variables used will include but not be limited to GDP, Consumer Price Index, House Price Index and unemployment rates.

The Bank will use three probability weighted scenarios (base case, upside and downside) to determine ECL.

Governance

As part of the implementation of IFRS 9, we have designed new controls and governance procedures in several areas that contribute to the calculation of expected credit losses. These include controls over credit risk data and systems, expected credit loss models and calculation engine, forecasts of future macroeconomic variables, design and probability-weighting of future macroeconomic scenarios, and the determination of significant increases in credit risk.

Hedge accounting

When initially applying IFRS 9, the Bank expects to exercise the accounting policy choice to continue to apply the hedge accounting requirements of IAS 39 for its macro hedging relationships and will adopt IFRS 9 in respect of its micro hedge accounting. However, the Bank will provide the expanded disclosures on hedge accounting introduced under IFRS 9's amendments to IFRS 7 Financial Instruments: Disclosures because the accounting policy election does not provide an exemption from these new disclosure requirements. Although the micro hedge accounting requirements under IFRS 9 are generally less restrictive, this is not expected to have a material impact on the Bank.

IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes a number of existing standards and interpretations from its effective date for accounting periods beginning on or after 1 January 2018. IFRS 15 introduces principals to recognise revenue by allocation of the transaction price to performance obligations.

IFRS 15 will apply to the Bank's fee and commission income, and other operating income, superseding IAS 18. Income from financial instruments will continue to be recognised under IFRS 9.

A detailed contract review has been performed for all revenue streams in scope in order to work through the five-stage revenue allocation process as defined in the standard. The review has concluded allocation of the transaction price to performance obligations results in no material differences to existing revenue recognition patterns and therefore there will be no material transitional adjustment.

Where relevant, the Bank intends to adopt the transitional arrangements option of recognising the cumulative effect of applying IFRS 15 as an adjustment to the opening balance of equity as at the date of initial application, being 1 March 2018.

IFRS 16 'Leases'

IFRS 16 will replace IAS 17 in its entirety and is effective for accounting periods beginning on or after 1 January 2019. It will result in most leases being recognised on the balance sheet. The Bank is currently reviewing the requirements of the new standard to determine its impact.

2. 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 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.

Capitalisation and carrying value of intangible assets

Capitalisation of intangible assets involves an assessment as to the appropriateness of costs that meet the qualifying criteria of IAS 38.

Intangible assets are assessed to ensure they continue to meet the criteria of IAS 38, and for indicators of impairment, at each balance sheet date or more frequently where required by changes in circumstances.

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

Effective interest rate

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 to customers significant judgement is applied in estimating the effect of various factors, including future customer transactional and repayment behaviours, on future cash flows. Estimates are based on historical experience from similar product types. Management considers that the most material judgement is the estimated life of Credit Card balances which is a maximum of 60 months. To the extent that the estimated life differs by +/- 12 months, the value of loans and advances to customers on the balance sheet would be £7 million higher or £6 million lower respectively.

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

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.

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.

3. Net interest income

Accounting policy

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

Income on available for sale debt securities is recognised on an effective interest rate basis and taken to interest receivable through the income statement.

	2018 £m	2017 £m
Interest income on loans and receivables	**256**	220
Interest income from available for sale financial instruments	**3**	3
Other interest income	**2**	1
Interest receivable	**261**	224
Interest expense on customer accounts, deposits and borrowings	**(55)**	(54)
Interest expense on subordinated liabilities	**(3)**	–
Interest expense on derivative liabilities	**(7)**	(7)
Interest payable	**(65)**	(61)
Net interest income	**196**	163

Net ineffectiveness recognised on fair value hedges was £nil (2017: £0.2 million).

4. Fees and commissions receivable

Accounting policy

Fees and commissions receivable

Fees and commissions that are not integral to the effective interest rate calculation primarily relate to Credit Card and ATM interchange fees, and Insurance introduction commission receivable from insurance partners. These are recognised in the income statement on an accruals basis 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 claw back period. Where the relevant contract requires the Bank to perform future services in respect of the income receivable, initial commission is recognised on completion of the service provided, with an element deferred to reflect services yet to be performed in future periods.

Nectar points

The costs of Nectar points, awarded as incentives to the Bank's 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. 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.

	2018 £m	2017 £m
Banking income	**72**	72
Insurance income	**23**	24
Other income	**2**	1
	97	97

5. Other operating income

Accounting policy

Margin from the sale of Travel Money, representing the difference between the cost price and the selling price, is recognised when the sale to the customer takes place within other operating income.

	2018 £m	2017 £m
Travel Money income	**33**	25
	33	25

Other operating income relates to the Bank's sale of foreign currency and related products through its Travel Money business.

6. Administrative expenses

	2018 £m	2017 £m
Staff costs:		
Wages and salaries	**54**	56
Social security costs	**5**	4
Pension costs	**3**	2
Share-based payments	**3**	2
	65	64
Marketing costs	**20**	24
Other operating costs	**158**	166
	243	254

Staff costs and other operating costs include £37 million (2017: £60 million) of non-underlying items as described in note 8.

See note 9 for further details on employee arrangements.

7. Gains on financial assets and liabilities

	2018 £m	2017 £m
Realised gains on derecognition	**–**	2
Fair value gains on instruments at fair value	**1**	–
	1	2

The fair value gains of £1 million (2017: £nil) relate to net fair value movements on derivative financial instruments not designated in a hedging relationship (see note 8).

8. Non-underlying items

Certain items recognised in the Bank's profit before taxation are of an unusual and infrequent nature and do not relate to the Bank's underlying performance. The Directors believe that the 'underlying profit before tax' measure presented provides a clear and consistent presentation of the underlying performance of the Bank. Underlying profit is not defined by IFRS and therefore may not be directly comparable with the 'adjusted' profit measures of other companies.

	2018 £m	2017 £m
Write down of intangible assets	**–**	14
New Bank Programme transition costs	**38**	46
Finance fair value movements	**(1)**	–
	37	60

New Bank Programme transition costs principally comprise contractor and service provider costs relating to the migration of data and other services to the Bank's new infrastructure and operating model. Costs which are directly attributable to the development of core banking platforms are capitalised and are not included above.

Further detail on capitalised expenditure and the write down of intangible assets is provided in note 18.

Finance fair value movements relate to net fair value movements on derivative financial instruments not designated in a hedging relationship.

9. Employees

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

	2018 Number	2017 Number
Full time	**919**	738
Part time	**1,019**	858
	1,938	1,596
Full time equivalent	**1,477**	1,168

Colleague costs are disclosed in administrative expenses in note 6.

Colleagues are eligible to join the defined contribution pension arrangements of J Sainsbury plc. 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 and amounted to £2.6 million (2017: £2.4 million) and was entirely in relation to the defined contribution schemes.

10. Directors' emoluments

	2018 £m	2017 £m
Emoluments	**3.1**	3.0
Employer contribution to defined contribution pension schemes	**–**	0.1
Share-based payments	**0.6**	0.8
	3.7	3.9
Highest paid Director:		
Emoluments	**1.2**	0.9
Share-based payments	**0.8**	0.2
	2.0	1.1

The Directors' positions and remuneration status are set out in the Directors' Report on page 16. The emoluments set out above include those Directors who held office during the year.

All Executive Directors were employed and remunerated by the Bank.

During the year four Directors (2017: six) received share awards under J Sainsbury plc share incentive schemes reflective of their qualifying services. Three Directors (2017: four) exercised share options in the year including the highest paid Director. Further detail of the relevant incentive plans are outlined in note 37.

During the year two Directors (2017: four) accrued retirement benefits in respect of qualifying services under money purchase schemes.

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 as their emoluments are deemed to be wholly attributable to services to the parent company. Accordingly, the above details include no emoluments in respect of these Non-Executive Directors (also see Directors' Report on page 16).

11. Profit before taxation

	2018 £m	2017 £m
Profit before taxation is stated including the following items of income and (expense):		
Interest on impaired loan balances	**1**	1
Operating lease rentals	**(1)**	(1)
Write down of intangible assets	**–**	(14)
Loss on disposal of intangible assets	**(2)**	–
Auditors' remuneration:		
Statutory audit of the Bank	**(0.7)**	(0.6)
Audit-related assurance services	**(0.1)**	(0.2)

Ernst & Young LLP were appointed as auditors during the year. Comparative information presented is in respect of remuneration payable to the previous auditors PriceWaterhouseCoopers LLP.

Audit-related assurance services primarily relate to assurance work performed in respect of the prospectus prepared in relation to the issuance of subordinated debt during the year.

12. Taxation

Accounting policy

Taxation 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.

	2018 £m	2017 £m
UK corporation tax on profit for the year	**5**	–
Adjustments in respect of prior years	**–**	–
Current tax	**5**	–
Deferred tax charge		
Origination and reversal of temporary differences	**(1)**	–
Adjustments in respect of prior years	**2**	4
Deferred tax	**1**	4
Total tax charge	**6**	4

Differences between profit before tax multiplied by the UK corporation tax rate for the year of 19.06% and the income tax expense recognised in the income statement are explained below:

	2018 £m	2017 £m
Profit before taxation	**25**	–
Tax on ordinary activities at 19.06% (2017: 20.00%)	**5**	–
Effects:		
Deferred tax on Group relief surrendered for nil consideration	**–**	4
Adjustment in respect of prior years	**2**	–
Net transfer pricing adjustments	**(1)**	–
Total income tax expense recognised in the income statement		
	6	4

13. Loans and advances to customers

Accounting policy

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 at the effective interest rate of the instrument. 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.

13. Loans and advances to customers continued

	2018 £m	2017 £m
Gross advances	**5,079**	4,030
Impairment	**(95)**	(78)
Adjustment in relation to fair value hedging	**(12)**	10
Loans and advances to customers	**4,972**	3,962
Gross advances being:		
Repayable on demand	**1,579**	1,095
Other loans and advances repayable:		
In 3 months or less	**311**	286
Between 3 months and 1 year	**777**	714
Between 1 and 5 years	**2,103**	1,860
After 5 years	**309**	75
	5,079	4,030

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

	2018 £m	2017 £m
Individuals:		
Secured lending	**309**	38
Unsecured lending	**4,770**	3,992
Gross loans and advances to customers	**5,079**	4,030

The Bank has also assigned the beneficial interest in a portion of its Personal Loans book to a Special Purpose Entity (SPE) for use as collateral in securitisation transactions and prepositioned a portion of its Personal Loans book with the Bank of England to facilitate participation in the Funding for Lending Scheme (FLS), Term Funding Scheme (TFS) and Indexed Long Term Repo Facility (ILTR). As at 28 February 2018 £379 million (2017: £378 million) of the Personal Loans portfolio was assigned to the SPE for use as collateral in securitisation transactions. £1,519 million (2017: £678 million) of the Personal Loans book was pledged to the Bank of England facilitating funding of £950 million (2017: £nil) from the TFS. There was no funding from FLS (2017: £260 million) or ILTR (2017: £155 million) at the balance sheet date.

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

Year ended 28 February 2018	**Unsecured lending £m**	**Secured lending £m**	**Total £m**
At 1 March 2017	**78**	**–**	**78**
New impairment provisions less releases	**42**	**–**	**42**
Recoveries of amounts previously written off	**5**	**–**	**5**
Amounts written off	**(31)**	**–**	**(31)**
Discount unwind on impaired loans and advances to customers	**1**	**–**	**1**
At 28 February 2018	**95**	**–**	**95**
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	**132**	**1**	**133**

Year ended 28 February 2017	Unsecured lending £m	Secured lending £m	Total £m
At 1 March 2016	79	–	79
New impairment provisions less releases	27	–	27
Recoveries of amounts previously written off	(6)	–	(6)
Amounts written off	(23)	–	(23)
Discount unwind on impaired loans and advances to customers	1	–	1
At 28 February 2017	78	–	78
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	111	1	112

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. Notes to the cash flow statement

Accounting policy	For the purpose of the cash flow statement cash and cash equivalents comprises cash in hand, deposits at central banks (less mandatory deposits) and deposits with banks with an original maturity of three months or less, together with 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.

Reconciliation of profit before taxation to cash flows used in operating activities

	2018 £m	2017 £m
Profit before taxation	**25**	–
Non-cash items included in profit before taxation		
Impairment losses on loans and advances	**42**	22
Depreciation on property, plant and equipment	**8**	7
Amortisation of intangible assets	**9**	4
Write down of intangible assets	**–**	14
Share-based payment expense	**3**	2
Loss on sale of property, plant and equipment	**2**	–
	64	49
Change in operating assets and liabilities		
Net (increase) in loans and advances to customers	**(1,052)**	(631)
Net (increase) in derivative assets	**(14)**	(1)
Net (increase) in investment securities greater than 3 months	**(194)**	(129)
Net (decrease)/increase in derivative liabilities	**(16)**	3
Net (increase) in other assets	**(171)**	(630)
Net increase in customer accounts	**879**	892
Net increase in borrowed funds	**722**	274
Net (decrease) in other liabilities including provisions	**(3)**	(6)
	151	(228)
Cash generated from/(used in) operations	**240**	(179)
Income taxes received	**–**	13
Cash flows generated from/(used in) operating activities	**240**	(166)
Operational cash flows from interest		
Interest paid	**(60)**	(71)
Interest received	**248**	232

Reconciliation of liabilities arising from financing activities

	Subordinated liabilities £m	Total £m
At 1 March 2017	–	–
Issuance of loan notes	175	175
Non-cash movements	(1)	(1)
At 28 February 2018	**174**	**174**

Restricted cash balances

	2018 £m	2017 £m
Bank of England deposit	**8**	6
	8	6

A reserve deposit is held with the Bank of England in accordance with statutory requirements. This deposit is not available for use in day-to-day operations and has been excluded from the cash and cash equivalents balance in the cash flow statement.

15. Cash, balances with central banks and other demand deposits

	2018 £m	2017 £m
Cash and balances with central banks	**833**	377
Other demand deposits	**43**	26
	876	403

The balances with central banks are repayable on demand, with the exception of the £8 million reserve deposit which is held with the Bank of England (see note 14).

16. Derivative financial instruments

Accounting policy

All derivative financial instruments are initially measured at fair value on the contract date and are re-measured to their fair value at each subsequent reporting date. Changes in fair value of all derivative instruments are recognised immediately in the income statement. Fair values are obtained from observable market data before the application of appropriate discounting factors.

Where the carrying value of a derivative is positive it is held and classified on the balance sheet as an asset. Alternatively, when the carrying value of a derivative is negative it is held and classified as a liability.

The Bank intends to use derivatives for economic purposes only, and not for trading. Where possible it will elect to designate the derivative into an effective hedge accounting relationship, where the gains and losses on derivatives are offset by effective hedge adjustments within the income statement.

Fair value hedging

The Bank designates certain derivatives as fair value hedges where the derivative financial instrument hedges the change in fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges). The Bank currently utilises fair value hedging against certain investment securities, a portfolio of personal loans and mortgages (see below), in addition to a one-for-one hedge on its Fixed Rate Debt issuance.

To qualify for hedge accounting, the Bank documents, at the inception of the hedge, the hedging risk management strategy, the relationship between the hedging instrument and the hedged item or transaction and the nature of the risks being hedged. The Bank also documents the assessment of the effectiveness of the hedging relationship, to show that the hedge is expected to be (prospectively) and, subsequently, has been (retrospectively) effective.

Fair value hedging matches the change in fair 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.

The effective part of any gain or loss on the hedged item adjusts the balance of the hedged item and is recognised in the income statement, 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.

Portfolio fair value hedging

The Bank uses portfolio fair value hedging as a risk management tool for hedging interest rate risk on the Personal Loans and Mortgage portfolios. 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.

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to reduce its exposure to market risks.

Interest rate swaps – Fair value hedges

The Bank executes interest rate swaps to hedge interest rate risk arising from fixed rate exposures in its retail personal loan and retail mortgage books and certain fixed rate treasury investment securities, which are predominantly funded by variable rate linked liabilities. The Bank has also executed an interest rate swap to hedge interest rate risk arising from its fixed rate debt issued. This is achieved by hedging specific balance sheet exposures.

The cash flows on the hedging instruments (interest rate swap derivatives) substantially match the cash flow profile of the hedged items (personal loans, mortgages, treasury investment securities and debt issued). The changes in fair value of the derivatives offset changes in the fair value of the hedged items through the income statement, with any ineffective portion also being recognised in the income statement.

Derivatives not in a hedge accounting relationship

The Bank's entire derivative portfolio is executed for economic purposes. Under IAS 39 rules, some of the Bank's hedging derivatives do not qualify, or prove too onerous, to be designated into an effective hedged relationship. In those instances, the interest rate swaps are viewed as trading derivatives under IAS 39 with any movements in fair value recognised in the income statement.

16. Derivative financial instruments continued

The table below shows the fair values of derivative financial instruments, split between those classified as in effective hedge relationships and those which are not, 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.

Derivatives in fair value hedge accounting relationships

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 28 February 2018	**2,767**	**14**	**(5)**
At 28 February 2017	2,376	1	(21)

During the year, fair value gains of £21.7 million were recognised in the income statement on derivatives which were designated in fair value hedge relationships. This was offset by a loss of £21.7 million recognised in the income statement during the year for fair value adjustments on the hedged items forming part of the hedge accounting relationships.

Derivatives not in fair value hedge accounting relationships

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 28 February 2018	**156**	**1**	**–**
At 28 February 2017	–	–	–

Forward currency sales

To mitigate the risk of exchange rate movements resulting in unexpected fluctuations in value of the foreign currency holdings within the Bank's Travel Money business, the Bank transacts forward sale contracts in respect of its most material currency holdings. Fair value movements on the forward sale agreements are recognised directly in profit and loss and partly offset any gains and losses arising from foreign exchange movements on the Bank's currency holdings. Settlement dates for forward currency agreements are no more than two business days from the transaction date in order to mirror the exposure to and turnover of currency holdings. As at 28 February 2018, the Bank had transacted forward sale agreements in respect of 7.2 million EUR (2017: 6.9 million EUR), 5.2 million USD (2017: 2.7 million USD), 0.1 million AUD (2017: nil), 1.6 million AED (2017: nil), and 0.5 million NZD (2017: nil). The positions had no significant fair value at the balance sheet date (2017: £nil).

17. Investment securities

Accounting policy

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, 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.

	2018 £m	2017 £m
Investment securities comprise the following:		
Debt securities issued by banks	**15**	–
Treasury bills	**70**	–
Gilts	**7**	41
Government backed investment securities	**67**	96
Covered bonds	**230**	102
Supranational investment securities	**147**	95
Asset backed securities	**62**	64
Commercial paper	**50**	–
	648	398
Of which:		
Maturing in 3 months or less	**120**	64
Maturing between 3 months and 1 year	**203**	100
Maturing between 1 and 5 years	**317**	213
Maturing after 5 years	**8**	21
	648	398

Investment securities include £nil (2017: £10 million) pledged as collateral under sale and repurchase agreements or derivative contracts. The fair value movement during the year on investment securities classified as available for sale was a gain of £0.3 million (2017: a gain of £2.4 million).

18. Intangible assets

Accounting policy

Computer software

Computer software is carried at cost less accumulated amortisation and any provision for impairment. Externally acquired software and licences are capitalised and amortised on a straight-line basis over their useful economic lives. 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 being:

- Core banking software – fifteen years
- Other software – three to ten 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 or, in the case of assets which are not yet available for use, at least annually. 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.

Cost includes the purchase price after deducting discounts and rebates, and other directly attributable costs of preparing the asset for its intended use.

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

	2018 £m	2017 £m
Cost		
At 1 March	**170**	138
Additions	**69**	46
Write down	**–**	(14)
Disposals	**(2)**	–
As at 28 February	**237**	170
Accumulated amortisation		
At 1 March		
Charge for the year	**(24)**	(20)
Disposals	**(9)**	(4)
As at 28 February	**–**	–
	(33)	(24)
Net book value as at 28 February		
	204	146

Intangible assets comprise computer software.

The £14 million write down in the prior year was written down as a result of the decision to deliver the credit cards platform with an alternative provider following the acquisition of Argos Financial Services, and changes to the planned delivery of data systems. There was no such write down during 2017/18.

19. Property, plant and equipment

Accounting policy

Land and buildings
Land and buildings are stated at cost less accumulated depreciation and any recognised provision for impairment. Capital work in progress is held at cost less any recognised provision for impairment. Cost includes the original purchase price of the asset and the costs incurred attributable to bringing the asset to its working condition for intended use. This includes capitalised borrowing costs.

Fixtures and equipment
Fixtures and equipment, including tenant's improvements, are held at cost less accumulated depreciation and any recognised provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition and its intended use.

Depreciation
Depreciation is calculated to write down the cost of the assets to their residual values, on a straight-line method, on the following bases:

- Freehold buildings and leasehold properties – fifty years, or the lease term if shorter
- Fixtures and equipment – three to ten years or, in the case of tenant's improvements, the lease term if shorter

Capital work in progress is not depreciated. Gains and losses on disposal are determined by comparing proceeds with the asset's carrying amount and are recognised within operating profit. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

28 February 2018	**Land and buildings £m**	**Fixtures and equipment £m**	**Total £m**
Cost			
At 1 March 2017	**1**	**96**	**97**
Additions	**–**	**8**	**8**
Disposals	**–**	**(1)**	**(1)**
As at 28 February 2018	**1**	**103**	**104**
Accumulated depreciation			
At 1 March 2017	**–**	**53**	**53**
Charge for the year	**–**	**8**	**8**
Disposals	**–**	**(1)**	**(1)**
As at 28 February 2018	**–**	**60**	**60**
Net book value as at 28 February 2018	**1**	**43**	**44**

28 February 2017	Land and buildings £m	Fixtures and equipment £m	Total £m
Cost			
At 1 March 2016	1	87	88
Additions	–	12	12
Disposals	–	(3)	(3)
As at 28 February 2017	1	96	97
Accumulated depreciation			
At 1 March 2016	–	49	49
Charge for the year	–	7	7
Disposals	–	(3)	(3)
As at 28 February 2017	–	53	53
Net book value as at 28 February 2017	1	43	44

20. Subsidiary undertakings

Accounting policy	Subsidiaries are entities, including special purpose entities (SPEs), over which the Bank has the power to govern the financial and operating policies. The results of subsidiaries are included in the income statement of the ultimate parent J Sainsbury plc. Investments in subsidiaries are carried at cost less any impairment loss in the financial statements of the Bank.

	Country of registration or incorporation	Ownership Interest	Registered address
Home Retail Group Card Services Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW
Home Retail Group Insurance Services Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW
ARG Personal Loans Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW

The following companies are also subsidiary undertakings of the Bank, being the SPE structures established in connection with the Bank's Personal Loans securitisation transactions. Although the Bank has no direct or indirect ownership interest in the equity of the companies, the companies were established for the purpose of providing a source of funding to the Bank by way of contractual agreement and the Bank has the rights to substantially all the benefits from their activities. The companies are therefore effectively controlled by the Bank.

	Country of registration or incorporation	Registered address
Lochside Asset Purchaser No.1 Holdings Limited	England	35 Great St. Helen's, London, EC3A 6AP
Lochside Asset Purchaser No.1 plc.	England	35 Great St. Helen's, London, EC3A 6AP

21. Other assets

Accounting policy	Other assets, including amounts receivable from Group companies, are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

	2018 £m	2017 £m
Amounts receivable from Group companies (see note 38)	**736**	636
Bank funds in course of settlement	**204**	131
Prepayments and accrued income	**57**	48
Customer funds in the course of settlement	**9**	–
Current tax asset	**–**	3
Cash collateral paid	**–**	22
	1,006	840

Other assets have no fixed maturities but are expected to be realised within 12 months, with the exception of £35 million (2017: £33 million) included in prepayments and accrued income. This represents the present value of a rebate receivable in respect of the build of certain computer software which will be received over a period of time once the related software is brought into use, which is expected to be greater than 12 months. See note 33 for further details on the residual contractual maturity of other assets.

22. Customer accounts

Accounting policy	Financial liabilities comprise customer accounts, deposits from banks, subordinated liabilities and other wholesale deposits. 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.

Customer accounts comprise Sterling interest bearing deposits.

	2018 £m	2017 £m
Repayable:		
On demand	**4,324**	3,603
Within 3 months	**86**	90
Between 3 months and 1 year	**256**	192
Between 1 and 5 years	**314**	216
	4,980	4,101

23. Other deposits

Accounting policy	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 deposits comprise Sterling wholesale deposits.

	2018 £m	2017 £m
Repayable:		
Within 3 months	**3**	129
Between 3 months and 1 year	**46**	148
Between 1 and 5 years	**1,182**	232
	1,231	509

24. Other borrowed funds

Accounting policy	Other borrowed funds comprises deemed loans to SPEs arising where assets transferred to the SPEs have not met the derecognition criteria, and subordinated 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.

	2018 £m	2017 £m
Deemed loan on securitisation		
Repayable in less than 1 year	**125**	121
Repayable between 1 and 5 years	**187**	190
Other borrowed funds	**312**	311

Deemed loan on securitisation

The Bank is party to a bilateral securitisation transaction which includes a £400 million funding facility. The terms of the transaction enable the Bank to maintain funding of up to £400 million until May 2019, at which time the facility will enter an amortisation period.

Under the facility, the beneficial interest in certain Personal Loans advanced to customers has been assigned to Lochside Asset Purchaser No.1 plc for the purposes of raising funds through the issue of collateralised loan notes. As the Bank retains substantially all risks and rewards of ownership of the relevant loans through contractual arrangements with Lochside Asset Purchaser No.1 plc, the loans continue to be recognised on the balance sheet of the Bank with a corresponding deemed loan recognised from Lochside Asset Purchaser No.1 plc.

Of the total £400 million facility, £312 million (28 Feb 2017: £312 million) of Senior 'A Notes' have been issued by Lochside Asset Purchaser No.1 plc backed by the cash flows from the relevant personal loans.

As part of the structure the Bank has acquired £88 million (28 Feb 2017: £88 million) of subordinated 'B Notes'. The B Notes are offset against the deemed loan from Lochside Asset Purchaser No.1 plc and are not presented as a separate asset because their recoverability is linked to the collectability of the purchased receivables which also remain as an asset on the Bank's balance sheet.

25. Subordinated Liabilities

Accounting policy	Subordinated liabilities are initially recognised at fair value and subsequently held at amortised cost. The interest payable is recognised in the income statement through interest payable.

	2018 £m	2017 £m
Fixed rate subordinated Tier 2 notes due November 2027	**175**	–
Accrued interest	**1**	–
Fair value hedge accounting adjustments	**(2)**	–
	174	–

The Bank issued £175 million of fixed rate reset callable subordinated Tier 2 notes on 23 November 2017. The notes pay interest on the principal amount at a rate of 6% per annum, payable in equal instalments semi-annually in arrears, until 23 November 2022 at which time the interest rate will reset. The Bank has the option to redeem these notes on 23 November 2022.

26. Other liabilities

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

All other liabilities are expected to be settled within 3 months, with the exception of deferred tax which is expected to settle after more than 12 months.

	2018 £m	2017 £m
Customer funds in course of settlement	**17**	21
Bank funds in course of settlement	**9**	9
Deferred tax liabilities	**2**	–
Accruals and deferred income	**81**	73
Cash collateral received	**8**	3
	117	106

The deferred tax liability is in respect of temporary differences which will reverse and result in a higher tax charge in future years, as follows:

	2018 £m	2017 £m
At 1 March	**9**	5
Movement in deferred tax liability charged to income statement	**(1)**	–
Adjustments in respect of prior years	**2**	4
Other adjustments	**(1)**	–
At 28 February	**9**	9

Tax effect of timing differences due to:

Other temporary differences	**(1)**	–
Accelerated capital allowances	**10**	9
	9	9

27. Provisions for liabilities and charges

Accounting policy	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.

	Customer redress £m	FSCS £m	Onerous costs £m	Total £m
At 1 March 2017	**5**	**1**	**9**	**15**
Charge to administrative expenses	**–**	**1**	**–**	**1**
Utilised in year	**–**	**(1)**	**(6)**	**(7)**
Released	**(5)**	**–**	**(1)**	**(6)**
At 28 February 2018	**–**	**1**	**2**	**3**

	Customer redress £m	FSCS £m	Onerous costs £m	Total £m
At 1 March 2016	5	1	10	16
Charge to administrative expenses	–	1	4	5
Utilised in year	–	(1)	(5)	(6)
At 28 February 2017	5	1	9	15

Customer redress provisions

Customer redress provisions mainly related to the expected costs of refunding customers in respect of Card Protection Plan insurance (CPP). The Bank previously sold this and other similar products until 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 plc). The Bank's more recent attempts to join the Scheme were rejected because it has now been formally closed and, following discussions with the FCA, the Bank will continue to consider claims on a reactive basis in line with the FCA's initial guidance for banks outside the Scheme.

27. Provisions for liabilities and charge continued

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. The Bank's share of the repayments is based on its share of industry protected deposits as at 31 December preceding the relevant regulatory year. The provision is recognised on the first day of the regulatory year being 1 April.

Onerous costs

As part of the transition to its new flexible banking platform, the Bank is unable to avoid certain contractual costs associated with the continued use of certain LBG platforms prior to migration. These costs are not related to the ongoing services being received from Lloyds Banking Group plc and have been provided for based on latest estimates of expected amounts payable. The provision is sensitive to changes in the timescales for delivery of the new flexible banking platforms.

28. Called up share capital

Accounting policy	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.

	2018 £m	2017 £m
Authorised, allotted, called up and fully paid ordinary shares (£1):		
At 1 March	**566**	436
Ordinary shares issued during the financial year	**190**	130
At 28 February	**756**	566

During the year the Bank issued 190 million (2017: 130 million) ordinary shares of £1 each at par to J Sainsbury plc.

29. Retained earnings

	2018 £m	2017 £m
At 1 March	**164**	166
Profit/(loss) for the financial year	**19**	(4)
Share-based payment (net of tax)	**3**	2
At 28 February	**186**	164

30. Other reserves

Other reserves comprise the unhedged fair value movements for available for sale securities. The available for sale reserve will unwind in line with the maturity profile of the underlying investment securities.

	Available for sale reserve £m
At 1 March 2017	**1**
Net unrealised gains	**–**
Realised gains reclassified to the income statement on disposal	**–**
At 28 February 2018	**1**
At 1 March 2016	1
Net unrealised gains	2
Realised losses reclassified to the income statement on disposal	(2)
At 28 February 2017	1

These balances include tax of £nil in the available for sale reserve (2017: £0.2 million).

31. Analysis of financial assets and liabilities by measurement basis

Accounting policy

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'.

Derecognition of financial assets

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The principal accounting policies 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 28 February 2018	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
Assets:				
Loans and advances to customers	**4,972**	**–**	**–**	**4,972**
Cash, balances with central banks and other demand deposits	**876**	**–**	**–**	**876**
Derivative financial instruments	**–**	**–**	**15**	**15**
Financial investments – available for sale investment securities	**–**	**648**	**–**	**648**
Other assets	**1,006**	**–**	**–**	**1,006**
Total financial assets	**6,854**	**648**	**15**	**7,517**
Non-financial assets:				
Property, plant and equipment				**44**
Intangible assets				**204**
				7,765

	Financial liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:			
Customer accounts	**4,980**	**–**	**4,980**
Other deposits	**1,231**	**–**	**1,231**
Other borrowed funds	**312**	**–**	**312**
Subordinated debt	**174**	**–**	**174**
Derivative financial instruments	**–**	**5**	**5**
Other liabilities	**100**	**–**	**100**
Total financial liabilities	**6,797**	**5**	**6,802**
Non-financial liabilities:			
Other liabilities			**8**
Provisions			**3**
Deferred tax			**9**
			6,822

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

At 28 February 2017	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
Assets:				
Loans and advances to customers	3,962	–	–	3,962
Cash, balances with central banks and other demand deposits	403	–	–	403
Derivative financial instruments	–	–	1	1
Financial investments – available for sale investment securities	–	398	–	398
Other assets	840	–	–	840
Total financial assets	5,205	398	1	5,604
Non-financial assets:				
Property, plant and equipment				44
Intangible assets				146
				5,794

	Financial liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:			
Customer accounts	4,101	–	4,101
Other deposits	509	–	509
Other borrowed funds	311	–	311
Derivative financial instruments	–	21	21
Other liabilities	87	–	87
Total financial liabilities	5,008	21	5,029
Non-financial liabilities:			
Other liabilities			10
Provisions			15
Deferred tax			9
			5,063

32. Loan and operating lease commitments

Accounting policy	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.

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:

	2018 £m	2017 £m
Commitments to extend credit	**267**	98

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:

	2018 £m	2017 £m
Due within 1 year	**2**	1
Due within 1 to 5 years	**6**	6
Due in more than 5 years	**3**	4
	11	11

33. Risk management

The Bank encounters a range of different risks and uncertainties as it undertakes its day-to-day activities and seeks to achieve its strategic objectives. Our approach to risk management and an overview of the primary risk types are described in the Risk overview section on page 6. Further detail on credit and liquidity risk exposures are shown below, with capital adequacy discussed further in note 34.

Credit risk

Credit risk is central to the Bank's day to day activities and is managed in line with the Board approved risk appetite as detailed within the principal risks section (page 6). Key developments over the course of the year have been the successful roll out of Sainsbury's Bank Mortgages providing our customers with a wider range of financial services to meet their needs, and the successful transition of loans applications from LBG to the New Bank Programme systems and processes. Work continues on the transfer of the Credit Card portfolio onto the New Bank Programme systems, with this due to complete within the 2018/19 financial year. The Bank has also developed its IFRS 9 modelling capacity in line with its implementation at the start of the 2018/19 financial year.

Retail credit risk

Retail credit risk is the possibility of losses arising from a retail customer failing to meet their agreed repayment terms as they fall due. Retail Credit utilise automated scorecards to assess the creditworthiness and affordability criteria of new applicants and ongoing behavioural characteristics of existing customers. The outcomes from all scorecard models are monitored utilising a set of credit quality metrics to ensure actual performance is in line with agreed expectations. Additional expert underwriting of credit applications is undertaken by a specialist operational team where further consideration is appropriate.

The Retail Credit Risk Committee provide portfolio oversight control over credit strategy to maintain lending in line with the Board approved risk appetite, with additional oversight and control provided by Executive Risk Committee and Board Risk Committee. Finally Internal Audit provide additional assurance by undertaking regular reviews on the adequacy of credit risk policies and procedures.

It is recognised IFRS 9 will impact on provision and impairment charges as detailed within the Standards effective in future periods (note 1).

Wholesale and derivative credit risk

The Bank invests its liquidity resources in eligible investment securities that qualify for the regulatory Liquidity Coverage Ratio (LCR) and internal Operational Liquidity Pool (OLP). These investments include the Bank of England's (BoE) reserve account, UK government securities (gilts or Treasury bills), multilateral development bank securities, government guaranteed agency securities, UK regulated covered bond programmes and asset backed securities.

Limits are established for all counterparty and asset class exposures based on their respective credit quality and market liquidity. Consideration is also given to geographical region and the strength of relevant sovereign credit ratings. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments and the credit risk arising from mark to market derivative valuations is mitigated by daily margin calls, posting cash collateral to cover exposures. Daily monitoring is undertaken by the Bank's Treasury department, including early warning indicators with appropriate triggers for escalation.

At 28 February 2018, 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 customers, loans and advances to banks, investment securities and credit lines and other commitments to lend. These are set out in notes 13, 15, 17 and 32 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.

33. Risk management continued

	2018 £m	2017 £m
Credit risk exposures relating to on balance sheet items		
Loans and advances to customers		
Unsecured	**4,663**	3,924
Secured	**309**	38
Cash balances with central banks and other demand deposits	**876**	403
Derivative financial instruments	**15**	1
Investment securities	**648**	398
Other assets	**1,006**	840
Credit risk exposures relating to off balance sheet items		
Loans commitments	**267**	98
Treasury bills drawn under FLS	**–**	260
Total credit risk exposures	**7,784**	5,962

Risk concentrations

Concentrations arise when a number of customers or 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 line with its risk principles, the Bank seeks to actively identify and manage risk concentrations across its business areas and activities. It has set clear targets for diversification within its asset and liability portfolios and sources of income. These are supported by a range of portfolio limits and a focus on key processes and controls across its activities, systems and supply chain.

Geographical sectors

Maximum exposure	2018 £m	2017 £m
United Kingdom	**7,412**	5,839
Europe	**357**	96
Other	**15**	27
	7,784	5,962

Concentration by location for investment securities is measured based on the location of the issuer of the security. The analysis reflects the credit risk associated with the balance and is not reflective of a currency exposure.

Industry sectors

Maximum exposure	2018 £m	2017 £m
Retail	**5,248**	4,060
Financial institutions	**1,668**	1,340
Government	**868**	541
Corporate	**–**	21
	7,784	5,962

33. Risk management continued

Credit quality per class of financial asset

Loans and advances to customers

Loans and advances are summarised as follows:

Maximum exposure	2018 £m	2017 £m
Impaired	**133**	112
Past due but not impaired	**23**	19
Neither past due nor impaired	**4,923**	3,899
Gross	**5,079**	4,030
Less: allowance for impairment	**(95)**	(78)
hedging fair value adjustment	**(12)**	10
	4,972	3,962

Credit quality analysis

At 28 February 2018	Unsecured lending £m	Secured lending £m	Total £m
Impaired			
Less than 3 months, but impaired	**2**	**–**	**2**
Past due 3 to 6 months	**14**	**–**	**14**
Past due 6 to 12 months	**–**	**–**	**–**
Past due over 12 months	**–**	**1**	**1**
Recoveries	**116**	**–**	**116**
Total gross impaired loans	**132**	**1**	**133**
Past due but not impaired			
Past due up to 3 months but not impaired	**22**	**1**	**23**
Total gross past due but not impaired	**22**	**1**	**23**
Neither past due nor impaired[1]			
Not impaired	**4,616**	**307**	**4,923**
Total gross neither past due nor impaired	**4,616**	**307**	**4,923**
Total gross amount due	**4,770**	**309**	**5,079**

1 Includes £4 million of loans that would have been past due or impaired had their terms not been renegotiated.

At 28 February 2017	Unsecured lending £m	Secured lending £m	Total £m
Impaired			
Less than 3 months, but impaired	2	–	2
Past due 3 to 6 months	10	1	11
Past due 6 to 12 months	–	–	–
Past due over 12 months	–	–	–
Recoveries	99	–	99
Total gross impaired loans	111	1	112
Past due but not impaired			
Past due up to 3 months but not impaired	18	1	19
Total gross past due but not impaired	18	1	19
Neither past due nor impaired[1]			
Not impaired	3,863	36	3,899
Total gross neither past due nor impaired	3,863	36	3,899
Total gross amount due	3,992	38	4,030

1 Includes £3 million of loans that would have been past due or impaired had their terms not been renegotiated.

33. Risk management continued

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 £6 million (2017: £7 million). The fair value of collateral held against possession cases was £nil (2017: £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'. A specialist debt recovery team will take steps to recover the debt, using their expertise to determine the optimum recovery strategy.

Collateral

The Bank holds collateral against loans and advances to customers in the form of mortgages over residential property and second charges over business assets, including commercial and residential property.

An analysis by loan-to-value (LTV) ratio of the Bank's residential mortgage lending is presented below. The value of collateral used in determining the LTV ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices.

At 28 February 2018	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70%	**203**	**1**	**1**	**205**
70% to 80%	**65**	**–**	**–**	**65**
80% to 90%	**33**	**–**	**–**	**33**
90% to 100%	**6**	**–**	**–**	**6**
Greater than 100%	**–**	**–**	**–**	**–**
Total mortgages	**307**	**1**	**1**	**309**

At 28 February 2017	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70%	32	1	1	34
70% to 80%	2	–	–	2
80% to 90%	1	–	–	1
90% to 100%	1	–	–	1
Greater than 100%	–	–	–	–
Total mortgages	36	1	1	38

Debt securities, cash and balances with central banks, and other eligible investment securities

The total gross amount of individually impaired debt securities, cash and balances with central banks, UK government securities (gilts and Treasury bills) and other eligible investment securities as at 28 February 2018 was £nil (2017: £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 UK government securities (gilts and Treasury bills) and investment securities by market value is also included. Analysis is by rating agency designation, based on Moody's ratings:

At 28 February 2018	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
Aaa to A3	**–**	**7**	**641**	**648**
ATM cash and balances with central banks	**833**	**–**	**–**	**833**
Other demand deposits	**43**			**43**
	876	**7**	**641**	**1,524**

At 28 February 2017	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
Aaa to A3	–	41	357	398
ATM cash and balances with central banks	377	–	–	377
Other demand deposits	26	–	–	26
	403	41	357	801

33. Risk management continued

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

The following table shows financial instruments which are subject to offsetting, master netting and similar agreements:

				Related amounts not offset in the balance sheet		
At 28 February 2018	**Gross assets/ (liabilities) recognised**	**Amounts offset £m**	**Net amounts recognised in the balance sheet £m**	**Financial instruments £m**	**Collateral pledged/ (received) £m**	**Net amounts £m**
Derivative financial instruments – assets	**15**	**–**	**15**	**–**	**(8)**	**7**
Derivative financial instruments – liabilities	**(5)**	**–**	**(5)**	**–**	**–**	**(5)**
	10	**–**	**10**	**–**	**(8)**	**2**
At 28 February 2017						
Derivative financial instruments – assets	1	–	1	–	–	1
Derivative financial instruments – liabilities	(21)	–	(21)	–	22	1
	(20)	–	(20)	–	22	2

The Bank has derivatives which are governed by the International Swaps and Derivatives Association (ISDA) and their associated credit support annex (CSA) bilateral agreements whereby if the fair value exceeds a pre-agreed level, cash collateral is exchanged. In September 2015, the Bank began moving its bilateral agreements to a central clearing counterparty, the London Clearing House (LCH), the terms of which also require an initial margin to be provided. At 28 February 2018, the Bank had received cash collateral of £8 million (28 Feb 2017: provided cash collateral of £22 million) against the net derivative asset position (2017: net derivative liability position), and £25 million of initial margin collateralised by encumbered treasury bills (28 Feb 2017: £21 million of initial margin was provided by way of off-balance sheet treasury bills obtained under the Funding for Lending Scheme).

Liquidity and funding risk

Liquidity risk is the risk that the Bank cannot meet its payment obligations as they fall due, or can only do so at extreme cost. The Bank seeks to ensure that financial obligations can be met at all times, even under liquidity stress conditions.

The annual Internal Liquidity Adequacy Assessment Process (ILAAP) enables the Bank to:

(1) Demonstrate that it understands the liquidity risks it is running

(2) Assess its liquidity needs under various stress scenarios and

(3) Put in place appropriate controls to mitigate liquidity risks.

In meeting its internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily monetised by outright sale or repurchase agreement to meet the Bank's obligations to depositors and other creditors.

The Bank's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are regularly monitored and forecast alongside cash flow and funding ratios. We prepare long-term and short-term forecasts to assess liquidity requirements, taking into account factors such as ATM cash management, contractual maturities and customer deposit patterns (stable or less stable deposits) as well as outflows regarding pipelines and commitments. These reports support daily liquidity management, with early warning indicators reviewed on a daily basis and appropriate triggers for escalation and action in line with the risk appetite, Liquidity and Funding Policy and Liquidity Contingency Plan. Asset encumbrance ratios and risk indicators for wholesale funding concentrations by type (total/secured/unsecured), maturity, sector, geography and counterparty are also regularly monitored and reported to ALCo.

The table on the following page 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 net 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.

33. Risk management continued

Residual contractual maturity analysis

At 28 February 2018	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						
Loans and advances to customers	**1,715**	**352**	**879**	**2,270**	**442**	**5,658**
Cash and balances at central banks	**876**	**–**	**–**	**–**	**–**	**876**
Investment securities	**36**	**88**	**215**	**316**	**6**	**661**
Other assets	**972**	**1**	**5**	**27**	**6**	**1,011**
	3,599	**441**	**1,099**	**2,613**	**454**	**8,206**
Net derivative asset cash flows	**(1)**	**4**	**–**	**11**	**–**	**14**
Total cash inflows	**3,598**	**445**	**1,099**	**2,624**	**454**	**8,220**
Liabilities						
Non-derivative liabilities						
Customer accounts	**4,337**	**56**	**264**	**509**	**–**	**5,166**
Other deposits	**2**	**2**	**57**	**1,228**	**–**	**1,289**
Other borrowed funds	**12**	**23**	**94**	**190**	**–**	**319**
Subordinated debt	**–**	**5**	**5**	**217**	**–**	**227**
Other liabilities	**100**	**–**	**–**	**–**	**–**	**100**
	4,451	**86**	**420**	**2,144**	**–**	**7,101**
Net derivative liability cash flows	**1**	**1**	**2**	**1**	**–**	**5**
Unrecognised loan commitments	**267**	**–**	**–**	**–**	**–**	**267**
Total cash outflows	**4,719**	**87**	**422**	**2,145**	**–**	**7,373**
Net liquidity	**(1,121)**	**358**	**677**	**479**	**454**	**847**

At 28 February 2017	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						
Loans and advances to customers	1,215	198	811	2,019	81	4,324
Cash and balances at central banks	403	–	–	–	–	403
Investment securities	10	60	112	205	18	405
Other assets	807	–	–	34	6	847
	2,435	258	923	2,258	105	5,979
Net derivative asset cash flows	–	–	–	1	–	1
Total cash inflows	2,435	258	923	2,259	105	5,980
Liabilities						
Non-derivative liabilities						
Customer accounts	3,720	40	197	219	–	4,176
Other deposits	13	118	152	244	–	527
Other borrowed funds	11	22	89	188	5	315
Subordinated debt	–	–	–	–	–	–
Other liabilities	87	–	–	–	–	87
	3,831	180	438	651	5	5,105
Net derivative liability cash flows	2	2	7	10	2	23
Unrecognised loan commitments	98	–	–	–	–	98
Total cash outflows	3,931	182	445	661	7	5,226
Net liquidity	(1,496)	76	478	1,598	98	754

33. Risk management continued

Asset encumbrance

An asset is defined as encumbered if it has been pledged as collateral against a recognised or off balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank. The encumbrance levels of assets and related recognised or off balance sheet liabilities are shown in the following tables:

At 28 February 2018	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	**1,905**	**3,067**	**4,972**
Debt securities	**25**	**623**	**648**
Other assets	**3**	**1,003**	**1,006**
Cash and balances with central banks	**8**	**868**	**876**
	1,941	**5,561**	**7,502**

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	**1,905**	**1,262**
Debt securities	**25**	**–**
Other assets	**3**	**5**
Cash and balances with central banks	**8**	**8**
	1,941	**1,275**

At 28 February 2017	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	1,056	2,906	3,962
Debt securities	31	367	398
Other assets	22	792	814
Cash and balances with central banks	6	397	403
	1,115	4,462	5,577

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	1,056	727
Debt securities	31	10
Other assets	22	21
Cash and balances with central banks	6	6
	1,115	764

The main sources of encumbrance in the Bank relate to margin requirements for derivative transactions and collateral relating to secured funding transactions. Cash collateral is advanced and received as variation margin on derivatives transactions, whilst eligible treasury assets are pledged as collateral for initial margin requirements on derivatives which are centrally cleared. Eligible personal loans with applicable haircuts are used as collateral for the bilateral personal loans securitisation facility and the Bank of England's Funding for Lending Scheme (FLS), Indexed Long-term Repo (ILTR) and Discount Window Facility (DWF). The Personal Loans used to secure the funding are held within Loans and advances to customers. There are assets which would not normally be considered available for encumbrance in the normal course of the Bank's business including intangible assets, property, plant and equipment, prepayments and accruals and deferred tax assets. These are included within the carrying value of unencumbered assets.

33. Risk management continued

Market risk

Market risk is the risk that the value of the Bank's assets, liabilities, capital and earnings are exposed to the adverse change of the market risk drivers. The Bank's market risks include Interest Rate Risk in the Banking Book (IRRBB) and foreign exchange (FX) risk. The Bank does not have a trading book.

Interest rate risk

IRRBB arises from interest rates movements which impact present value and timing of future cash flows resulting in changes in the underlying value of a bank's assets, liabilities and off-balance sheet instruments and hence its economic value. Interest rates movements also affect a bank's earnings by altering interest-sensitive income and expenses, affecting its net interest income.

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

- Re-pricing gap risk: the risk arising from timing differences in the interest rate changes 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 different interest rate indices (e.g. administered rate on 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.

Interest risk exposure is actively managed within limits that are aligned with the Bank's risk appetite by using financial instruments such as interest rate swaps and by taking into account natural hedges between assets and liabilities. The hedging strategies are implemented to ensure the Bank remains within its limits and that it takes advantage of natural hedging opportunities between fixed rate assets and liabilities with similar re-pricing characteristics.

In order to measure the exposure to interest rate risk under various interest rates shock scenarios, the Bank uses both economic value and earnings-based metrics: Market Value Sensitivity and Earnings at Risk. These metrics are monitored monthly and reported to the Asset and Liability Committee.

For interest rate risk measurement, products are allocated within re-pricing gap analysis based on their nearest re-pricing date (all non-maturing deposits are assumed to re-price in month one) and Personal Loans are allocated according to behavioural repayment profile.

As at 28 February 2018 earnings at risk (change in net interest income) for changes in interest rates of +/-200 basis points and +/-100 basis points movements in rates are as follows:

	2018 £m	2017 £m
+/- 200 basis points	**(17)/2**	(18)/3
+/- 100 basis points	**(8)/0**	(9)/3

The above analysis assumes that interest rates would floor at 0% and would not result in negative rates becoming applicable.

Foreign exchange risk

The Bank is exposed to FX risk through its holding of cash denominated in foreign currencies, primarily Euro and US Dollar, within its Travel Money bureaux in J Sainsbury's stores. From February 2017 onwards the FX positions are hedged on a daily basis. Further details of the hedging arrangements in place at year end are disclosed in note 16.

34. Capital resources

The following table analyses the regulatory capital resources under CRD IV. From a prudential perspective, the Bank is monitored and supervised on a consolidated basis with its subsidiary, Home Retail Group Card Services Limited, from the point of acquisition of Argos Financial Services in September 2016. The Bank has obtained an individual consolidation waiver from the PRA, which allows the Bank to monitor its capital position on a consolidated basis only. Therefore, the 28 February 2018 capital position shown below is on a regulatory consolidated basis.

	2018 £m	2017 £m
Common Equity Tier 1 (CET1) capital:		
Ordinary share capital	**756**	566
Allowable reserves (unaudited)	**174**	148
Regulatory adjustments (unaudited)	**(205)**	(147)
Total Common Equity Tier 1 (CET1) capital	**725**	567
Tier 1 capital	**725**	567
Loan notes (listed)	**155**	–
Tier 1 capital	**155**	–
Total capital	**880**	567

Regulatory capital is calculated under the Capital Requirements Regulations and Capital Requirements Directive (collectively known as CRD IV) as enacted in the UK. Common Equity Tier 1 (CET1) capital includes ordinary share capital, other reserves, losses and regulatory deductions. The Bank does not currently hold any Tier 2 capital.

34. Capital resources continued

The movement of CET1 capital during the financial year is analysed as follows:

	2018 £m	2017 £m
At 1 March 2017/1 March 2016	**567**	485
Share capital issued	**190**	130
Verified profit/(losses) attributable to shareholders	**19**	(4)
Verified profit/(losses) of subsidiary undertakings	**4**	(17)
Other reserve movements	**3**	2
(Increase) in intangible assets	**(58)**	(29)
As at 28 February 2018/28 February 2017	**725**	567

Reconciliation of statutory reserves to regulatory reserves

	2018 £m	2017 £m
Total shareholders' funds	**943**	731
Total shareholders' funds of subsidiary undertakings and consolidation adjustments	**(13)**	(17)
Intangible assets (including subsidiary undertakings)	**(205)**	(147)
CET1 capital	**725**	567

Leverage ratio (Unaudited)

The leverage ratio is defined as the ratio of Tier 1 capital to adjusted assets, which is measured below on a regulatory consolidated basis. The denominator represents the total non-risk weighted assets of the regulatory group (Bank and Home Retail Group Card Services Limited) adjusted for certain off balance sheet exposures assets and regulatory deductions and provides a non-risk-weighted 'backstop' capital measure. The leverage ratio is calculated below as at 28 February 2018. The Bank's leverage ratio of 8.6% exceeds the minimum Basel leverage ratio of 3%.

	2018 £m	2017 £m
Components of the leverage ratio		
Total assets as per published financial statements	**7,765**	5,794
Uplift on consolidation of subsidiary undertakings	**61**	42
Exposure value for derivatives and SFTs	**27**	269
Off balance sheet exposures: unconditionally cancellable (10%)	**716**	633
Off balance sheet: other (100%)	**54**	20
Other adjustments	**(205)**	(168)
	8,418	6,590
Tier 1 capital	**725**	567
Leverage ratio	**8.6%**	8.6%

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. During the year to 28 February 2018, the Bank received further injections of £190 million of ordinary share capital from J Sainsbury plc and £175 million of subordinated debt (of which £155 million is currently eligible as Tier 2 capital). Capital adequacy is monitored on an ongoing basis by senior management, the ALCo, 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.

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

35. Fair value of financial instruments

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 exchange 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 below table provides an analysis of the relevant fair value hierarchy for items recognised at fair value:

At 28 February 2018	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Derivatives designated as fair value hedging instruments	**–**	**14**	**–**	**14**
Derivatives not in fair value hedging relationships	**–**	**1**	**–**	**1**
Investment securities	**648**	**–**	**–**	**648**
Total assets	**648**	**15**	**–**	**663**
Derivatives designated as fair value hedging instruments	**–**	**5**	**–**	**5**
Derivatives not in fair value hedging relationships	**–**	**–**	**–**	**–**
Total liabilities	**–**	**5**	**–**	**5**

At 28 February 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivatives designated as fair value hedging instruments	–	1	–	1
Derivatives not in fair value hedging relationships	–	–	–	–
Investment securities	398	–	–	398
Total assets	398	1	–	399
Derivatives designated as fair value hedging instruments	–	21	–	21
Derivatives not in fair value hedging relationships	–	–	–	–
Total liabilities	–	21	–	21

The table below summarises the fair value of financial assets and liabilities that are not presented in the Bank's balance sheet at fair value. 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 28 February 2018 or 28 February 2017.

	2018		2017	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Assets:				
Loans and advances to customers	**4,972**	**4,977**	3,962	3,972
Cash and balances at central banks	**876**	**876**	403	404
Liabilities:				
Customer accounts	**4,980**	**4,973**	4,101	4,106
Other deposits	**1,231**	**1,231**	509	509
Other borrowed funds	**312**	**311**	311	310
Subordinated debt	**174**	**184**	–	–

The carrying value of other assets and other liabilities is a reasonable approximation of fair value.

35. Fair value of financial instruments continued

The fair value hierarchy classification adopted by the Bank in respect of assets not presented in the Bank's balance sheet at fair value is shown in the following table:

At 28 February 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers	–	**4,977**	–	**4,977**
Cash and balances at central banks	–	**876**	–	**876**
Total assets	–	**5,853**	–	**5,853**
Customer accounts	–	**4,973**	–	**4,973**
Other deposits	–	**1,231**	–	**1,231**
Other borrowed funds	–	**311**	–	**311**
Subordinated debt	**184**	–	–	**184**
Total liabilities	**184**	**6,515**	–	**6,699**

At 28 February 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers	–	3,972	–	3,972
Cash and balances at central banks	–	403	–	403
Total assets	–	4,375	–	4,375
Customer accounts	–	4,106	–	4,106
Other deposits	–	509	–	509
Other borrowed funds	–	310	–	310
Subordinated debt	–	–	–	–
Total liabilities	–	4,925	–	4,925

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

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.

36. Parent company

The immediate and ultimate parent company and controlling party of the Bank is J Sainsbury plc, which is registered in England. Its registered office is 33 Holborn, London, EC1N 2HT. J Sainsbury plc forms the only group into which the financial statements of the Bank are consolidated. Copies of the parent company's financial statements may be obtained from www.j-sainsbury.co.uk.

37. Share-based payments

Accounting policy

The Bank, through schemes operated by its parent company J Sainsbury plc, provides benefits to employees (including Directors) of the Bank in the form of equity-settled and cash-settled share-based payment transactions, whereby employees render services in exchange for shares, rights over shares or the value of those shares in cash terms.

For equity-settled share-based payments the fair value of the employee services rendered is determined by reference to the fair value of the shares awarded or options granted, excluding the impact of any non-market vesting conditions. All share options are valued using an option-pricing model (Black-Scholes or Monte Carlo). This fair value is charged to the income statement over the vesting period of the share-based payment scheme with a corresponding increase to equity.

Income statement

The Bank recognised £3.1 million (2017: £2.0 million) of employee costs (note 6) related to share-based payment transactions made during the financial year. Of these, £nil (2017: £nil) were cash-settled.

The parent company, J Sainsbury plc, operates various share-based payment schemes, in which employees of the Bank participate, as set out on the following pages:

37. Share-based payments continued

a. Savings Related Share Option Scheme ('SAYE')

The Group operates a Savings Related Share Option Scheme, which is open to all UK employees with more than three months' continuous service. This is an approved HMRC Scheme and was established in 1980. Under the SAYE scheme, participants remaining in the Group's employment at the end of the three-year or five-year savings period are entitled to use their savings to purchase shares in J Sainsbury plc at a stated exercise price. Employees leaving for certain reasons are able to use their savings to purchase shares within six months of their leaving.

A reconciliation of Sharesave option movements is shown below:

	2018 Number of options million	**2018 Weighted average exercise price pence**	2017 Number of options million	2017 Weighted average exercise price pence
Outstanding at beginning of year	**0.7**	**198**	0.5	215
Granted	**0.4**	**184**	0.3	185
Forfeited	**(0.1)**	**195**	(0.1)	230
Exercised	**–**	**212**	–	267
Colleagues transferred from fellow Group companies	**–**	**–**	–	221
Colleagues transferred to fellow Group companies	**–**	**–**	–	235
Outstanding at end of year	**1.0**	**189**	0.7	198
Exercisable at end of year	**0.1**	**214**	–	316
Exercisable price range		**213 to 267**		185 to 332

The weighted average share price of J Sainsbury plc during the period for options exercised over the year was 255 pence (2017: 285 pence). The weighted average remaining contractual life of share options outstanding at 28 February 2018 was 2.9 years (2017: 3.0 years). Options granted during the year were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

		2018	2017
Share price at grant date (pence)		**238**	231
Exercise price (pence)		**184**	185
Expected volatility	— 3 year period (%)	**27.2**	29.9
	— 5 year period (%)	**26.0**	25.5
Option life	— 3 year period (years)	**3.2**	3.2
	— 5 year period (years)	**5.2**	5.2
Expected dividends (expressed as dividend yield %)		**4.8**	4.9
Risk-free interest rate	— 3 year period (%)	**0.8**	0.8
	— 5 year period (%)	**1.3**	1.6
	— 3 year period (pence)	**51**	49
	— 5 year period (pence)	**49**	45

The expected volatility is based on the standard deviation of J Sainsbury plc's share price for the period immediately prior to the date of grant of award, over the period identical to the vesting period of the award, adjusted for management's view of future volatility of the share price.

b. Long-Term Incentive Plan 2006

Under the Long-Term Incentive Plan 2006, shares in J Sainsbury plc are conditionally awarded to the senior managers in the Company. The core awards are calculated as a percentage of the participants' salaries and scaled according to grades.

Performance is measured at the end of the three-year performance period. If the required performance conditions have been met, the awards vest and 50% of the award will be released. Subject to participants remaining in employment for a further year, the balance will then be released one year after the vesting date. Options granted to acquire the award of shares will expire two years from the vesting date. Dividends will accrue on the shares that vest in the form of additional shares.

The core award can grow by up to four times, dependent on the level of performance. Straight-line vesting will apply if performance falls between two points. Awards are structured as nil cost options.

A reconciliation of the number of shares conditionally allocated is shown below:

	2018 million	2017 million
Outstanding at beginning of year	**0.7**	0.4
Conditionally allocated	**0.3**	0.4
Forfeited	**(0.2)**	(0.1)
Outstanding at end of year	**0.8**	0.7

37. Share-based payments continued

The weighted average remaining contractual life of share options outstanding at 28 February 2018 was 1.3 years (2017: 2.0 years).

Details of shares conditionally allocated at 28 February 2018 are set out below:

Date of conditional award	2018 million	2017 million
15 May 2014 (2014 Future Builder)	**0.1**	0.1
14 May 2015 (2015 Future Builder)	**0.2**	0.2
12 May 2016 (2016 Future Builder)	**0.2**	0.4
11 May 2017 (2017 Future Builder)	**0.3**	–
	0.8	0.7

Options to acquire the award of shares were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

Date of conditional award	2018	2017
Share price at grant date (pence)	**267**	265
Option life (years)	**4.0**	4.2
Fair value per option (pence)	**267**	265

During the year, a total number of 57,355 (2017: 4,945) options were exercised. The weighted average share price during the year for options exercised was 271 pence (2017: 264 pence).

c. Deferred Share Award

The Deferred Share Award targets a diverse range of financial and strategic scorecard measures. These are intended to reward the top managers in the Group, including Executive Directors, for driving the short-term objectives that will directly lead to building the sustainable, long-term growth of the Group. Awards are structured as nil cost options.

Share-based awards are made to participants subject to performance against a basket of measures. At least 50% of the awards are based on the delivery of financial performance and returns to shareholders. The balances are based on measures which will assess the Group's performance relative to its competitors as well as key strategic goals.

Performance against the target is measured over one financial year, but any shares awarded are deferred for a further two years to ensure that management's interests continue to be aligned with those of shareholders. The shares are subject to forfeiture if the participant resigns or is dismissed for cause prior to their release date. Dividends accrue on the shares that vest in the form of additional shares.

A reconciliation of the number of shares granted over the year is shown below:

	2018 million	2017 million
Outstanding at beginning of year	**0.3**	0.1
Granted	**0.2**	0.2
Exercised	**(0.1)**	–
Lapsed	**(0.1)**	–
Outstanding at end of year	**0.3**	0.3

The number of shares allocated at the end of the year is set out below:

	Shares conditionally allocated 2018 million	Shares conditionally allocated 2017 million
14 May 2015	**–**	0.1
12 May 2016	**0.2**	0.2
11 May 2017	**0.1**	–
	0.3	0.3

The weighted average remaining contractual life of share options outstanding at 28 February 2018 was 0.2 years (2017: 0.8 years). The weighted average share price during the year for options exercised was 252 pence (2017: 267 pence).

37. Share-based payments continued

d. Bonus Share Award

The Bonus arrangements for senior managers include corporate and personal performance targets. A profit gateway is in place which means that a certain level of underlying profit before tax must be achieved before any bonus related to the corporate element of the bonus is released.

60% of the bonus is paid in cash and 40% awarded in shares. They are automatically released after three financial years. Shares are subject to forfeiture if the participant resigns or is dismissed.

Dividends accrue on these shares and are released at the end of the three-year retention period.

A reconciliation of the number of shares granted over the year is shown below:

	2018 million	2017 million
Outstanding at beginning of year	**0.6**	0.3
Granted	**0.6**	0.4
Lapsed	**(0.2)**	(0.1)
Outstanding at end of year	**1.0**	0.6

The number of shares conditionally allocated at the end of the year is set out below:

	2018 million	2017 million
14 May 2015	**0.2**	0.2
12 May 2016	**0.3**	0.4
11 May 2017	**0.5**	–
	1.0	0.6

The weighted average remaining contractual life of share options outstanding at 28 February 2018 was 1.3 years (2017: 1.6 years). The weighted average share price during the year for options exercised was 264 pence (2017: 261 pence).

38. Related party transactions

a) Transactions with related entities

J Sainsbury plc

The Bank is a wholly owned subsidiary of J Sainsbury plc.

	2018 £m	2017 £m
Transactions during the year		
Services and loans provided by J Sainsbury plc:		
Management services	**41**	36
Share capital issued to J Sainsbury plc	**190**	130
Balances at end of year		
Payables:		
Management services	**4**	3

Lochside Asset Purchaser No.1 plc.

The Bank has securitised certain personal loans by the transfer of the loans to Lochside Asset Purchaser No.1 plc, a special purpose entity (SPE) controlled by the Bank. The securitisation supports the issuance of debt by Lochside Asset Purchaser No.1 plc to investors who gain the security of the cash flows from the securitised loans. The Bank continues to recognise the loans on its own balance sheet after the transfer because it retains the risks and rewards of ownership through contractual arrangements with the SPE. The proceeds received from the transfer are accounted for as a deemed loan repayable to the SPE and the resultant cash flows are accounted for as interest payable in accordance with IAS 39.

The relevant personal loans continue to be serviced by Sainsbury's Bank plc for which a servicer fee is receivable.

38. Related party transactions continued

	2018 £m	2017 £m
Transactions during the year		
Interest paid on deemed loan	**(6)**	(8)
Servicer fee received	**1**	1
Balances at end of year		
Other assets:		
Intercompany loan	**7**	7
Payables:		
Deemed loan	**312**	311
Book value of personal loans for which beneficial interest has transferred to SPE	**379**	378

For additional disclosure on the nature of the deemed loan, see note 24.

Home Retail Group Card Services Limited
Following acquisition in September 2016, the Bank provides funding to Home Retail Group Card Services Limited via an intercompany loan.

	2018 £m	2017 £m
Transactions during the year		
Services and loans provided by Sainsbury's Bank plc:		
Interest receivable on intercompany loan	**8**	3
Balances at end of year		
Other assets:		
Intercompany loan	**729**	629

The loan to Home Retail Group Card Services Limited has no fixed repayment term but is repayable at the Bank's request. The loan operates as a revolving facility to fund the store card lending portfolio of Home Retail Group Card Services and the balance fluctuates in line with overall lending on that portfolio. Interest is payable three months in arrears at LIBOR plus a margin of 0.8%.

b) Transactions with key management personnel
For the purposes of IAS 24 'Related Party Disclosures', key management personnel comprise members of the Sainsbury's Bank plc Board and the Executive Committee of the Bank, who held office during the year.

Remuneration and other compensation

	2018 £m	2017 £m
Short-term employee benefits	**5.2**	4.4
Post-employment benefits	**0.1**	0.1
Termination benefits	**–**	–
Share-based payments	**0.4**	1.2
	5.7	5.7

Short-term employee benefits represent salary, bonus and benefits in kind. Post-employment benefits relate to employer's contributions to money purchase pension schemes operated by J Sainsbury plc. Share-based payments relates to share schemes operated by J Sainsbury plc (see note 37).

38. 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 plc key management personnel and members of their close families.

	Number of key management personnel	Directors £000	Other £000
Mortgages, credit cards and term loans			
At 28 February 2016	7	4	–
Resignations during 2016/17	(1)	–	–
Appointments/New accounts during 2016/17	–	–	–
Amounts advanced during the year	–	56	–
Amounts repaid during the year	–	(44)	–
At 28 February 2017	**6**	**16**	**–**
Resignations during 2017/18	**–**	**–**	**–**
Appointments/New accounts during 2017/18	**2**	**–**	**21**
Amounts advanced during the year	**–**	**131**	**62**
Amounts repaid during the year	**–**	**(140)**	**(59)**
At 28 February 2018	**8**	**7**	**24**

	Number of key management personnel	Directors £000	Other £000
Savings and deposit accounts			
At 28 February 2016	4	353	1
Appointments/New accounts during 2016/17	–	–	–
Amounts deposited during the year	–	69	–
Interest paid	–	4	–
Amounts withdrawn during the year	(1)	(145)	(1)
At 28 February 2017	**3**	**281**	**–**
Resignations during 2017/18	**(1)**	**(102)**	**–**
Appointments/New accounts during 2017/18	**3**	**–**	**1**
Amounts deposited during the year	**–**	**58**	**1**
Interest paid	**–**	**2**	**–**
Amounts withdrawn during the year	**(1)**	**(23)**	**(1)**
At 28 February 2018	**4**	**216**	**1**

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 28 February 2018 was £nil (2017: £nil).

39. Capital commitments

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

	2018 £m	2017 £m
Property, plant and equipment	**1**	–
Software development	**10**	2
	11	2

40. Contingent liabilities

The Bank is aware of remediation activity being conducted by Lloyds Banking Group (LBG) in relation to historic customer conduct matters. Where, as a result of services provided by LBG, the relevant matters have impacted customers of the Bank, the Bank has opted for those customers to be included in the remediation exercise.

The Bank is protected from certain costs arising from such remediation activity through clauses within its contractual agreements with LBG. However, it remains possible that a liability may be incurred in respect of costs not covered by the contractual provisions. The Bank is unable to form a view as to the potential quantum of any liability as it has not yet received sufficient detail around the activities in order to assess against the relevant contractual provisions.

However, the Bank does not currently expect any of the potential liabilities to have a material adverse effect on its financial performance or position.

Glossary

Bad debt asset ratio – Impairment losses as a percentage of the average balance of loans and advances to customers.

Tier 1 capital – A measure of the Bank's financial strength as defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.

Common equity tier 1 capital ratio – Tier 1 capital as a percentage of risk-weighted assets.

Cost : income ratio (underlying) – Underlying operating expenses as a percentage of total income.

Debt securities – Assets held by the Bank representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.

Earnings at risk – Approach set out for the quantification of interest rate risk expressed as the impact of the sensitivity analysis on the change to net interest income.

Effective interest rate – The effective interest rate method calculates the amortised cost of a financial asset or financial liability, and allocates the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or financial liability.

Encumbered asset – An asset is defined as encumbered if it has been pledged as collateral against an existing or off-balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank.

Fair value – The amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.

Financial Services Compensation Scheme (FSCS) – The UK's independent statutory compensation fund for customers of authorised financial services firms, which pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on authorised firms.

Full time equivalent – The hours worked by part time employees are accumulated along with the number of full time employees and counted as full time equivalents. This is a more consistent measure of the amount of time worked than employee numbers which will fluctuate as the mix of part time and full time employees changes.

Funding for Lending Scheme (FLS) – A Bank of England run scheme designed to encourage banks to increase lending to businesses by lowering interest rates and increasing access to credit. This was facilitated by BoE lending to the banks at cheaper than market rates for up to four years.

Impaired loans – Impaired loans are loans for which all the full contractual cash flows are no longer expected to be collected or collection of such cash flows will not be as they are contractually due.

Impairment losses – An impairment loss is the reduction in value that arises after the impairment review of an asset that determines that the asset's value is lower than its carrying value.

Interest rate risk – The risk of a reduction in the value of earnings or assets resulting from an adverse movement in interest rates.

Loans past due – These are loans for which a customer has failed to make payment as and when they are contractually due.

Leverage ratio – CET1 capital divided by the exposure measure. This is a new balance sheet metric introduced by the PRA.

Liquidity coverage ratio (LCR) – Percentage of the stock of highly liquid assets such as cash to net cash outflow over a 30-day period.

Loans to deposits ratio – The ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits.

Master netting agreement – An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Net interest margin – Net interest margin is net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) – Amount of available stable funding (ASF) relative to the amount of required stable funding (RSF) over a one-year time horizon, assuming a stressed scenario.

Pillar 3 – The third pillar of the Basel III framework which aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.

Repurchase agreements – An agreement where one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and they are reverse repurchase agreements (reverse repos) from the buyer's perspective.

Return on tangible equity – Underlying profit after tax divided by average tangible equity (equity excluding intangible assets).

Securitisation – This is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.